

# HOLLYWOOD NORTH: TAX INCENTIVES AND THE FILM INDUSTRY IN CANADA

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*Traditionally, Canadian trade negotiators have fought to exclude culture and cultural products from the scope of international trade agreements, in the belief that vibrant domestic cultural industries protected from outside influence were necessary to create a strong sense of national identity among Canadian citizens. In recent years however, Canadian governments at all levels have undergone an attitudinal shift in regard to the cultural industries and have adopted the American view of cultural products as tradable economic commodities that have the potential for generating substantial revenues for the state. This paper examines one rapidly growing industry – the Canadian film industry – in the wake of federal and provincial government tax credits that have played a major role in attracting foreign film productions to Canada. The authors also examine the outcry from the US with respect to this phenomenon of “runaway productions” and conclude that while these tax incentives do not violate existing trade agreements between Canada and the United States, this trade issue will continue to linger until and unless the powerful Hollywood lobby receives some concessions from US state governments.*

## I. INTRODUCTION

THE OXFORD ENGLISH DICTIONARY defines culture as “the civilization, customs, artistic achievements, etc., of a people, especially at a certain stage of its development or history.”

When one thinks “Canadian”, cultural values such as multiculturalism, peacekeeping, and Medicare come to mind.<sup>1</sup> Authors such as Northrop Frye have suggested that a shared national set of cultural values, representative of the unique features that form the social fabric of Canadian society, are necessary to bring together as a single community

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<sup>1</sup> Other more superficial symbols of Canadian culture include items such as the maple leaf, hockey and the Royal Canadian Air Farce. The authors would suggest it is necessary to examine a deeper set of shared values, rather than merely pop culture symbolism (as found in Molson’s “I am Canadian” commercials, for example), in order to conduct a meaningful examination of the collective Canadian identity.

Canadians from various backgrounds and diverse regions – indeed, it could be stated that a nation's unique culture contains the features that unite its citizens, while setting it apart from its global neighbours. In this regard, culture is hardly distinguishable from national identity and sovereignty and, it may be argued, should therefore be protected and preserved from external influence. The traditional view of the role that Canadian culture has played in shaping the national fabric may be illustrated as follows:

Culture is [also] a critical tool in the task of nation building. Canadian culture represents the values that make us unique from other nations. The Canadian government, like governments in other countries, recognizes that cultural diversity, like biodiversity, must be preserved and nurtured. As the world becomes more economically integrated, countries need strong local cultures and cultural expression to maintain their sovereignty and sense of belonging.<sup>2</sup>

In contrast, the American definition of culture has been narrowly limited to the economic output produced by United States (US) cultural industries. In other words, culture is viewed as:

an enterprise which is capable of making money, by means of cultural industries, including publications, films, videos, music recordings, and radio and television broadcasting.<sup>3</sup>

When reduced to its pure economic form, cultural products may be treated as tradable commodities, goods, and services just like any other item, subject to rules and regulations governing bilateral or multilateral trade agreements. Based upon this economic rationale, the American government has protested against any Canadian protectionism of domestic cultural industries, arguing that foreign ownership restrictions, Canadian content requirements and domestic subsidies constitute unfair trade

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<sup>2</sup> "New Strategies for Culture and Trade: Canadian Culture in A Global World" The Cultural Industries Sectoral Advisory Group on International Trade (February 1999), online: Department of Foreign Affairs and International Trade, Trade Negotiations and Agreements, Other Trade Policy Issues, Canadian Culture in a Global World <<http://www.dfait-maeci.gc.ca/tna-nac/canculture-e.asp>>.

<sup>3</sup> J. W. Warnock, *Free Trade and the New Right Agenda* (Vancouver: New Star Books Ltd., 1988) at 217.

practices that unfairly restrict American access to Canadian markets.

The importance of protecting and promoting Canadian culture has long been championed by various proponents within government and the cultural industries sector.<sup>4</sup> Canada's proximity to the US and the fact that the two nations share the same primary language has made Canada a major target for the export of US cultural products. As of February 1999, foreign cultural products accounted for:

- 45% of Canadian book sales;
- 81% of English magazines on Canadian newsstands;
- 63% of Canadian magazine circulation revenue;
- 79% of Canadian sales of tapes, concerts, CDs, merchandise, sheet music;
- 85% of Canadian film distribution revenue; and
- 94 - 97% of Canadian theatre screen time.<sup>5</sup>

As a result, the Canadian government has opted to protect and promote domestic cultural industries through a series of measures that include financial and program incentives, Canadian content requirements, foreign investment and ownership controls, and measures to protect intellectual property. These protectionist measures have more recently been augmented both by initiatives to promote Canadian cultural products in international export markets, and by initiatives to entice foreign producers to create their works within the Canadian marketplace, rather than merely exporting the finished product.

This paper will explore one such measure implemented by both the federal government and many provincial governments across the country: tax incentives provided to the film industry. This incentive will be explored in the context of the North American Free Trade Agreement (NAFTA) – Canada - United States Free Trade Agreement (FTA) provisions governing cultural industries; its impact on Canada-US trade relations will also be examined.

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<sup>4</sup> See for example, P. Herndorf, *Toronto Life* publisher, who stated “[o]ur concern is getting access to our own market. Everyone is interested in expanding into the US, but only after we’ve repatriated our own culture.” *Ibid.* at 222.

<sup>5</sup> *Supra* note 2 (pagination unavailable).

## II. CANADA-US FREE TRADE AGREEMENT

THE FTA WAS IMPLEMENTED IN 1989, the end result of a complex and contentious set of negotiations between two neo-conservative administrations led by Ronald Reagan and Brian Mulroney.

Ronald Reagan's inauguration as President of the US symbolized a new era in Canada-US political relations, and a move toward a freer trading regime between the nations. Reagan believed that political freedom and economic freedom were interdependent concepts – economic relations were best left to a free market system, with government functions restricted to a minimal supervisory role. In his view, government intervention in the economy could only be justified in the event of a market failure.

Brian Mulroney's economic philosophy was also one of market supremacy. Although Mulroney had originally been opposed to free trade during his 1983 bid for leadership of the Progressive Conservative Party of Canada, two primary goals of his new conservative government influenced his decision to seek a free trade agreement with the US: one was a commitment to place Canada-US relations on a less adversarial tone, and the second was a desire to reduce the role of government and allow markets to play a larger role in Canadian economic life. A free trade agreement with the US clearly fit into Mulroney's plan for the Canadian economy, in that he believed that free trade was the vehicle that would provide employment and prosperity for the Canadian nation.<sup>6</sup> At the same time, a free North American market would reduce the role of the state in economic affairs, fitting into Mulroney's plan for small government, regional power, and decentralization.

James Baker, former secretary of treasury in the Reagan administration and a key negotiator in the FTA trade talks, summed up the contributions of Reagan and Mulroney to the resulting FTA as follows:

As important as the work of negotiators was, the FTA was ultimately the creation of two men: Ronald Reagan and Brian Mulroney. Only they could commit the respective

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<sup>6</sup> In January 1988 the Canadian Department of Finance estimated: that the FTA would result in a 10.5 percent increase in manufacturing output and a 3.5 percent increase in overall exports, as well as a general lowering of factor and consumer prices.

M. I. Krauss, "The Canada-US Free Trade Agreement: Now or Never" *Policy Analysis* No. 105 (3 May 1998), online: CATO Institute <<http://www.cato.org/pubs/pas/pa105.html>>.

bureaucracies to the difficult process of negotiating a pact. Only they could provide the vision necessary to sway public opinion. And only they could make the hard decisions required to broker a final agreement.

Now, Brian Mulroney and Ronald Reagan were – and are – quite different men by age, background and personal disposition. Both shared, first, a profound belief in the importance of free trade and, second, the political courage to pursue that belief in face of significant domestic opposition. That commitment and that courage were perhaps most clearly articulated in March 1985 when, at the Quebec City Summit, President Reagan and Prime Minister Mulroney pledged themselves to freer trade and investment between their two countries. But they were also to prove critical in the difficult years of negotiation that followed. Both placed an agreement at the very top of their administrations' respective agendas.<sup>7</sup>

Brian Mulroney's initiative to undertake a comprehensive free trade agreement with the US was met with considerable apprehension and resistance from many sectors of the population, including representatives of the Canadian cultural industries sector. The Pro-Canada Network, an umbrella group for 34 anti-free trade organizations (including cultural workers) spent three years lobbying against the FTA.<sup>8</sup> Opposition to the FTA by the cultural community arose out of concern for the potential erosion of Canadian political and cultural sovereignty, which appeared inevitable under the Agreement. In response to the concerns of the Canadian people, Mulroney and External Affairs Minister Joe Clark attempted to assure the public that culture would not be on the table in the free trade negotiations. In the end, cultural industries were dealt with under Article 2005 of the FTA, which provided that:

1. Cultural industries are exempt from the provisions of this Agreement, except as specifically provided in Article 401 (tariff elimination), paragraph 4 of Article 1607 (divestiture of an indirect acquisition) and Articles 2006

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<sup>7</sup> From a speech given at the "Free Trade @ 10" Conference, held 4-5 June 1999 in Montreal. The text of the speech may be found online: Free Trade @ 10 Speeches & Papers <<http://www.freetradeat10.com/speeches/baker.html>>.

<sup>8</sup> "Call Referendum on Free Trade, Opponents Say" *The Toronto Star* (23 November 1988) A17.

(retransmission rights) and 2007 (print-in Canada requirement) of this Chapter.

2. Notwithstanding any other provision of this Agreement, a Party may take measures of equivalent commercial effect in response to actions that would have been inconsistent with this Agreement but for paragraph 1.<sup>9</sup>

Upon a strict reading of paragraph one, cultural industries are exempt from the Agreement. In practice, however, “the implicit formula is to treat cultural products like any other commodity,”<sup>10</sup> a notion which is supported by paragraph two of Article 2005, which provides that a party may take retaliatory measures against any actions that are seen not to conform to the spirit of the Agreement.<sup>11</sup>

### III. THE CANADIAN FILM INDUSTRY

THE RECENT GROWTH OF FILM PRODUCTION north of the border has resulted in Canada becoming tagged with the moniker “Hollywood of the North.” Actors who have starred in both feature films and made-for-television movies in Canada include Gary Sinise, Sylvester Stallone, and Ben Affleck. Big ticket movies filmed north of the border include *Murder at 1600*, *Legends of the Fall*, and *Good Will Hunting*.<sup>12</sup> Science fiction

<sup>9</sup> *Canada-US Free Trade Agreement*, 1989, Article 2005, online: Canada-US Free Trade Agreement (1989) <<http://wehner.tamu.edu/mgmt.www/nafta/fta>>. As described in more detail below, Annex 2106 of the North American Free Trade Agreement (NAFTA) basically provides that measures affecting “cultural industries” should be governed by the conditions set out in FTA Article 2005 of the FTA.

<sup>10</sup> H. Galperin, “Cultural Industries in the Age of Free-Trade Agreements” (Winter 1999) Vol. 24, No. 1 *Canadian Journal of Communications* (pagination unavailable).

<sup>11</sup> A prime example of the potential to use the remedies afforded by paragraph 2 arose during the recent dispute over split-run magazines. Proposed measures by Canadian Heritage Minister Sheila Copps to restrict foreign advertising and content in split-runs met with the threat of retaliatory action by the United States against the Canadian steel industry – notably, one of the largest industries in Minister Copps’ home riding of Hamilton. The United States would not have sought the approval of any NAFTA dispute settlement body before carrying out such threats (as it would be required to do under Article 21.5 of the *WTO Dispute Settlement Understanding*). It would have imposed its retaliatory measures and waited for Canada to prove that the quantum of retaliation was too high, or that the so-called “cultural exemption” actually was not applicable.

<sup>12</sup> A. Pollack, “Hollywood Jobs Lost to Cheap (and Chilly) Climes” *New York Times* (10 May 1999) A1.

favourite *The X Files* was filmed in Vancouver for five seasons, until star David Duchovny got homesick for Los Angeles.<sup>13</sup>

The economic impacts of film and television production in Canada are being felt in centres across the country. Not only are provinces competing for business from the US, but they are also competing amongst themselves for Canadian productions. Vancouver earned approximately \$675 million from film production in 2000, and this number is expected to double over the next ten years. In fact, Vancouver currently ranks third behind Hollywood and New York City as a North American film production centre.<sup>14</sup> As a result of the recent production boom, Montreal has gone from four local film crews to 28 in the space of a decade. As stated by Toronto director Atom Egoyan: “[t]he facilities and crews we have [in Canada] are world class.... There is a whole infrastructure in place now.”<sup>15</sup>

This boom in film production and the resulting growth of the Canadian film infrastructure did not happen overnight. In order to attract productions to Canada the federal and provincial governments, in conjunction with local film commissions, have used a variety of measures to provide incentives to ensure that their location is seen as the preferred place to make movies. One such incentive – currently provided by the federal government, eight provinces, and one territory – is a tax credit targeted towards production and labour costs. While the amounts and requirements of each tax credit vary, the overall focus appears to be on ensuring the growth of a domestic Canadian labour pool and infrastructure, so that not only is there an economic spin-off created by production, but Canadian jobs are also created on a permanent basis. In effect, the government’s focus has appeared to shift from promoting the creation of Canadian cultural products, to creating a Canadian cultural infrastructure that will allow for both domestic and foreign cultural products to be created here. This paper will touch primarily upon the tax credit provided by the province of Manitoba, as it is representative of the various tax incentives found in other Canadian jurisdictions.<sup>16</sup>

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<sup>13</sup> The move reportedly resulted in a cost increase from \$3 Million (US) per episode to \$5 Million (US). A. Strachan, “Pope, Gunmen Headed for Fall” *Vancouver Sun* (17 May 2000) C4. The lower Canadian costs occurred as a result both of the exchange rate on the Canadian dollar and the tax incentives provided by the British Columbia government.

<sup>14</sup> I. Bailey, “Runaway Filming Called No Threat to Hollywood” *The Globe and Mail* (19 July 1999) A5.

<sup>15</sup> A. Purvis, “Look Who’s on the Marquee...” Vol. 154, No. 6 *Time Magazine* Special Report, Canada 2005, Culture (9 August 1999) at 42.

<sup>16</sup> A detailed examination of the various provincial tax credits may be found in Appendix A.

#### IV. THE MANITOBA FILM INDUSTRY

THE MANITOBA FILM AND VIDEO PRODUCTION TAX CREDIT was implemented in 1997.<sup>17</sup> The goals of the program are to “provide an incentive to the private film and television production industry to create economic employment growth in the province.”<sup>18</sup> When introducing the tax credit in the legislature, former Finance Minister Eric Stefanson stated that:

One of the most remarkable success stories of the last several years has been the spectacular growth of Manitoba’s film and video industries.... We looked seriously at tax cuts or tax initiatives that will enhance our economy and help create jobs.<sup>19</sup>

It is clear that the Filmon government’s agenda was to promote and “grow” Manitoba’s film industry. It is unclear, however, why film production was selected as a targeted industry (as opposed to other cultural industries, such as sound recording, for example), and it is also unclear why the offering of a tax credit was the preferred method of incentive.<sup>20</sup>

The tax credit allows for a 35% rebate of approved expenditures on Manitoba labour, up to a maximum of 22.5% of eligible production costs. If qualified Manitoba crew members are not available for a specific project, the salary of a non-resident may be deemed an eligible labour expense, provided that a Manitoba resident is trained in the same area during the course of the production. Clearly, the focus is on providing Manitoba residents with training and employment opportunities within the film industry.

In order to qualify for the program, applicants:

- must be Canadian corporations;
- cannot hold a CRTC broadcast license; and
- must pay a minimum 25% of salaries and wages to Manitoba employees.

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<sup>17</sup> It was intended that the tax credit be implemented on a trial basis. The Manitoba government has recently extended the program until the end of the 2004/05 fiscal year. “Film and Video Production Tax Credit,” online: Manitoba Film and Sound <<http://www.mbfilmsound.mb.ca/setThis.html>>.

<sup>18</sup> *Ibid.*

<sup>19</sup> M. Cash, “Tax Cuts Give Added Push: Growing Film, Aviation, Mining Industries Reap Benefits of Budget” *Winnipeg Free Press* (18 March 1997) B8.

<sup>20</sup> In regard to the offering of a tax credit, the authors surmise that this incentive was chosen in part due to the reluctance of the Conservative government, for ideological reasons, to provide a direct financial subsidy to the industry.



Since the inception of the tax credit, a total of 77 projects have applied to the program, with 45 currently approved to receive the rebate. This will result in a total of \$6.5 million in foregone revenues.<sup>21</sup> However, the benefits reaped from increased production are manifold. The provincial government currently provides \$1.05 per capita to the film industry through the tax credit and other direct funding initiatives. This funding in turn is able to leverage an additional \$21.00 per capita in economic spin-offs.<sup>22</sup> And it is telling that in 1998-99, 1,200 direct full-time equivalent jobs and 2,000 indirect jobs in the film industry were created in Manitoba. This represents three times the estimated job creation numbers for the year.<sup>23</sup>

The growth of Manitoba's film industry may also be illustrated by the success the Manitoba Film and Sound Development Corporation has had in attracting foreign producers to film their movies in Manitoba. International stars such as Harrison Ford and Patrick Swayze have recently made appearances in Manitoba to star in feature films being produced in the province. In addition, the National Screen Institute recently relocated its offices to Winnipeg, and PS Production Services has announced that it also will be making Winnipeg its home base.

It should be noted, however, that since the tax credit was introduced in 1997, while foreign production activity has more than doubled, domestic production activity in Manitoba has actually declined in terms of budgetary dollars. A summary of production budgets from fiscal years 1998/99 - 2000/01 is as follows:

**FIGURE 1**  
**1998/99 - 2000/01 PRODUCTION BUDGETS**

	<b>Domestic Activity</b>	<b>Co-Production Activity</b>	<b>Foreign Activity</b>
<b>1998/1999</b>	\$11,032,945	\$26,122,368	\$11,895,827
<b>1999/2000</b>	\$4,441,272	\$21,181,174	\$6,772,291
<b>2000/2001<sup>24</sup></b>	\$6,848,381	\$20,775,381	\$24,767,000

<sup>21</sup> These dollars have been accounted for by the provincial government during the budgetary process. For example, when the tax credit was introduced in 1997, \$1.5 million in rebates were budgeted for. Interview with Carole Vivier, CEO, Manitoba Film and Sound Development Corporation (13 March 2001).

<sup>22</sup> *Ibid.*

<sup>23</sup> "Film Programs," online: Manitoba Film & Sound <<http://www.mbfilm-sound.mb.ca/setThis.html>>.

<sup>24</sup> The totals for 2000/2001 represent findings as of 6 March 2001. Final totals are based on production activity in the fiscal year, and as such, the 2000/2001 totals are incomplete and subject to change.

## V. THE AMERICAN POSITION – “RUNAWAY PRODUCTIONS”

“**E**CONOMIC RUNAWAY” MAY BE DEFINED AS “US-developed feature films, movies for television, TV shows or series, which are filmed in another country for economic reasons.”<sup>25</sup> The Monitor Report commissioned by the Directors Guild of America and the Screen Actors Guild revealed the following statistics:

- in 1998, 27% of US film and television productions and 45% of US made-for-television movies were economic runaways;
- 81% of these runaway productions are being produced in Canada;
- the total economic impact of runaway productions resulted in a loss of \$10.3 billion and 23,500 jobs for the US film industry.<sup>26</sup>

In response to the above-mentioned figures, Directors Guild of America President Jack Shea stated:

This report bears out the seriousness of the problem of runaway productions. It is impossible to look at this study and say that this issue does not pose a grave threat to the future of film and television production in the United States.... [W]e’ve heard from many of our assistant director and unit production manager members who cannot find work because so many productions are going to Canada, where the government mandates that their jobs be filled by Canadian citizens. The DGA is committed to doing whatever it takes to ensure that these jobs return to our members who helped build this industry.<sup>27</sup>

American actors and movie crews even staged a demonstration in the

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<sup>25</sup> Directors Guild of America, News Release, (25 June 1999), online: Directors Guild of America <<http://www.dga.org/index2.php3>>.

<sup>26</sup> *Ibid.* For the text of the report see Directors Guild of America, online: <[http://www.dga.org/news/pr\\_runaway.pdf](http://www.dga.org/news/pr_runaway.pdf)>. A similar study undertaken for the Directors Guild of Canada by Pricewaterhouse-Coopers stated that only \$573 million entered Canada as a result of foreign productions in 1998. This disparity in numbers has been a huge area of contention between Canadian and American lobbyists. The Canadian study uses audited production budgets as its base, and is therefore believed to be a more accurate depiction.

<sup>27</sup> *Supra* note 25 (pagination unavailable).

streets of California in order to grab the attention of US politicians.<sup>28</sup> The film industry is pushing for the same form of domestic labour-based tax incentives that Canadian provinces are currently offering.<sup>29</sup> So far, the industry's lobbying efforts have resulted in two pieces of proposed legislation. In California, state legislation aimed at providing tax credits to the film industry was not passed, as a funding commitment to pay for the tax breaks could not be made.<sup>30</sup> On 31 July 2001, a bipartisan senate bill called the US Independent Film and Television Incentive Act of 2001 was introduced by Arkansas Senator Blanche Lambert Lincoln. This legislation, if passed, will provide a wage tax credit for productions filmed in the US that have total wage costs of between \$200,000 and \$1 million. Generally, the amount of this wage tax credit will be 25% of the first \$25,000 in qualified wages per employee, while for areas classified as "new markets," the wage credit will rise to 35%.<sup>31</sup>

The American entertainment industry has always been a powerful lobby group – and it is clear that politicians are listening. A Congressional Entertainment Industry Task Force was formed to build consensus among members of congress for incentives to keep US film and television production jobs in the country.<sup>32</sup> In fact, the issue of runaway productions was serious enough for then-Vice President Al Gore to meet with industry representatives in order to discuss a response at the federal level.<sup>33</sup> Eight congressmen, including California representative Howard

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<sup>28</sup> However, not everyone involved in the American film industry supports the cause. Actor Alec Baldwin indicated in an interview with CBC news that producers have no one but themselves to blame for the flight of US productions. Baldwin indicated that if the industry really wanted to help itself by cutting costs, perhaps the studios should "make fewer movies." For further details see "Alec Baldwin says Hollywood should blame itself for 'runaway productions,'" online: CBC Radio Arts

<[http://www.infoculture.cbc.ca/archives/filmtv/filmtv\\_09151999\\_alecbaldwin.html](http://www.infoculture.cbc.ca/archives/filmtv/filmtv_09151999_alecbaldwin.html)>.

<sup>29</sup> T. Milewski, "U.S. Film Industry Workers Demonstrate Against 'Runaway Films'" (7 July 1999), online: cbc.ca

<[http://www.infoculture.cbc.ca/archives/filmtv/filmtv\\_07071999\\_runaway-filmdemo.html](http://www.infoculture.cbc.ca/archives/filmtv/filmtv_07071999_runaway-filmdemo.html)>.

<sup>30</sup> See Appendix B for a listing of tax incentives currently offered to the film industry by U.S. states.

<sup>31</sup> Directors Guild of America, News Release, (31 July 2001), online: Directors Guild of America <<http://www.dga.org/index2.php3>>.

<sup>32</sup> Directors Guild of America, News Release, (16 August 1999), online: Directors Guild of America <<http://www.dga.org/index2.php3>>.

<sup>33</sup> Directors Guild of America, News Release, (8 September 1999), online: Directors Guild of America <<http://www.dga.org/index2.php3>>.

Berman, are pushing for the inclusion of the runaway production issue in the next round of global trade discussions. A letter from the congressmen to US trade representative Charlene Barshefsky stated that: "Canadian cultural sovereignty has been replaced by rules and regulations that are nothing more than protectionism – plain, simple and unfair."<sup>34</sup>

While this issue is obviously of pressing concern for the US film industry, how it will impact the trade relationship between Canada and the US is questionable. The Monitor Report stated four primary causes of runaway productions:

- location,
- exchange rates,
- foreign tax incentives, and
- foreign infrastructure.<sup>35</sup>

These four factors all work together to attract foreign production to Canada; other than through anecdotal evidence, it is impossible to measure the degree of influence each exerts. In the context of this discussion, tax incentives are the only factor that shall be considered in light of the FTA, Article 2005.

As previously stated, cultural industries are subjected to a special regime of exemption and retaliation under the NAFTA.<sup>36</sup> Accordingly, it appears that even if the provision of tax incentives to a "cultural industry" constituted a *prima facie* NAFTA breach, the only avenue open to another NAFTA Party would be to impose measures of "equivalent commercial effect." It would not be open to a NAFTA Party to challenge the

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<sup>34</sup> D. Robb, "Congressman War On Canada" Vol. 359:46 *Hollywood Reporter* (7 October 1999) (pagination unavailable).

<sup>35</sup> *Supra* note 26.

<sup>36</sup> NAFTA Article 2106 provides that NAFTA Annex 2106 "applies to the Parties specified in that Annex with respect to cultural industries." NAFTA Annex 2106 provides that "as between Canada and the United States, any measure adopted or maintained with respect to cultural industries... and any measure of equivalent commercial effect taken in response, shall be governed under this Agreement exclusively in accordance with the provisions of the *Canada - United States Free Trade Agreement*." There is some debate as to whether a cultural measure which would breach a NAFTA provision, but not a FTA provision, would be subject to retaliation under Article 2106. This is because FTA Article 2005 permits retaliation under "this Agreement" – which could be interpreted as being the FTA, rather than the NAFTA. If the former interpretation was adopted, a breach of NAFTA Chapter 11, which contains very different investment protections than are con-

existence of the incentive itself. Moreover, it is unclear that the provision of such incentives would actually breach any NAFTA provision.<sup>37</sup>

If the US was justified, under FTA Article 2005(2), in imposing measures of “equivalent commercial effect” in response to the benefits provided by way of these various tax incentive measures,<sup>38</sup> a breach of the NAFTA would necessarily be required. The most likely candidate would be the national treatment obligation. The NAFTA’s national treatment obligations<sup>39</sup> require NAFTA Parties (and state and local governments) to provide treatment to foreign investors and their investments, and to foreign service providers, which is no less favorable than that which is provided to their domestic competitors.

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tained within the FTA, would be exempted from the NAFTA and not subject to retaliation under Article 2106. However, even if this extremely literal approach was adopted by a NAFTA tribunal, it is important to recall that the arguments would only arise within the context of a NAFTA Parties’ challenge to another Parties’ measures of “equivalent commercial effect” – not a challenge to the cultural measure against which such retaliation would be made. See, *infra*, footnote 11.

<sup>37</sup> For example, NAFTA Article 1106(3) prohibits NAFTA Parties from conditioning the receipt of an “advantage” in connection with an investment in its territory on compliance with requirements “to achieve a given level or percentage of domestic content” or “to purchase, use or accord a preference to goods produced in its territory, or to purchase goods from producers in its territory.” The provision of a tax incentive to cultural industry investors in Canada may well violate this provision, but paragraph 4 of the same Article provides a wide-ranging exemption which states: “Nothing in paragraph 3 shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory.”

<sup>38</sup> Note that no retaliatory action has been threatened. As a matter of fact, Screen Actors Guild National Executive Director Ken Orsatti stated:

I want to make it clear that we do not regard our sister unions in Canada and throughout the world as our adversaries. We are not talking about protectionism, but rather a pro-business approach to leveling the playing field.

Directors Guild of America, News Release, (25 June 1999), online: Directors Guild of America <<http://www.dga.org/index2.php3>>.

<sup>39</sup> See NAFTA Articles 1102 (governing the regulation of investors and investments) and 1202 (governing the regulation of cross-border service providers).

Tax incentives provided by Canadian governments are generally applicable to all producers, regardless of nationality. However, the Manitoba Film and Video Production Tax Credit scheme requires that an applicant must be a Manitoba-based company which has been incorporated in Canada. This requirement would appear to preclude the grant of a tax credit to foreign-based film production companies. While US companies may be able to qualify under Manitoba's tax credit scheme by establishing a local subsidiary, (as foreign share ownership does not affect eligibility) or by entering into co-productions with existing Manitoba production companies (a route which is more frequently taken), such actions may have numerous, undesired regulatory and tax implications.

In this regard, it is interesting to note that the Feature Film Advisory Committee, which was struck by the Department of Canadian Heritage in February 1998 to review Canada's feature film policy, recommended that the federal government's Production Tax Services Credit be revamped to ensure that only "Canadian feature film producers producing Canadian feature films for theatrical release are permitted access to the program."<sup>40</sup> It is the committee's position that:

...non-Canadian producers will have more than enough incentive to continue to make films in Canada even if this tax benefit is reduced. For instance, individual provinces have programs of their own to attract both Canadian and non-Canadian productions to a region.... In addition, since the tax credit was introduced in 1997, the value of the Canadian dollar has dropped more than 10%. The strong US dollar gives an American producer incredible buying power in all aspects of production and support services. In our experience, talented Canadian crews are generally more affordable than those with equivalent expertise in the US.<sup>41</sup>

However, to this point the federal government has refused to tinker with the tax credit, primarily due to fears of lost revenues if foreign productions decide not to use Canada as a home away from home any longer. Such a change may also have the effect of instigating the exact kind of US

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<sup>40</sup> "The Road to Success," *Report of the Feature Film Advisory Committee*, Part 4, online: Department of Canadian Heritage <[http://www.pch.gc.ca/culture/cult\\_ind/film-pol/pubs/advcomm/toc.html](http://www.pch.gc.ca/culture/cult_ind/film-pol/pubs/advcomm/toc.html)>.

<sup>41</sup> *Ibid.*

retaliation which has thus far not been forthcoming. All signs indicate that, far from instigating retaliatory measures against Canada, the entertainment industry lobby is actually pushing for similar tax credits in the US. Accordingly, unless the Canadian tax incentive schemes are modified to preclude access by foreign producers, there appears to be very little chance that either Canada or the US will begin to treat such measures as prohibited under the NAFTA.<sup>42</sup>

Indeed, the Canadian ambassador to the United States, Raymond Chretien, stated in a letter to California Congressman Howard Berman that the tax incentives:

...are entirely consistent with our trade obligations. The fact that the creation of labour-based tax credits is being considered by the California legislature illustrates the belief in California that these are internationally appropriate tools.<sup>43</sup>

A spokesperson for the ambassador to Canada has confirmed that the Americans also take the position that states and provinces are entitled to use tax credits as an economic incentive.<sup>44</sup> Therefore, it appears as though the two nations have come to a *de facto* agreement that the use of tax credits to provide incentives for the film industry are not cause for retaliatory action under the FTA or NAFTA.

## VI. CONCLUSION

**I**N RECENT YEARS, the Department of Foreign Affairs and International Trade (DFAIT) has shifted its view of the role that cultural industries play in the economy to bring it more closely in line with that of the United States. In 1994-95, the cultural industries contributed over \$20 billion dollars to the Canadian economy, or three percent of Canada's Gross Domestic Product. The cultural sector also provided jobs for 610,000 people – almost five percent of Canada's labour force.<sup>45</sup> It is clear that the impact of the cultural sector cannot be ignored anymore, due in

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<sup>42</sup> If the Feature Film Advisory Committee is correct, and the tax rebates are not the primary incentive causing foreign producers to choose Canada as a shooting location, the Canadian film industry will not suffer as a result of this "leveling of the playing field" in the area of tax incentives.

<sup>43</sup> Bailey, *supra* note 14.

<sup>44</sup> *Ibid.*

<sup>45</sup> *Supra* note 2.

large part to its increasing contribution to the Canadian economy, as well as its potential for acting as an ambassador for the Canadian nation. In order to demonstrate the significance of the cultural industries, the DFAIT made culture one of Canada's "four trade pillars," with cultural icons such as the Royal Winnipeg Ballet accompanying Team Canada on its trade missions around the globe.

The Cultural Industries Sectoral Advisory Group on International Trade, which provides advice to the DFAIT, provided a report which suggested new directions for the inclusion of cultural industries within free trade agreements.<sup>46</sup> The advisory group indicated that there are two primary and contradictory approaches that the federal government could take:

1. continued use of the "cultural exemption strategy used in the past, which takes culture 'off the table' in international trade negotiations;" or
2. promotion of "a new strategy that would involve negotiating a new international instrument that would specifically address cultural diversity, and acknowledge the legitimate role of domestic cultural policies in ensuring cultural diversity."<sup>47</sup>

The House of Commons Standing Committees on Foreign Affairs and International Trade and Canadian Heritage, supported the recommendation of the advisory group that proposed a new international strategy on cultural diversity. The language used by the advisory group in making the proposal, and the language used by the standing committees in accepting the recommendation do not clarify what the substance of such a strategy would be. As a result, it remains to be seen which direction the Canadian government will take when it comes to the negotiation of future international trade agreements and the inclusion of culture within the free trade arena.

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<sup>46</sup> The inclusion of cultural industries within the free trade regime is seen as timely, considering the approaching deadline for the negotiation of the Free Trade Area of the Americas (FTAA).

<sup>47</sup> *Supra*, note 2.



**APPENDIX A****FIGURE 2  
PROVINCIAL TAX INCENTIVES*****YUKON FILM COMMISSION***

1. 50% rebate for the cost of travel from Vancouver to Whitehorse.
2. 35% labour rebate for eligible Yukon labour:  
Eligible Yukon labour costs are capped at 50% of total Yukon expenditures.

***BRITISH COLUMBIA FILM***

1. Basic Incentive tax credit – 20% of eligible labour costs.
2. Regional Incentive tax credit – 12.5% of eligible labour costs.
3. Training Incentive tax credit – the lesser of 30% of trainee salaries or three percent of eligible labour costs.

Eligible labour costs during a taxation year are capped at 48% of the total cost of producing the production.

***ALBERTA FILM COMMISSION***

1. Seven percent GST recovery, provided the production company is carrying on a commercial activity and is registered for GST.
2. No PST.

***SASKATCHEWAN FILM***

Saskatchewan Film Employment Tax Credit – rebate of 35% of the total wages of all Saskatchewan labour and deemed labour for Saskatchewan productions and co-productions.

“Deemed labour” refers to persons from outside the province serving as a trainer or “mentor” to Saskatchewan employees, provided:

***MANITOBA FILM AND SOUND DEVELOPMENT CORPORATION***

Manitoba Film and Video Production Tax Credit – rebates 35% of approved Manitoba labour expenditures up to a maximum of 22.5% of eligible production costs.

### **ONTARIO FILM DEVELOPMENT COMMISSION**

1. Ontario Film and Television Tax Credit (OFTTC): The OFTTC provides Canadian production companies with a tax credit of 20% of eligible labour expenditures incurred in a film or video production. First-time producers may be eligible for a 30% tax credit rate.
2. Ontario Production Services Tax Credit (OPSTC): The OPSTC provides Canadian or foreign-controlled production companies with a refundable tax credit of 11% of Ontario labour expenditures for eligible film or television productions. There is no limit to the amount of labour expenditures which may be eligible, and no limits on the amount of the OPSTC which may be claimed.
3. Ontario Interactive Digital Media Tax Credit (OIDMTC): The OIDMTC is a refundable tax credit of 20% of eligible Ontario labour expenditures incurred by a qualifying corporation to develop interactive digital media products for commercial exploitation in Ontario. The credit may be claimed on labour expenditures incurred on or after 1 July 1998. To claim an OIDMTC, a corporation must file with its tax return a certificate obtained from the OFDC.
4. Ontario Computer Animation and Special Effects (OCASE) Tax Credit: The OCASE is a refundable tax credit based on Ontario labour expenditures incurred by a corporation in computer animation and special effects activities. The tax credit is calculated as 20% of eligible expenses. Labour expenses for individuals working in Ontario, who are not employees of the corporation, may be eligible for a 50% tax credit.

### **QUEBEC FILM AND TELEVISION OFFICE**

1. Federal tax credit of 11% for salaries paid in Canada.
2. Provincial tax credit of 11% for salaries paid in Quebec (can go as high as 31% for jobs in computer animation and special effects).

### **NEWFOUNDLAND & LABRADOR FILM DEVELOPMENT CORPORATION**

1. Newfoundland and Labrador Film and Video Industry Tax Credit – a fully refundable corporate income tax credit administered by the Newfoundland and Labrador Film Development Corporation (NLFDC) for the Newfoundland and Labrador Department of Finance. The program encourages the development, training and hiring of Newfoundland film personnel in all disciplines.
2. Newfoundland and Labrador Film Tax Credit – provincial corporate tax credit. The tax credit provides incentives to the private film and television production industry to create economic growth in the Province. The

credit is based on a calculation of eligible labour limited to the lesser of 25% of the total eligible budget or 40% of the total eligible labour expenditures.

Once the production company's final audited cost report breaking out the eligible Newfoundland and Labrador labour expenditure is submitted for review, the Newfoundland and Labrador Department of Finance may issue a certificate to be filed with the production company's corporate tax return. The credit may also be considered as part of a producer's equity in a given production.

At least 25% of the total salaries and wages must be paid in Newfoundland and Labrador to eligible employees.

### **FILM NEW BRUNSWICK**

Labour Incentive Tax Credit – the percentage of wages applicable to the Tax Credit is determined as follows:

- 40% of wages budgeted for first-time productions (features or documentaries meeting the criteria of "Eligible Projects" in the FILM NB Program Guide of at least 24 minutes' duration, where a producer has no more than one previous screen credit in a commercial production and has not participated as a producer in a production that previously earned a New Brunswick Tax Credit).
- 30% of wages budgeted for subsequent productions by a company which has, or whose principals have, already received a first-time production tax credit.
- 35% of wages budgeted for subsequent productions in excess of a production company's previous year's wage expenditures.

The Labour Incentive Tax Credit is limited to \$1 million per production and \$2 million per corporation or associated group of all productions commenced in one 12-month period.

### **NOVA SCOTIA FILM DEVELOPMENT CORPORATION**

Nova Scotia Film Industry Tax Credit – refundable corporate tax credit of 30% - 35% of the eligible Nova Scotia labour to a maximum of 15% - 17.5% of the total production costs:

- there is no limit on the size of the production budget
- there is no corporate cap
- there are no Canadian content requirements
- there are no copyright ownership requirements.

## APPENDIX B

**FIGURE 3**  
**US TAX INCENTIVES FOR FILM**

STATE	TAX INCENTIVES	9/27/99
<b>Alabama</b>	Sales tax exemption for hotel accommodations after 30 days. Some local option tax exemptions exist on hotel rooms after 60 days.	
<b>Alaska</b>	No state sales tax. No state individual income tax.	
<b>Arizona</b>	<p>A 50% sales (transaction privilege) and use tax rebate on the purchase or lease of tangible personal property if producers spend over \$1 million in Arizona filming movies for theaters, television, video, industrial, or education films commercial advertising. A second threshold of expenditures of \$250,000 applies to television commercial or advertising in commercials aired in two minutes or less. No withholding tax from wages of nonresidents engaged in any phase of motion picture production.</p> <p>A 1996 law provided for an exemption of retail sales tax on the purchase of machinery and equipment used primarily at sound stages constructed between 1 July 1996 and 1 January 2002.</p> <p>No state tax on lodging after 30 days.</p>	
<b>Arkansas</b>	Full gross receipts and use tax refund on the purchase of property and services including in connection with production costs. To qualify, a production company must spend at least \$500,000 within six months or \$1 million within 12 months in connection with the production.	
<b>California</b>	<p>No sales or use tax on production or postproduction services on a motion picture or TV film. No sales and use tax on services generally. Such industry specific services include writing, acting, directing, casting, and storyboarding. Five percent sales tax exemption on the purchase or lease of postproduction equipment by qualified persons.</p> <p>No sales and use tax on 45% of the charges for sets, including labour to design, construct, and strike and</p>	

	<p>no sales tax on the full charge for the rental of personal property.</p> <p>No state hotel tax on occupancy, however cities or countries that impose a local tax have a tax exemption for occupancies in excess of 30 days.</p>
<b>Colorado</b>	No sales and use tax on film company services if, in fact, the company is providing a service and not tangible personal property.
<b>Connecticut</b>	Sales and use tax exemption for the purchase, lease, use, storage, or other consumption of motion picture, video production, or sound recording equipment for use in the state for production activities that become an ingredient of any motion picture, audio tape, or recording produced for commercial entertainment. No hotel occupancy tax for hotel stays in excess of 30 days.
<b>Delaware</b>	No state sales tax.
<b>Florida</b>	<p>Sales and use tax refund for the purchase or lease of motion picture, video, or other equipment (depreciable equipment with a useful life of at least three years) if used exclusively as an integral part of production activities in the preparation of motion pictures, tapes, TV, or productions produced for commercial use or sale.</p> <p>If equipment and personnel used belong to the producer of a qualified motion picture, there is no tax on fabrication labour. Repair of motion picture equipment is used exclusively by the producer as an integral part of production activities.</p> <p>No state individual income tax.</p>
<b>Hawaii</b>	Income tax credit up to four percent, which is deductible from net income tax liability of the costs incurred in the state in the production of motion picture and television films; and up to six percent for costs incurred in the state for actual expenditures for transient accommodations. Must spend at least \$2 million in Hawaii for motion pictures or at least \$750,000 to produce a television episode, pilot, or movie of the week. If the tax credit exceeds the income tax liability, the excess will be refunded to the taxpayer.

<b>Idaho</b>	No hotel occupancy tax on hotel stays of 30 days or longer.
<b>Illinois</b>	Sales and use tax exemption for products of photo-processing produced for use in motion pictures for public commercial exhibition. The 14.9% hotel tax is reimbursed for stays in excess of 30 days.
<b>Kansas</b>	Sales tax refund for certain film, television, commercial, or video production expenditures. Must spend at least \$200,000 per project in Kansas. Expires 30 June 2000.
<b>Kentucky</b>	Sales and use tax refund for purchases made by a motion picture production company in connection with filming in Kentucky if the company films or produces one or more motion pictures in the state during any 12-month period.
<b>Louisiana</b>	State sales and use tax refund on purchases made in connection with filming or production if purchases exceed \$1 million or more in a 12-month period. After 30 consecutive days, the 14.9% hotel tax is reimbursed and no further taxes and charged.
<b>Maine</b>	Hotel occupancy taxes are rebated after 28 consecutive days.
<b>Maryland</b>	No state sales tax for hotel stays in excess of 30 days.
<b>Mississippi</b>	A 1998 attorney general opinion declared film production a manufacturing process. This would provide a sales and use tax cap of one and one-half percent on the purchase of machinery, equipment, and tangible personal property used in the production of motion pictures, television programs, commercials, and documentaries. This opinion requires clarification by the State Revenue Department.
<b>Minnesota</b>	Provides for an annual appropriation of \$500,000 per year for payments to producers for a portion of services and wages paid for in-state production jobs up to a maximum of \$100,000 per film. No sales tax on hotel stays of 30 days or more.

<b>Missouri</b>	Provides an income tax credit up to 25% of expenditures in the state to a maximum of \$250,000 in tax credits per project. Productions must spend a minimum of \$300,000 in the state. No sales tax on hotel stays after 31 days.
<b>Montana</b>	No sales tax. No property tax on out-of-state equipment used exclusively in motion picture or commercial production. No accommodation tax for hotel stays in excess of 30 days.
<b>Nebraska</b>	No hotel occupancy for stays in excess of 30 days.
<b>Nevada</b>	No corporate or individual income tax. Low hotel room tax.
<b>New Hampshire</b>	No state sales tax. Individual income tax on interest and dividends only.
<b>New Jersey</b>	Sales tax exemption for all film and video related machinery and equipment as well as services of installing or repairing equipment used directly in production and post-production of motion pictures, television, or commercials.
<b>New Mexico</b>	State sales tax exemption on all production costs including set construction, wardrobe, facility and equipment rental, all production and post-production services. After 30 days, the four percent ledgers tax is waived for hotel guests.
<b>New York</b>	Comprehensive state and New York City sales and use tax exemption for machinery, equipment, and services used in production and post-production activities in the production of feature length films, television programs, music videos, and commercials. Film, television, and commercial production are considered a manufacturing process.
<b>North Carolina</b>	Reduced sales and use tax (one percent rate) on the purchase and rentals for motion picture production films of cameras, films, set construction materials; as well as chemicals and equipment used to develop and edit film that is used to produce release prints. Full

	<p>exemption for the purchase of film that becomes a component part of release prints sold or leased. Chemicals used to develop prints for sale or lease are also exempt. A 1997 law included a sales tax exemption for audiovisual master tapes made or used in production.</p>
<b>Ohio</b>	No state sales tax on hotel stays in excess of 30 days.
<b>Oklahoma</b>	<p>Sales tax exemption on sales of tangible, personal property, or services to a motion picture or television production company to be used or consumed in connection with an "eligible production." An eligible production is defined as all television productions (not including commercials), television pilot, or on-going series televised on a network or a feature-length motion picture intended for theatrical release. State sales tax rebate on hotels after 30 days.</p>
<b>Oregon</b>	No state sales tax.
<b>Pennsylvania</b>	<p>A 1997 law granted a six percent sales and use tax for the purchase or rental of any tangible personal property in Pennsylvania used directly in the production of a feature length commercial motion picture distributed to a national audience. The exemption covers props, sets, supplies, tools, production and post-production services including processing, editing, etc.</p>
<b>South Carolina</b>	<p>Sales and use tax exemption for all suppliers, technical equipment, machinery, and electricity sold to motion picture companies for use in the filming or producing of motion pictures. For tax years after 1998, corporate and personal income tax credits for investments in South Carolina production projects or facilities.</p>
<b>South Dakota</b>	No state individual income tax.
<b>Tennessee</b>	<p>Sales and use tax refund for out-of-state motion picture companies for use in filming or producing motion pictures. For tax years after 1998, corporate and personal income tax credits for investments in South Carolina production projects or facilities.</p>



<b>Texas</b>	Comprehensive sales and use tax exemption for purchased or rented equipment or services used in the production of a motion picture or video recording for ultimate sale, license, or broadcast (including cable broadcast). No sales tax on hotel rooms for stays in excess of 30 days.
<b>Utah</b>	Transient occupancy tax rebate after 30 days.
<b>Vermont</b>	Credit for non-resident income tax for commercial film production if Vermont income tax exceeds income tax rate in state of residence. No tax on hotel stays in excess of 30 days.
<b>Virginia</b>	Sales and use tax exemption for production services or fabrication in connection with the production of any portion of exempt audio/visual work, feature or made-for-television films, programs, documentaries, commercials, etc. Tangible personal property including scripts, artwork, supplies, equipment, and accessories are also exempt.
<b>Washington</b>	Sales and use tax exemption for the purchase or rental of production equipment and services used in motion picture or video production or post-production. No sales and use tax on vehicles used in production. No tax on hotel stays in excess of 30 days. No state individual income tax.
<b>Wyoming</b>	No tax on hotel stays in excess of 30 days. No state corporate or individual income tax.