Italy’s tax incentive scheme for international film industry: an ongoing evaluation of impact

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Abstract
A film production company is always in search of cost effective solutions during the film preparation phase, especially deciding where, when and for how many weeks the shooting will take place. All European countries have implemented tax schemes or other financial measures aimed at attracting international projects, mainly US productions. Italy has been able to catch up only in 2007, by introducing in the yearly financial law (244/2007) a bunch of fiscal measures, among which a 25% tax credit on production costs incurred in Italy and other European countries in connection with foreign productions. The tax credit can be offset against the production company fiscal debt during production resulting in an actual saving. The effort of Italian Government and Parliament has therefore been addressed to encourage inward investments and shooting in Italy. As a result, huge mainstream films have been shot in various Italian locations throughout 2009 and 2010, bringing the Studios back to Italy after a long period of absence. The aim of this work is to provide a first evaluation of the impact of these productions, at an economic and communication level, as well as to assess if and how positive the effect can be considered. Starting from the figures and data emerging from the existing new experiences, the paper estimates the new value added produced by Italian companies and the amount of direct expenses in domestic goods and services made by International companies. Finally the work tries to contribute to the international debate on the film-induced tourism and its multiplier effect on the territory.

Summary
1. Introduction
2. An essential outline of the Italian Tax credit Scheme
3. The Italian experience: “The Tourist” and “The American” projects
4. Conclusions

1. Introduction

The global economic crisis has affected film finance as the scarcity of capitals has lead to a tightening of credit lending by financial institutions. Even if movie industry is typically counter cyclical, raising finance for film production is getting increasingly difficult and all sources of soft money are becoming increasingly important. Film incentive programmes designed to attract foreign film investment have therefore been introduced (or strengthened) almost all over the world.

In Europe, where there is a long tradition of incentives to encourage foreign shoots, new tax incentives have been introduced in Italy, France, Czech Republic and Austria and almost all European countries are now competing to foster film investment. In the US, film incentives have been included in several state programmes and recently increased as they proved to be very successful such as in Louisiana and New York. Asia is also entering in this area and becoming an interesting source of soft money.

Italy has joined the arena as it has recently implemented its location based tax credit programme aimed to attract foreign film investment. The Italian scheme is proving to be successful in pursuing the goal of increasing local spend (as it has a multiplier effect on local economy and tourism) and increase the lure of local industry (resulting from the increasing involvement of Italian talents in foreign productions).
2. An essential outline of the Italian Tax credit Scheme

The Italian Parliament has approved a three years tax credit scheme in December 2007. The scheme has then been greenlit by the European Union at the end of 2008. Applications (including retroactive applications for qualifying productions) have been made available to producers only since August 2009.

Under the Italian scheme qualifying foreign theatrical motion pictures can obtain a tax credit up to 25% of the eligible production costs. Such tax credit cannot exceed € 5 millions per film and 60% of the overall production budget.

Eligible production costs are the production costs (including pre and post production costs) actually incurred in Italy (or in other European countries as long as such costs are not more than 30% of the overall production budget).

The credit accrues during production on the basis of the costs actually incurred by an Italian production service company from the date of the preliminary application until the date of the final application. The final amount obtained by each project is verified by the Ministry of Culture and the Italian Tax Authorities upon submission of the final application.

Foreign producers cannot apply directly for the Italian benefit as only Italian executive production service companies - that are subject to taxation in Italy and meet certain legal requirements – are entitled to apply. Foreign producers must therefore go through the hiring of an Italian executive production service company that applies, gets the tax credit for the picture and then use the credit to cover certain Italian production costs.

It must be noted that as the Italian tax credit accrues during production (while production costs are incurred), the applicable regulation allows the Italian production service company to use such credit to pay all picture-related Italian tax liabilities (such as social security and withholding taxes for Italian cast and crew, Italian VAT etc) and therefore to save on production costs.

Indeed even if the Italian production company can offset the tax credit against any of its tax debts (even if unrelated to a specific production), such credit is usually entirely applied against the picture-related tax liabilities so to maximize and optimize the immediate benefit for the foreign production.

In essence the Italian tax credit results in tax saving applied by the Italian production company against qualifying foreign picture’s Italian production costs. Foreign producers actually benefit of the credit by getting (through the Italian executive production company) an actual cost reduction up to 25% of the picture Italian spend.

Unlike many other European incentives, the Italian tax credit is not-tradable and not assignable. Only the Italian production service company that gets the tax credit can use it and it can be used only to pay tax liabilities of such production service company. The tax credit does not have an expiry date and therefore can be offset against future tax debts of the Italian company.

The non tradability of the Italian tax credit could impair the Italian scheme in the European and global competition to attract foreign production investment. Indeed, if the tax credit accrued on the Italian spends of a foreign production is not entirely used to reduce the production costs of such foreign project, it might become difficult for the foreign producer to receive the benefit in full. The unused tax credit should be cashed somehow (by the Italian production service company or through banks) or applied to future film production realized by the same foreign producer and the Italian production company.

However, this potential downside of the Italian scheme is overshadowed by the advantage of the tax credit being usable during production and therefore resulting in an actual saving.

Indeed the Italian tax credit is one of the few worldwide (and, most likely, the only one in US and EU) that allows a saving during production instead of a reimbursement or retroactive tax rebates on the local production spend.

This advantage of the Italian incentive is particularly appealing and appreciated by foreign producers now that “the economic crisis is manifesting itself in part through a growing
reluctance on the part of national banks to cash flow even government backed tax credits in some territories, particularly the UK and Germany\(^1\).

As all European film incentive, the Italian tax credit is accessible only for qualifying pictures. To qualify for Italian tax credit foreign theatrical pictures must pass the cultural eligibility test scoring at least 50 (out of 100) points across three section (content, creative and production). Two out of the four content requirements are mandatory for the foreign picture to qualify. Namely, the film must (i) be adapted from a literary work; (ii) relate to an historical, legendary, religious, social, artistic or cultural event; (iii) relate to a celebrity of artistic, historical, religious, social or cultural import; and/or (iv) be set in Italy or Europe. The more the picture involves Italian and European creative talents and crew members and the more production and post production activities are based in Italy, the higher the score reached by the project.

Last, but not least, the Italian tax incentive is not difficult to access. There is no uncertainty on whether the foreign production qualifies for the credit. Indeed the producers will know if the picture qualifies at the latest within the end of the month following the submission of the preliminary application and, in the event the picture does not reach the minimum requirements, may resubmit the application changing some picture elements. Once the project has qualified, it is quite easy for the producer to calculate in advance the amount of the tax credit as it is a simple percentage of the eligible Italian production costs.

The Italian tax credit may also be easily combined with other national incentives. This is extremely important as producers always try to build international co-productions in order to maximize and optimize access to incentives available in different territories. To this respect, it should however be noted that access to incentives in EU cannot exceed 50% of the overall production spend. This is a mandatory EU rule binding for all European countries.

The Italian tax credit is not a stable one. As the Italian government has approved the scheme for three years from 2008 to 2010, it will expire in at the end of December 2010. However it is expected to be renewed for another three years and therefore until the end of 2013. To complete this overview of the Italian incentives, it might be worth to note that the tax credit is the only national incentive made available for foreign productions, but it is not the only incentive such productions may obtain in Italy. Indeed, in addition to this national benefit, several Italian regions (such as Tuscany, Piedmont, Sicily and so no) are offering regional funding and in particular grants to productions (both local and foreign) that shoot in such region. Regional funding is indeed an interesting experience as it is world-wide proving to be increasingly successfully in attracting film investment.

3. The Italian experience: “The Tourist” and “The American” projects

The Italian tax credit scheme has been made available for foreign productions only since August 2009. Even if Italy’s financial incentive has been regarded by producers as a viable option only very recently, it is proving to be appealing and successful in boosting inward international film production investment.

During the first year of its actual application, 7 foreign films applied for the benefit, for more than 50 Million Euros direct expenditure in Italy. Among those, there are two important US productions that have been realized with the support of the Italian incentive. Namely, “The American” directed by Anton Corbijin starring George Clooney for Focus Features and “The Tourist” directed by Florian Henckel von Donnersmarck starring Angelina Jolie and Johnny Depp for GK Films and Columbia Pictures. Both such productions are completed and shall open in 2010.

The feedback of these two projects is therefore very interesting for evaluating the Italian scheme.

The first project to have tested the incentive is “The American” produced by Focus Features and theatrically released in September 2010.

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The project has passed the cultural tests easily as it satisfied all content, creative and production requirements. Indeed, it is a film adapted from a novel by Martin Booth entitled “A Very Private Gentleman” whose plot has been summarized as follows. Alone among assassins, Jack is a master craftsman. When a job ends more harshly than expected for this American abroad, he vows to his contact that his next assignment will be his last. Jack reports to the Italian countryside, where he holes up in a small town and relishes being away from death for a spell. The assignment is in the offing as a weapon is constructed. Surprising himself, Jack seeks out the friendship of local priest Father Benedetto and pursues romance with local woman Clara. But by stepping out of the shadows, Jack may be tempting fate.

Whilst post production was mainly in UK, the picture has been almost entirely shot in Italy and in particular in Abruzzi in the areas affected by the 2009 earthquake. Indeed “The American” has spent almost three months shooting in Italy plus one week in Sweden. Production costs incurred in Sweden were within the limits allowed by the Italian scheme and therefore the tax credit has been calculated also on 25% of the eligible Swedish spend. Furthermore certain important roles were played by Italian actors and most of the crew was also Italian.

Interviewed by Screen International, Anne Carrey, one of the US producers of “The American”, was very enthusiastic about the Italian scheme. She said “One of the biggest benefits is that you get it during production. With many tax credits in the US you do not see the return for one or two years. Italy’s is a rolling benefit you see during production. That’s huge.” Carrey also clarified that “The credit allowed us to shoot in Italy, otherwise frankly we would have had to look in to Easter Europe.”

Carrey’s view is confirmed also by Enzo Sisti, one of the most experienced and appreciated Italian professional, executive producer of “The American”. In his view the availability of the tax credit was the first and the main reason for shooting the entire picture in Italy, even if it was not the only reason as also the appeal of the Italian location and the first class level of the Italian crew played an important role. “Lacking the tax credit, the picture would have been most likely shot in Easter Europe where costs are lower and rebate for film investments are available or in Germany where the rebate to attract foreign production is working very well”. In Sisti’s view, the most competitive European countries for US productions today are Germany and UK (thanks to the tax incentives, the flexibility of the crew working hours and, in UK, the lower cost of social security charges). Eastern Europe countries follow closely thanks to lower production costs and appealing tax incentives such as the Hungarian tax rebate. As where to shoot a picture is a cost driven decision, Italy can compete only if the tax credit is confirmed. But, with the tax credit, Italy can compete very well.

Sisti says “the Italian tax credit is the best scheme with respect to how and when you receive the money as the foreign producer gets the benefit during shooting as a cost reduction and a cash flow saving. Timing is indeed the added value and the competitive advantage of the Italian scheme.”

“The American” has proved that the Italian scheme not only effective in attracting foreign projects, but also in achieving the goals to involve Italian (and European) creative talents and crew members and to support local suppliers and industry. Indeed all Italian characters were played by Italian actors and the casting of Italian and European characters was entirely done in Italy. As to the crew, 140 out of 150 crew members (excluding, of course, the director, the creative producers and the editors as the post production was made in UK) were Italians. All production materials have been purchased or rented in Italy. Almost all locations were Italian. If compared with foreign project shot prior to the introduction of tax credit, the attitude is positively changed and the involvement of Italian resources increased.

According with Sisti, international film production investment in Italy can be increased further by confirming the tax credit, strengthening regional and local funding, reviewing the crew collective agreement narrowing the gap with other European countries or American for what working hours are concerned and schedule simplifying access to shooting permits in the main cities.

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Another major US picture has tested the Italian tax credit. “The Tourist” directed by Florian Henckel von Donnersmarck starring Angelina Jolie and Johnny Depp for GK Films and Columbia Pictures, one of the most important and high profile films being produced in the world in 2010.

The picture is the remake of the French film entitled “Anthony Zimmer”. The film revolves around Frank, an American tourist visiting Italy to mend a broken heart. Elise is an extraordinary woman who deliberately crosses his path in order to mislead all those following her former lover. Against the breathtaking backdrop of Venice, Frank pursues a potential romance but soon finds himself the pursued as he and Elise are caught in a whirlwind of intrigue and danger. The movie follows the series of manipulations, as characters realise that they are merely pieces being played by an unseen mastermind of the game.

David Nichols, with his Italian production service company, was the executive producer of the picture and his feedback is extremely interesting for an assessment of the Italian scheme. “Because the story is set in Venice, some filming would have taken place in Italy anyway. When I was first contacted to become involved in the project the intention was to film about 20-25% of the movie in Venice, and to base the rest of the shooting in UK in a studio to benefit from the UK tax rebate. On the very first location scout to Venice the foreign producer and director became interested to consider shooting the whole film on location in Venice. The director was naturally excited by this concept. The significant additional location costs involved in this concept could only be considered because they would be offset by the Italian tax credit. If the tax credit had not been in effect only a small portion of the film would have been produced in Italy” says David Nichols. “The tax credit legislation is the best incentive seen to date in Italy. This has already greatly incentivised foreign producers and as the tax credit becomes more widely known and publicized around the world the annual number of productions coming to Italy will undoubtedly increase dramatically (We are currently in contact with 3 different USA producers about new projects).”

Also in Nichols's view to the most competitive European countries for US productions today are Germany and UK. Indeed “The UK and Germany are both very attractive to foreign producers on account of their similar financial incentives. The UK system has no cap and is therefore potentially worth more. The German and UK systems are both simpler and easier to implement than the Italian tax credit. This is due to the complexity and bureaucracy of the Italian system which adds additional costs to the foreign producer. UK and Germany have lower social security contributions than Italy which makes them attractive to foreign producers.” Nevertheless “The tax credit legislation has put Italy on the world map again as a production location. Italy is a country everyone wants to visit, and filmmakers around the world all want to shoot here (every studio has several scripts set in Italy). Until now, Italy has been considered too expensive. Now, with the tax credit, foreign producers are looking again, very hard at how to bring productions to Italy where they know they can benefit from the rich film history and tradition, and where they can find some of the best film technicians and craftsmen in the world”. The film has had a very positive impact on the local economy and industry as “approximately 60% of the ‘production’ budget was spent in Italy and approximately 20% of the total budget. This film had very high USA above-the-line costs. It would be usual for a foreign film to spend up to 40-50% of its overall budget if the film was shot entirely in Italy. This percentage would increase if post-production was based in Italy”. Furthermore “Approximately 50% of the cast of the film were Italian actors”.

As to the pros of the tax credit, “there is an obvious financial benefit that a very large Hollywood production brings to the local economy, considering hotel accommodation, transportation, living costs etc. of the several hundred people involved in such an activity. Also, the majority of the camera, grip, electrical and art department equipment and set dressing materials were sourced in Italy”. Nichols also highlighted an additional important pro of the tax credit as “The less obvious but equally important investment is to the Italian film industry; “The
Tourist” is one of the most important and high profile films being produced in the world this year. The level of expertise and excellence of the foreign crew brought in to work with the Italian crew was of the highest standard. The learning and innovation benefit this brings to the Italian film technicians is important. Similarly, the technical developments of equipment which had to be imported from UK or USA for the production because it does not exist in Italy are developments which will positively impact the standard of equipment and services being offered in Italy in the future. The impact of “The Tourist” on the industry should also be significant, considering that the two main actors of the film are arguably the leading film stars in the world today”. Furthermore there is the benefit to the local tourism “Anthony Minghella’s “The Talented Mr Ripley” which produced many “Ripley” tourists several years ago demonstrated the effect to the tourism industries.”

Interviewed about his Italian experience, Bahman Naraghi, COO of GK Films, producer of “The Tourist”, recognized the pros of shooting in Italy, in the “Very high quality of the crew, in particular of the craftsmanship of those members utilized for set decoration (“painters”) and of the camera department. We have had a great camera crew”, whilst the cons lie in the “Highly bureaucratic and convoluted legal and tax system. Significant delays in obtaining VAT refunds (in particular if compared to other European countries).”

Furthermore Naraghi gave an extremely valuable feedback for the assessment of the Italian tax scheme. Indeed, while confirming that the British scheme (because it is uncapped, easy to use and because of the time of the recovery) is the most attractive EU scheme, follow closely by the German scheme. He said that the very good aspect of the Italian scheme is that “you can offset the Italian tax credit during production. However this works fine only if you have enough tax debts. It worked for us because the production had tax debts in excess. For smaller production it could be a significant problem. Indeed the Italian tax credit goes to the Italian production company – not to the US company – and it is not tradable. The US entity is forced to take an exposure on future activities of the Italian executive production company. This is an unbelievable liability. The Italian tax credit should be improved by making it tradable”.

4. Conclusions

The Italian tax credit scheme – introduced after several years of lobbying by the local industry - has proved to be effective in attracting inward foreign film investment and indeed in the first year of actual implementation (i.e. from August 2009) it has attracted important foreign productions amid which the top profile films being produced in the world this year. US producers and local executive producers of both pictures shot in Italy this year (i.e. “The American” and “The Tourist”) have all reported that if the tax credit had not been in effect, no shooting or only a small portion of the picture (to the extent unavoidably required by the script) would have been produced in Italy. Indeed until now Italy has been perceived as an expensive country that cannot really compete in the global or European arena as where to locate a film production is mainly a cost driven decision. The tax credit scheme has put Italy on the world map again as a production location.

The experience of “The American” and “The Tourist” has proved that film production brings a significant financial benefit to the local economy (considering hotel accommodation, transportation, living costs etc. of the several hundred people involved in such an activity and that most of production materials are usually sourced in Italy) and to the Italian tourism as an international audience may appreciate the Italian locations. Furthermore foreign shooting brings a benefit to the Italian film industry as Italian creative talents and crew are involved in the foreign productions. The learning and innovation benefit, as well as of international allure, this brings to the Italian industry is important.

Last, but not least, the benefits of the tax credit are subject to a cultural test and may therefore be accessed only if the foreign productions meet and satisfy content artistic, creative and cultural requirement.

As the film productions are culture, art and business, we believe that the preceding is a clear evidence that art and culture are policy issues and amid the most important ones.
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