Expenditure Tracking Tips

March 2014

A. GENERAL TRACKING TIPS

1. Credit Allocation Letter Date: Expenses incurred whether paid or not (crew that has worked or is working, materials used or in use, services that have already been performed) prior to the issuance of the Credit Allocation Letter (CAL) are not qualified expenditures. However, qualified items which required full or partial payment (insurance premium, completion bonds, office rent) prior to the issuance of the CAL may be pro-rated. For example, insurance premium payment may be prorated by the number of pre-production and production weeks, with the payments for weeks after issuance of the CAL considered qualified expenditures. Insurance premiums that are prorated should be calculated by your insurance broker and given to the CPA performing the AUP.

2. Cut off Date For Tracking Costs: Costs are qualified only until 30 days after the creation of the final elements regardless of when paid. Only expenditures incurred up to 30 days after that date shall be considered qualified expenditures (pre-paid items for services that have not yet been performed do not qualify). Documentation which indicates the date of completion of the final elements e.g., digital air master, composite answer print, or digital cinema files, will be required by the CPA performing the Agreed Upon Procedures. This documentation should be a facility invoice or letter evidencing the date the final elements were completed.

3. Refunds and credit notes received for discounts, rebates, insurance claims, invoicing errors and purchase returns must be credited to the production costs.

4. In-kind services and deferrals are not considered qualified expenditures. Only direct out-of-pocket costs may qualify.

5. Contingency funds which are spent during the production period should be properly allocated into the specific accounts on the cost reports.

6. All receipts/invoices must be legible; illegible documentation may not be accepted by the CPA. Petty Cash (P.C.) receipts should be numbered, legible, and must not be truncated, with each transaction clearly marked on the front of the P.C. envelope or on a spreadsheet.

7. The costs recorded are to be actual costs with no markups, profit additions or personal expenses.

B. SPECIFIC TRACKING TIPS & USEFUL INFORMATION

1. Producer (Hyphenate) Wage Split

Any individual receiving an on screen producer credit must also receive a BTL on screen credit in a qualified occupation in order for those wages to qualify. For example, if an employee is receiving any kind of on screen Producer (see definition in CFC Guidelines) credit on the project *along with a below the line credit*, the wages (exclusive of fringes) attributable to the below the line account will qualify up to $100,000 (if DGA UPM) or commensurate with other department heads for non-union production managers. If the Producer/UPM will not be receiving a UPM credit on the project, than none of the UPM salary will qualify.

Other Examples:

- If a Visual Effects Supervisor also receives a Visual Effects Producer screen credit, the wage attributable to the VFX Supervisor account will qualify up to $100,000.
- If a Post Supervisor also receives an Associate Producer screen credit, the wages attributable to the Post Supervisor account will qualify up to the industry standard rate.
- If a First Assistant Director receives a Co-Producer screen credit as well as a 1st AD credit, the wages attributable to the First Assistant Director account will qualify up to $100,000 (DGA) or industry standard rate if non-union.
- All wages attributable to any individual that receives an on screen producer credit are subject to review.

2. Box Rentals/Car/Cell Phone Allowances – IF THE SALARY QUALIFIES, THE ALLOWANCE QUALIFIES

Box Rentals, Cell Phone and Car Allowances are considered qualified expenditures for qualified individuals. Box Rentals, Cell Phone and Car Allowances for producer-hyphenates are considered qualified expenditures. These expenditures do not qualify for non-qualified individuals. Payments for cell phones rented for nonqualified ATL crew or cast which are paid from an actual bill are considered qualified spend.

3. Proof of Usage in State (filming in and out of CA)

The use of goods - purchased or rented out of state but used in the state - qualify for the tax credit, as do goods purchased or rented in state. Items purchased in state will need to be prorated if items are also used out of state. For items purchased out of state, the production company must be able to provide proof (e.g. call sheets, production reports, etc,) of use of such items in California to the CPA performing the Agreed Upon Procedures (AUP). This includes any items purchased over the internet and used in the state (see #7 below regarding shipping goods). If proof is not available, cost may be disallowed. For productions where 100% of shooting occurs in California, all items purchased or leased for direct use in the production shall be assumed to be used in-state.

4. Proration For Out of State Work, Goods, and Services (filming in and out of CA)

If at any time during the production period the project operates out of state, wages, goods and services must be prorated proportionately to accurately allocate the costs. For example, if an employee who makes $1000/week works 2 days out of the state and 3 days in the state, his or her salary would be prorated and $600 ($200/daily rate x 3 days) would be the employee's qualified wages for that week. If a company is contracted to perform work both inside and outside of the state, their contract amount would need to be prorated proportionately for the percentage of work time expended in and out of California. Rented or purchased items such as camera equipment, self-drive cars, production trucks, picture cars, wardrobe, props and the like must all be prorated if they are used out of state. Insurance premiums must also be prorated if filming occurs out of the state. For any items fabricated or built in the state but filmed out of state, only the labor will qualify – not the materials (can prorate for usage in state).

5. **Proration for Stunt Coordinator or Stunt Riggers/Performers**

Stunt Coordinator, stunt riggers or safeties earnings are considered qualified wages when not on camera. The production company must indicate on production reports and Exhibit “G’s” those days when a stunt coordinator or stunt person is “not photographed” or performs on camera and tag wages accordingly. All other on-camera principal and supporting performers’ wages do not qualify, including on days in which they are not photographed nor have wardrobe fittings. (Like performers whose wages do not qualify for fittings or rehearsals, should the stunt coordinator or stunt players have wardrobe fittings or rehearsals for planned on-camera work, their wages do not qualify either)

6. Travel Expenses

Airfare is considered a qualified expenditure if air travel originates and concludes in California (intrastate only). Travel day salaries for qualified individuals traveling within the state are qualified expenditures. Travel day salaries for qualified individuals traveling into or out of the state do not qualify. Travel Agency fees qualify when airfare is purchased from a California travel agent for intrastate travel. Luggage fees qualify for intrastate travel only. Relocation costs for relocating series do not qualify.
Travel allowances to unqualified cast or crew are not considered qualified expenditures; however, if the production company directly pays for a hotel room or corporate housing (no private housing rentals) or intrastate airfare, those expenditures will qualify. Proof of intrastate travel (itemized) will also be required for any travel allowances provided.
Aerial photography is qualified provided the helicopter or plane takes off and lands in California.

Per Diems for non-qualified individuals do not qualify. For producer-hyphenates, per diem is considered a qualified expenditure up to the amount commensurate with per diems given to other department heads.

7. Shipping Goods

The costs to ship items into or out of the state are not qualified expenditures. The costs to ship items intrastate do qualify; however, in both instances, please break out the cost of the item from the shipping costs, so as to properly code these expenses. Save any return address labels which prove the item was shipped intrastate (if purchased on the internet).

8. Insurance Claims Refunds, & Budget Thresholds

Cash refunds received as the result of an insurance claim must be credited to the cost report and offset related qualified expenditures. Proceeds from the refunds that are spent on qualified labor and/or materials will count toward your tax credit amount. Any additional costs associated with an insurance claim will not be counted toward the budget threshold criteria (e.g., if an insurance claim causes the production to exceed the $10 mil or $75 million thresholds, the production will not be disqualified or reclassified). This also applies to litigation costs.

9. Fiscal Year End Expenditure Report

This report asks for information similar to that asked on the Expenditure Summary Report (see below), and is required for productions which span 2 fiscal years. The California fiscal year is from July 1st to June 30th of the following year. This report is due on August 1st of the new fiscal year. Productions that will be submitting their final documentation by August 1st do not need to fill out this report.

C. Expenditure Summary Report

1 . Expenditure Summary Report

When applying for the Tax Credit Certificate, production companies will be asked to fill out this report which requests information including the following: (*indicates data that can be obtained from payroll service):

- *Number of man/days (the sum of the number of days (full or partial) a person worked. For example, Jane works 35 days; Jim works 26 days so total Man/days would be 61; this figure is required for all cast/crew/labor and extras & stand-ins;
- *Total number of residents and non-residents hired;
- Total qualified wages & fringes and non-wages (excluding post-production);
- Total qualified wages & fringes and non-wages (post-production only)
- *Total State Income taxes paid (qualified and non-qualified wages); (Note: Any production issuing a large amount of 1099's will need to provide their CPA with an "Information Return Master File", which the taxpayer can request a copy by calling the IRS at (866) 455-7438. This form verifies that all 1099's have been reported.
- Total Expenditures on Taxable Goods and non-wage Services incurred or used in the state (the total amount of purchases and rentals including the California sales and use taxes for which the production has been charged).
- Copyright registration number: Applicants will need to include a Certificate of Copyright registration in order to receive a Tax Credit Certificate.

This report also asks for information on the **diversity of the cast and crew**. Employees generally have the option of providing this information on their start paperwork. If the information is provided, ask your payroll service to include this information with the employee's information, so as to be able to provide a report to the production company at the end of the production period. If the payroll service does not ask for this information, please include an ethnicity question, at the employee's option to answer, on the deal memo or a separate form. It is important to explain to the employee that this question is being asked because your production is participating in the California Film & Tax Credit Program, and it is a requirement of the program, although answering the question is optional. The data from this report will enable the production to complete the Employment Diversity information on the Expenditure Summary Report.

Accountants will need to create free fields or "tag" accordingly when inputting the information for cost reporting purposes, so the information required for this report can be tracked. When inputting employee data, the payroll service can tag and track some of this information, so it is important for the accountant to discuss this with the paymaster early in the process. (See Appendix A for tagging methodology)

2. Allocating Wages and Materials in Package Deals

The Expenditure Summary Report asks for a breakout of wage and non wage spend. It is important statistically to ascertain where the money is allocated in a package deal, as it is customary for some contracted work to package together labor, services, and materials (e.g., prosthetic manufacture, post sound packages, visual effects digital work, set or prop manufacturing). Invoices should indicate what costs of the package are attributable to labor and what costs are attributable to materials or facility costs. The labor portion of this work must be included in the total qualified wage figures in your Expenditure Summary Report. In recognizing that it is sometimes difficult to apportion services, below please find some guidelines:

- Post-production facilities which bundle services should break out all labor charges for any sound editorial work.
- Facility stage costs such as ADR recording, Foley recording, and Dubbing stage, digital intermediate creation, and similar services which combine labor and facility/materials may be attributed as non-wage expenses if it is not feasible to separate wages from services/materials.
- Visual Effects companies may use the ratio of 65% labor, 35% materials for all invoices for reporting purposes to the California Film Commission.

D. Agreed Upon Procedures (AUP): Required documentation

1. Certified Public Accountants

Agreed Upon Procedures Report must be performed by a CPA with an active California license to perform attest services or a practice privilege permit. Applicants are unable to engage the same CPA/Accountant who performed any production accounting and/or post-production accounting for the approved project. Only CPAs who have attended a CPA Orientation Seminar are able to conduct AUPs; CFC supplies a listing of CPAs who have attended a seminar and are familiar with the California Film & Television Tax Credit Program.

2. Verification of In-state Work

Each production must obtain documentation from visual effects, digital effects, post sound and/or title design companies or contractors in order to verify that visual effects, digital effects, post sound and/or title design work was performed in the state. Documentation may be a letter or invoice from the supplier, with full contact information, stating that the labor and materials invoiced are attributable to work performed in the state. If a portion of the work was performed out of state by the company or its subcontractors, the statement or invoice must indicate the dollar amount for such work and/or materials. Emails are not acceptable. This documentation will be reviewed by the CPA performing the Agreed Upon Procedures and the CFC.

3. Related Party Transactions

All related party* transactions must be in accordance with an arm's length standard. In determining the true expense of a related party, the standard to be applied in every case is that of a person dealing at arm's length with an unrelated person. A related party transaction meets an arm's length standard if the results of the transaction are consistent with the results that would have been realized if related parties had engaged in the same transaction under the same circumstances with an unrelated party (arm's length result). Whether a transaction produces an arm's length result generally will be determined by reference to the results of comparable transactions under comparable circumstances.

The production company is required to provide the CPA performing the Agreed Upon Procedures with a breakdown of all related party transactions, as they are subject to review and sampling; comparison bids and/or studio rate cards will be requested. If the production company rents equipment from a BTL crew member, this is not a related party transaction. However, renting company services or equipment from cast or crew whose salaries are not qualified for the tax incentive program are considered related parties by the CFC and are subject to review.

*The term "related parties" is understood to mean the reporting entity; its affiliates; principal owners, management, and members of their immediate families, entities for which investments are accounted for by the equity method; and any other party with which the reporting entity may deal when one party has the ability to significantly influence the management or operating policies of the other, to the extent that one of the transacting parties might be prevented from fully pursuing its own separate interest. Related parties also exist when another entity has the ability to significantly influence the management or operating policies of the transacting parties or when another entity has an ownership interest in one of the transacting parties and the ability to significantly influence the other, to the extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

4. Production Assets

Proceeds from the sale of props and other production assets must be deducted from the cost presented in the cost report. Asset lists are required as part of the Agreed Upon Procedures documentation.

a) Any assets with a purchase price of $10,000 and over will be subject to review in determining tangible personal property value. As a general rule, the lesser of the net cost of the asset after sales proceeds (if assets sold) or 50% of the purchase price will be allowed as a qualified expenditure. If the asset is destroyed during the process of production, applicant should maintain documentation as proof for verification by the Certified Public Accountant (CPA) performing the Agreed Upon Procedures for the company. <u>An asset list of all items with a purchase price of $10,000 or more is required for the AUP and for review by the CFC.</u>

b) Any leased or rented items manufactured, assembled, or fabricated to specification with a value of $10,000 or more shall be treated as a capital lease if it meets any one of the following four conditions: 1. If the term of the lease exceeds 75% of the life of the asset; 2. If there is a transfer of ownership to the lessee at the end of the lease term; 3. If there is an option to purchase the asset for substantially less than the fair market value ("bargain price") at the end of the lease term; 4. If the present value of the lease payments, discounted at an appropriate discount rate, exceeds 90% of the fair market value of the asset. Any such rental or lease agreement that meets the standards for a capital lease will be considered a purchase and subject to a 50% expense cap for purposes of qualifying for the tax incentive. <u>All such items are required to be on the asset list of items with a purchase price of $10,000 or more.</u>

c) Office electronic, post production or effects equipment such as computers, hardware, drives, scanners, monitors and relevant components, copiers, and printers which are purchased for the production will be allowed the lesser of the net cost of the asset after sales proceeds (if assets sold) or 20% of their purchase price as a qualified expenditure. <u>Digital assets with a purchase price equal to or less than $250.00 are not subject to this requirement.</u> Props or set dressing that involves digital equipment are also subject to this rule, except for period props/dressing manufactured more than 5 years from the date of usage. <u>An asset list of all such items is required for the AUP and for review by the CFC.</u>

d) Licensed Assets: Per statute, any licensed materials, e.g., music licenses, software, are not qualified expenditures. Please tag these items accordingly.

Here are some examples regarding the disposition of assets:

1. <u>If an Asset over $10k is Sold (e.g. 50% assets):</u>
   If the asset is sold, the qualified cost is the lesser of the net cost after sales proceeds or 50% of the original purchase price. So in one example, if a $15,000 asset is sold for $6,000 (net cost of $9,000), the qualified cost is $7,500 (50% of the original purchase). In a second example, if a $15,000 asset is sold for $11,000 (net cost of $4,000), the qualified cost is $4,000. So in summary, if the asset is sold the most you could get as a qualified cost would be 50% of the original purchase price.

2. <u>If an Asset over $10k is Retained (e.g. 50% assets):</u>
   If the asset is retained, the qualified cost is limited to 50% of the original purchase price in all cases.

3. <u>If an Asset over $10k is Destroyed (e.g. 50% assets):</u>
   If the asset is destroyed as part of the production, the qualified cost is the full value of the asset. However, in all cases the production company must maintain documentation that the asset was destroyed (e.g. photographs, production reports, video footage, etc.).

4. Asset under $10k (not including the post, office electronic, digital and effects equip): If the asset purchase price is below $10k, the qualified cost is the full value of the asset. The production company does not need to specifically track the asset but upon request, may need to provide a listing of all assets to the auditor and CFC.

5. If an Asset is a Post, Office electronic, Digital and Effects Equipment Purchase: If the asset is post, office electronic or effects equipment, the qualified cost is limited to 20% of the original purchase price The production company must track these types of purchases regardless of dollar amount of the purchase price, but the 20% limit does not apply to digital assets with a purchase price equal to or less than $250.00.
6. If an Asset is given to a non-qualified individual, e.g., director, producer, actors, the purchase price of the asset must be fully deducted from the qualifying expenditure total.

E. MATERIALS FOR VERIFICATION OF EXPENDITURES

Production companies will need to provide the CPA that will be performing the Agreed Upon Procedures report access to the following materials (including but not limited to):

- Copy of Credit Allocation Letter
- Full set of final, signed Production Reports for principal photography and any reshoots/additional photography
- Shooting schedule
- Final crew, cast, and vendor lists – no social security numbers please
- Final cost report including all non-qualifying expenditures
- For productions close to threshold limits, CPAs will review ATL contracts for any guaranteed deferments or bonuses, which must be included in the total budget amount.
- Detailed Cost Ledger, e.g., Bible
- Payroll register of all cast, crew, and staff paid
- Detailed Trial Balance
- Detailed Ledger of expenditures - digital and hard copy
- Petty cash envelope summaries (front of each petty cash envelope along with original receipts)
- Bank Statements & Reconciliations
- Information to substantiate qualified expenditures, including invoices, purchase orders, receipts, contracts, deal memos, time cards, stop/start forms, etc.
- List of all visual effects, digital effects, and/or title companies who worked on the production.
- Complete Inventory/Asset list (electronic);
- Listing of items with a purchase price over $10,000 indicating the status of the assets (e.g. destroyed, sold, donated, being held for future productions, given to cast or crew, etc).

- Listing of office, post production or effects equipment purchased for the production and its disposition.
- Listing of customized leased or rented items manufactured, assembled, or fabricated to specification with payment aggregating $10,000 or more.
- Listing of all related party transactions, including type of relationship, transactions, amount of transactions; comparison bids may be requested.
- Listing of all parties with a 5% or greater ownership in or other affiliation with the production company.

APPENDIX A

Tagging Expenditures

The tagging methodology below will enable each production accountant to track qualified wages and expenditures, as well as provide the information required on both the Fiscal Year End Summary Report and the Expenditure Summary Report:

QT = Qualified Taxable Expenditures (Qualified Non-Wage Spend Subject to Sales/Use Tax)
NT = Nonqualified Taxable Expenditures (Nonqualified Non-Wage Spend Subject to Sales/Use Tax)

Sum of QT + NT = Total Expenditures on Taxable Goods and Services

QN = Qualified Nontaxable Expenditures (Qualified Non-Wage Spend NOT Subject to Sales/Use Tax)

Sum of QN + QT = Total Qualified (non-wage) Spend (to be allocated between Production & Post)

QW = Qualified Wages and Fringes (to be allocated between Production & Post)
NQ = Nonqualified Wages and Fringes & Nonqualified Nontaxable Expenditures
LO = Qualified Loan Outs and Fringes (As Loan Out fringes don't qualify (except for Vacation, Holiday, and payroll service fees from a California-based payroll service), Loan Outs may require a different free field from "QW" so that they can have a different "default" of fringe free field coding – check with your payroll service.)

To break out post production amounts, run reports from the accounting system and isolate line items in the post production range of accounts. Once you have only the post production accounts:

1. **Sort by free field code QW to get Qualified Wages & Fringes – Post Production Only.**
2. **Sort by free field QN and total all QNs.**
3. **Sort by QT and total all QTs.**
4. **Add the total QT amount to the total QN amount to get Qualified Non-Wage Spend – Post Production Only.**

We advise all projects to utilize this tagging method or verify that the tagging method being used with enable you to provide the required breakout of figures. Most payroll services will be able to pre-program your software with these naming conventions, as well as enable their clients to tag the qualified fringes or track the qualified fringes for you by isolating them in their fringe tables.

We understand that some projects may have a need to keep track of expenditures for other purposes, and may need to add tags or utilize their own system. We also advise projects to tag those assets that are subject to the 20% and 50% rules so the assets can be discounted properly.

Please refer to the Qualified Expenditure Charts to confirm qualified and non qualified expenditures. However, do not hesitate to contact the CFC Film & Television Tax Credit Program if you are unsure if an expenditure is or is not qualified. We are here to make this program as user-friendly as possible.