Expenditure Tracking Tips 2.0

June 2015

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. Please use the Final Element Creation Verification Form, which can be found on the CFC website.

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 and used in the state - qualify for the tax credit. Rentals and/or purchases will need to be prorated if items are also used out of state. Any items purchased over the internet and used in the state (see #7 below regarding shipping goods) will need proof that the item was purchased from a California vendor. If proof is not available, cost may be disallowed. Productions who film outside of CA may be asked to prove items purchased and/or rented in California were also used in California. 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". On those days when a stunt coordinator, safety or rigger rehearses or has wardrobe fittings for planned on-camera work, their salaries would not qualify.

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

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.

C. TRACKING EXPENDITURES

INDEPENDENT PRODUCTIONS
RELOCATING TV SERIES
NON-INDEPENDENT PRODUCTIONS WITHOUT "UPLIFT" EXPENDITURES

Independent productions and Relocating TV Series do not qualify for the 5% additional tax credits ('uplifts') and therefore do not need to create budget groups for uplift related costs. These productions, along with non-independents without uplift expenditures, need only 3 tagging groups:

1. **QW** - Qualified Wages
2. **QE** - Qualified Expenditures (non-wage)
3. **NQ** - Non-Qualified costs

See “Budget/Tagging” instructions for detailed tagging methodology. Applicants who fall under this category may skip the next section, which refers to coding for non-independent productions with uplift expenditures.

NON- INDEPENDENTS WITH UPLIFTS - GROUP CATEGORIES

Productions that have “uplift” spend will need to add the applicable tagging groups:

- **VU** - Visual Effect
- **MU** - Music scoring / track recording
- **ZU** - Out-of-zone costs (for qualified wages outside the zone)
- **PX** – A category to exclude post-production expenditures, legal, bond, and insurance; these items should be tagged and are noted in RED on the QEC

Important information when tagging for Out-of-Zone (OZ) “uplift” expenditures: (Non-Independents Only)

- If a Principal Photography day is split between in the zone and out of the zone, the day must begin with the first location OZ to be considered a principal photography day OZ.

- OZ uplift only applies to work associated with filming original photography (principal photography and/or reshooting original footage) out of the LA zone. Post production out of the zone does not qualify for this uplift.

- Wages: Applies only during the “applicable period”, which is prep, shoot, and time needed to strike sets in the OZ location.

- OZ labor costs will be the actual labor costs for work performed OZ.

- OZ non-labor costs (purchases, rentals, and contracted services) will be calculated via the on-line application portal by taking the total budgeted (or actual) non-labor costs (excluding post production, insurance, legal, bond and contingency – tagged “PX” and noted in RED in the qualified expenditure charts) and prorating it by the percentage of principal photography days OZ in relation to total principal photography days in the state.

- OZ materials that are totally consumed (as defined in the regulations, e.g., fuel, food, dry cleaning, location site rentals, security guards, etc.) can be tagged separately if desired. If documentation is sufficient, the cost of these items will be credited 100% toward the tax credit (not prorated). If they are not specifically documented, they will be prorated along with non-consumable OZ purchases and rentals. A listing of total consumables can be found in the Appendix A of the Guidelines.

For Visual Effects “uplift” expenditures: (Non-Independents Only)

- VFX expenditures in-state must equal at least $10 million dollars OR 75% of total VFX costs in order to qualify for the uplift.

- The VFX costs which qualify for the 5% uplift are primarily vendor payments for VFX processes, such as previz, postviz, Lidar, element creation, CG shot costs. Labor that is paid directly by the production company and whose primary staff function is visual effects, such as VFX Supervisor, VFX Coordinator, VFX Editor, CG Artist , as well as their computer rentals, will also qualify for the uplift. (Refer to Qualified Expenditure charts – all VFX costs which qualify for the uplift are in GREEN)

For Music Scoring and Track Recording "uplift" expenditures: (Non-Independents Only)

- All qualified wages and expenditures (incurred in California) listed in the qualified expenditure charts under music noted in GREEN qualify for this uplift.

D. EXPENDITURE SUMMARY REPORT

When applying for the Tax Credit Certificate, production companies will be asked to fill out via the on-line portal an expenditure summary report (Form FF) that pertains to their type of production: FF-1 for Non-Independent Productions, FF-2 for Independent Films, or FF-3 for Relocating TV Series. The Report will ask for final schedule and budget information.

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.

E. 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 2.0 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 2.0.

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. Vendors must utilize the Verification of In-State Work form available on the website. If a portion of the work was performed out of state by the company or its subcontractors, the letter must indicate the dollar amount for such work and/or materials. 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 or on-set 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. <u>Asset under $10k (not including the post, office electronic, digital and effects equip):</u>
   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, <u>may need to provide a listing of all assets to the auditor and CFC.</u>

5. <u>If an Asset is a Post, Office electronic, Digital and Effects Equipment Purchase:</u>
   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. <u>If an Asset is given to a non-qualified individual,</u> 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
- 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 (summary)
- Detailed Trial Balance
- Detailed Ledger of expenditures - digital and hard copy
- Petty cash envelope summaries 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.

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.

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