



A REPORT
TO THE
MONTANA
LEGISLATURE

LEGISLATIVE AUDIT
DIVISION

11P-08

PERFORMANCE AUDIT

Big Sky on the Big Screen Act: Montana's Film Incentive Program

*Department of Commerce
Department of Revenue*

SEPTEMBER 2011

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PERFORMANCE AUDITS

Performance audits conducted by the Legislative Audit Division are designed to assess state government operations. From the audit work, a determination is made as to whether agencies and programs are accomplishing their purposes, and whether they can do so with greater efficiency and economy.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Members of the performance audit staff hold degrees in disciplines appropriate to the audit process.

Performance audits are performed at the request of the Legislative Audit Committee which is a bicameral and bipartisan standing committee of the Montana Legislature. The committee consists of six members of the Senate and six members of the House of Representatives.

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September 2011

The Legislative Audit Committee
of the Montana State Legislature:

This is our performance audit of the Big Sky on the Big Screen Act, Montana's film incentive program, administered by the Montana Promotion Division within the Department of Commerce and the Business and Income Taxes Division within the Department of Revenue.

This report provides the Legislature information about the certification process at the Department of Commerce and the tax credit process at the Department of Revenue. This report includes recommendations to both departments for strengthening controls over the administration of the Act to ensure ineligible production companies do not receive tax credits. The report also includes comparative data related to how Montana's film incentive program compares to other states.

We wish to express our appreciation to Department of Commerce and Department of Revenue personnel for their cooperation and assistance during the audit.

Respectfully submitted,

/s/ Tori Hunthausen

Tori Hunthausen, CPA
Legislative Auditor

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MONTANA LEGISLATIVE AUDIT DIVISION

PERFORMANCE AUDIT

Big Sky on the Big Screen Act: Montana's Film Incentive Program

Department of Commerce

Department of Revenue

SEPTEMBER 2011

11P-08

REPORT SUMMARY

While the Big Sky on the Big Screen Act will sunset January 1, 2015, controls could be strengthened to ensure ineligible production companies do not receive tax credits.

Context

The Big Sky on the Big Screen Act (Act) was passed by the Legislature in 2005. The Act was established to revitalize the motion picture and television industries in Montana by offering incentives to production companies for filming in Montana. Incentives are offered in the form of refundable tax credits for employing Montana residents and purchasing Montana goods and services. The Montana Promotion Division within the Department of Commerce and the Business and Income Taxes Division within the Department of Revenue administer the Act.

To qualify for the Act, a production company must meet statutory eligibility requirements. The Department of Commerce is responsible for approving eligibility through its certification process. The Department of Revenue is responsible for verifying and approving the production company's expenditures and ensuring the accuracy of the tax credit amount claimed.

The following table shows the level of activity related to the Act including the number of productions certified for the incentive, the number of productions that claimed the tax credit, and the amount of tax credit claimed.

Montana's Film Incentive Statistics

Calendar Years 2005-2010

Years	Certified Productions	Productions that Claimed Credits	Tax Credit Claimed
2005	7	1	\$2,702
2006	15	7	\$193,760
2007	17	13	\$171,011
2008	25	8	\$70,190
2009	12	4	\$42,072
2010	12	3	\$28,697
Totals	88	36	\$508,432

Source: Compiled by the Legislative Audit Division from Department of Commerce and Department of Revenue data.

Results

Audit work determined controls over the Big Sky on the Big Screen Act could be strengthened to ensure production companies comply with statutory requirements. Specific areas are discussed below.

During our review of the Department of Commerce's certification process we determined not all productions had a complete application. Since applications were not complete, we could not verify whether the production met statutory requirements of the Act. The Department of Commerce should strengthen controls to ensure the production

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company meets statutory requirements before being certified. Additional recommendations related to the certification process include, ensuring the production is certified prior to the start of principal photography, ensuring the application aligns with statute, and establishing rules for the certification process. By strengthening controls, the Department of Commerce will be better able to ensure all productions certified for the Act meet statutory requirements.

Audit work also determined the Department of Revenue could improve its controls over the Act. Recommendations made to the Department of Revenue include ensuring production companies meet statutory requirements prior to issuing the tax credit. Specific areas include ensuring the production company submits expenditure and payroll records in a timely manner, pays the \$500 application fee, and certifies it has paid all Montana vendors.

When comparing the Act to other states' film incentive programs, we determined Montana's program is similar to those in comparable states; however, it does not have a program or production cap limiting the fiscal impact on the state. Without legislative action, the Act will sunset on January 1, 2015.

Recommendation Concurrence	
Concur	7
Partially Concur	0
Do Not Concur	0
Source: Agencies audit response included in final report.	

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Chapter I – Introduction

Introduction

The Big Sky on the Big Screen Act (Act) was passed by the Legislature in 2005. The Act was established to revitalize the motion picture and television industries in Montana by offering incentives to production companies for filming in Montana. Incentives are offered in the form of refundable tax credits for employing Montana residents and purchasing Montana goods and services. The Montana Promotion Division within the Department of Commerce and the Business and Income Taxes Division within the Department of Revenue administer the Act. This report provides information, conclusions, and recommendations resulting from our audit.

Audit Objectives

Based on our assessment of the Act, we developed three audit objectives:

1. Determine whether controls exist to ensure Big Sky on the Big Screen Act is administered in accordance with state law, administrative rules, and department policy.
2. Determine whether the level of coordination between the Department of Commerce and the Department of Revenue could be strengthened.
3. Determine how the Big Sky on the Big Screen Act compares to other states' film incentive programs.

Audit Scope

Audit scope focused on the certification process at the Department of Commerce and the tax credit process at the Department of Revenue, including determination of qualified expenditures and payroll. Our review included reviewing applications at the Department of Commerce and tax documentation at the Department of Revenue. The scope of our audit focused on documentation and certification decisions for calendar years 2008 and 2009.

Audit Methodologies

To address the audit objectives we conducted the following audit work:

- ♦ Interviewed staff responsible for the administration of the Act at both departments.
- ♦ Reviewed the Department of Revenue's policy and procedures.
- ♦ Reviewed the Department of Commerce's procedures.
- ♦ Compared departments' procedures to applicable state laws, administrative rules, and Department of Revenue policy.

- ♦ Reviewed applications and related documentation for 19 productions at the Department of Commerce.
- ♦ Reviewed documentation and related tax forms, if applicable, for the same 19 productions at the Department of Revenue.
- ♦ Reviewed 166 records, including payroll records and expenditure receipts, for 12 productions that claimed a tax credit.
- ♦ Contacted five other states to obtain information related to film incentive programs in those states.

Report Content

This report includes four chapters that address our audit findings, conclusions, and recommendations in the following areas:

- ♦ Chapter II provides background information related to the Act, as well as employment and expenditure data compiled during audit work.
- ♦ Chapter III presents audit findings related to the Department of Commerce's controls over the certification process. This chapter also discusses coordination between the Department of Commerce and the Department of Revenue related to the Act.
- ♦ Chapter IV presents audit findings related to the Department of Revenue's controls over determining the tax credit process.
- ♦ Chapter V provides an assessment of how Montana compares to other states' film incentive programs.

Chapter II – Background

Introduction

Many states currently offer film incentives to encourage in-state film production. States began offering incentives in response to production companies filming in other countries, primarily Canada. While Montana was one of the first states to offer film incentives, over 40 states currently offer incentives.

Department of Commerce Administers the Certification Process

To qualify for the Big Sky on the Big Screen Act (Act), a production company must submit an application to the Department of Commerce. The Department of Commerce refers to this application as the pre-certification application. A copy of the application can be found in Appendix A of this report. Once received, the Department of Commerce reviews the application and approves or denies the production based on statutory requirements.

Table 1
Montana's Film Incentive Statistics
Calendar Years 2005-2010

<u>Years</u>	<u>Certified Productions</u>	<u>Productions that Claimed Credits*</u>	<u>Tax Credits Claimed*</u>
2005	7	1	\$2,702
2006	15	7	\$193,760
2007	17	13	\$171,011
2008	25	8	\$70,190
2009	12	4	\$42,072
2010	12	3	\$28,697
Totals	88	36	\$508,432

*The number of productions that claimed credits and the amount of claimed tax credits, are figured on the year the production was certified, not the year the production company claimed the tax credit.

Source: Compiled by the Legislative Audit Division from Department of Commerce and Department of Revenue data.

If approved, the Department of Commerce assigns a certification approval number for the production and sends the production company the forms, instructions, and information needed to claim the tax credit. As seen in Table 1, the department has certified over 88 productions since the inception of the program. The certification process is discussed further in Chapter III of this report.

Department of Revenue Administers the Tax Credit Process

When the Department of Commerce approves and certifies a production, it sends a copy of

the application to the Department of Revenue. To claim the credit, the production company must keep payroll records for Montana residents and receipts of Montana expenditures made for the production. The company must submit these receipts, along

with required forms, to the Department of Revenue. The Department of Revenue verifies and approves the production company's expenditures and ensures the accuracy of the tax credit amount claimed by the company. Table 1 shows the number of productions that claimed the tax credit and the amount of tax credit claimed.

Legislative History

As discussed in Chapter I, the Legislature established the Act in 2005. The Act had an original sunset date of January 1, 2010. In 2009, the Legislature extended the sunset date to January 1, 2015.

The Act originally offered a 12 percent refundable tax credit on wages paid to Montana residents and an 8 percent refundable tax credit on qualified Montana expenditures made for the production. In 2007, the legislature amended these percentages to their current levels of 14 percent on wages paid and 9 percent on qualified Montana expenditures. In 2007, the legislature also amended statute to require the company certify that it paid each Montana vendor in full for goods and services purchased before it is eligible to receive the tax credit.

Montana's Film Incentive Program Data for 2008 and 2009

To meet our objectives, we conducted a file review of productions certified in calendar years 2008 and 2009. For these two years, as can be seen in Table 1, the Department of Commerce certified 37 productions. Twelve out of the 37, or 32 percent, of these productions claimed a tax credit. About half of the production companies claiming the tax credit were in-state companies and the majority of productions were commercials.

During our review, we determined that for all productions certified in 2008 and 2009, five claimed resident wages for the tax credit. For these productions, 46 Montana residents were hired. Wages paid to these residents totaled \$78,106 and the average hourly wage was \$33.24. While only 42 percent of the production companies claimed resident wages for the tax credit, 100 percent claimed qualified expenditures for the tax credit. The 12 productions that claimed expenditures for the tax credit paid a total of \$1,154,958 to Montana vendors for goods and services.

We also used our file review to test whether both departments were complying with statutory requirements, administrative rules, and department policy related to the Act. The results of our testing are discussed throughout Chapter III and Chapter IV of the report.

Chapter III – Department Of Commerce Certification Process

Introduction

As discussed in the previous chapter, a production company must submit the Big Sky on the Big Screen Act (Act) application to the Department of Commerce. Since the Department of Commerce is also responsible for bringing productions into Montana and working with producers, this is rarely the production company's first contact with the Department of Commerce.

When the Department of Commerce receives the application, staff reviews and approves or denies the application based on statutory requirements. If the department approves the application for the tax credit, it assigns a certification number and notifies the Department of Revenue.

To qualify for the Act, the production company must meet certification requirements as outlined in statute. These requirements are outlined in §15-31-904, MCA. Specific requirements discussed throughout this chapter relate to:

- ♦ Application Requirements
- ♦ Certification Requirements
- ♦ Bankruptcy Certification
- ♦ Development of Rules

Application Requirements

Section 15-31-904, MCA, states the production company must submit the application to the Department of Commerce before the start of principal photography. Additionally, §15-31-904(2)(g), MCA, requires the application include the proposed dates of production from preproduction to the start and completion of principal photography. Principal photography is the phase of film production when the movie is filmed and actors are on set.

Audit Determined the Application Does Not Meet all Statutory Requirements

To test controls over the certification process at the Department of Commerce, we reviewed 19 of the 37 certified productions' applications and related documentation for calendar years 2008 and 2009. During file review, we noted the Department of Commerce did not require the production company provide the start date of principal photography on its application.

Since the Department of Commerce does not require the start date of principal photography on its application, we could not verify the department received four of 19 (21 percent) productions' applications prior to the start of principal photography. For the other 15 applications, we were able to obtain the start date of principal photography through the Department of Commerce's documentation. Documentation reviewed included correspondence between the Department of Commerce and the production company located in the hardcopy file and/or in the Montana Film Office's database.

Since we could not verify the application was received prior to the start of principal photography, we could not determine whether these applications should have been certified for the tax credit. Based on file review and application requirements in statute, the Department of Commerce could improve its certification process by requiring the start date of principal photography on its application. By including the start date of principal photography on its application, the Department of Commerce will be able to ensure it certifies productions in compliance with state law.

RECOMMENDATION #1

We recommend the Department of Commerce comply with §15-31-904(2)(g), MCA, by requiring a start date of principal photography on its application.

Certification Requirements

According to §15-31-904(2), MCA, the production company must meet the following requirements:

- ◆ Submit an application to the Department of Commerce before the start of principal photography. The application must include the following:
 - ◇ a statement that the applicant meets the definition of a production company
 - ◇ a copy or synopsis of the production script
 - ◇ a statement that the proposed production does not contain any material that would be considered obscene
 - ◇ a statement that the production will not receive any money for tobacco product placement, advertisement, or other tobacco use

A production is defined in §15-31-903(2)(a), MCA, as a nationally or regionally distributed feature-length film, short film, documentary, television series or segment, television pilot, magazine advertising, or commercial made in Montana. Therefore,

the Department of Commerce requires the production company to attach its intended plan for distribution with the application.

Additionally, §15-31-903(3)(b), MCA, states the definition of a production company does not include a company owned, affiliated, or controlled by, in whole or in part, a company or person that is in default on a loan made by this state or a loan guaranteed by this state or a company or person that has filed for bankruptcy. Therefore, the Department of Commerce has included a bankruptcy certification on its application. Statute also requires the manager, agent, president, vice president, or other person authorized to represent the production company, sign the application.

While the Department of Commerce's application includes most statutory requirements, we determined controls could be strengthened to ensure the production company submits a complete application before the start of principal photography.

Audit Identified Incomplete and Untimely Applications

Based on our file review, we determined 10 of the 19 applications we reviewed were incomplete. Some applications were missing multiple elements, examples include:

- ◆ Four applications did not include a distribution plan.
- ◆ One application did not indicate bankruptcy certification.
- ◆ Four applications did not include a script, synopsis, or storyboard attached. Additionally, we could not obtain a script, synopsis, or storyboard during file review.
- ◆ One application did not indicate obscenity certification.
- ◆ One application was not signed by the production company.

As discussed in the previous section, we were able to obtain the start date of principal photography for 15 of the 19 applications we reviewed. For these 15 productions, we determined one production's application was received after the start of principal photography. This production company did not claim a tax credit for this production. Department of Commerce staff believes the company resubmitted an application; however, we could not verify the Department of Commerce received the initial application prior to the start of principal photography.

Additionally, the end date of principal photography is required on the application; therefore, we were able to determine one production submitted its application to the Department of Commerce after the end of principal photography. The Department of Commerce certified this production even though it received the application after the start of principal photography. This production company claimed \$6,188 in tax credits.

Controls Could Be Improved to Ensure Certification Requirements Are Met

Since the Department of Commerce approved and certified incomplete and untimely applications, it is difficult to verify, without further investigation, whether a production should be eligible for the tax credit. For example, we reviewed one production's documentation and determined it did not indicate it met the requirements of the bankruptcy certification. Since no other verification beyond the application exists, the Department of Commerce does not have documentation showing the production met statutory requirements related to bankruptcy.

Another example includes those companies that did not attach a script, synopsis, or storyboard to the application. Without a script, synopsis, or storyboard, it is difficult to verify whether the company has any tobacco related advertising or obscenity in the production without viewing the production. The content of the production could potentially make it ineligible for the tax credit. Based on interviews with Department of Commerce staff, we determined staff had knowledge of all certified productions and could provide information about the production. However, if turnover occurred within the office, new staff may not have the same industry knowledge.

The Department of Commerce should strengthen controls to ensure the production company, for each production, submits a complete and timely application prior to department approval and certification. By strengthening controls, the Department of Commerce would be able to ensure companies meet application requirements and are eligible to receive the tax credit as outlined in statute.

RECOMMENDATION #2

We recommend the Department of Commerce strengthen controls to ensure the production company, for each production, meets statutory requirements and is eligible to receive the tax credit as outlined in §15-31-904, MCA.

Bankruptcy Certification Required for Certification

Section 15-31-903(3)(b), MCA, states the definition of a production company does not include a company owned, affiliated, or controlled by, in whole or in part, a company or person that is in default on a loan made by this state or a loan guaranteed by this state or a company or person that has filed for bankruptcy.

The Application Does Not Align With Statutory Requirements

During our audit, the Department of Commerce's application bankruptcy certification stated, "this is to certify this production company does not include any company owned, affiliated, or controlled, in whole or in part, by any company or person which is in default on a loan made by the state of Montana or a loan guaranteed by the state, or any company or person who has ever declared bankruptcy **under which an obligation of the company or person to pay or repay public funds or moneys was discharged as a part of such bankruptcy [emphasis added].**" See Appendix A.

According to the bankruptcy certification on the application, a person or company that claimed bankruptcy could still qualify for the tax credit, as long as the bankruptcy did not involve the discharge of an obligation of the company or person to pay or repay public funds. This requirement is inconsistent with the statutory requirement that any person or company that has filed for bankruptcy is ineligible for the tax credit.

This inconsistency leads to uncertainty regarding which companies qualify for the Act. Since ambiguity exists, the Department of Commerce should revise its bankruptcy certification statement, on its application, to align with statutory requirements.

RECOMMENDATION #3

We recommend the Department of Commerce revise its application to align with §15-31-903(3)(b), MCA.

Formal Policy and Procedures Are Needed

Section 15-31-904(6), MCA, states the Department of Commerce shall prescribe rules, including a procedure for review of its denial or revocation of state certification. However, the Department of Commerce has not established rules for a review of denial or revocations. Additionally, the Department of Commerce has not established formal policy and/or procedures to guide the approval of applications.

Formal Policy and Procedures Would Help Ensure Consistency

By not establishing rules, the Department of Commerce is in noncompliance with statute. Additionally, formal policy and procedures could help ensure the Department of Commerce's certification process is clearly outlined.

During file review, we identified instances in which it was unclear whether the production company should have been certified for the tax credit. For example, on its application, the Department of Commerce included a Secretary of State certification in which the production company is supposed to certify whether it is registered with the Secretary of State. However, neither the Department nor statute requires the company register with the Secretary of State. Since the Department of Commerce has not documented specific procedures, without discussing the approval process with Department of Commerce staff, it appears a production company would be denied if they did not register with the Secretary of State.

During our file review we also determined, instead of attaching a distribution plan, eight productions wrote their distribution plan on the application. For example, production companies wrote TV, television commercial, television only, etc. Since locally distributed television commercials are not eligible for the tax credit, in some cases, it was unclear whether the write-in on the application was appropriate for a distribution plan. While the department confirmed the specific write-ins were appropriate, formal policy and/or procedures would ensure consistency in the approval of applications.

Formal Policy and Procedures Should Be Developed to Ensure Consistency

Department of Commerce staff indicated it worked with the Department of Revenue to develop administrative rules, but does not believe it has rulemaking authority. Based on our review of rules, the Department of Revenue has established rules related to the approval and denial of specific expenditures; however, rules related to the certification process have not been established.

Since formal policy and procedures ensure consistency and objectivity when certifying production companies for the tax credit, we believe the Department of Commerce could improve its controls by establishing formal policy and procedures. Additionally, by establishing rules for a review of denial or revocations of applications, the Department of Commerce would be in compliance with §15-31-904(6), MCA.

RECOMMENDATION #4

We recommend the Department of Commerce comply with §15-31-904(6), MCA, by developing rules for the certification process.

Coordination Between the Departments Ensures Accuracy

Once the Department of Commerce approves a production, according to §15-31-904(4)(b)(i), MCA, it must notify the Department of Revenue of the approval and certification number. To address our second objective, during our file review, we verified the Department of Revenue received the approval and certification number regardless of whether the production claimed the tax credit.

Based on audit work, the Department of Commerce has controls in place to ensure the Department of Revenue receives all approval notices and corresponding certification numbers. During file review, we identified correspondence between the two departments including questions related to qualified expenditures, status of projects, and notification of changes to forms. Based on audit work, we determined the two departments do coordinate as required in statute.

CONCLUSION

The Department of Commerce and Department of Revenue do coordinate to ensure production companies are certified to claim the tax credit.

Chapter IV – Department Of Revenue Tax Credit Process

Introduction

As discussed in the previous chapter, once the Department of Commerce approves and certifies the production for the tax credit, Department of Commerce staff sends the approval and certification number to the Department of Revenue. The Department of Revenue maintains this information until the production company completes its principal photography. At the end of principal photography, the production company submits the Department of Revenue's "Film Production Credit: Submission of Costs-End of Principal Photography" form and includes corresponding payroll records and expenditure receipts.

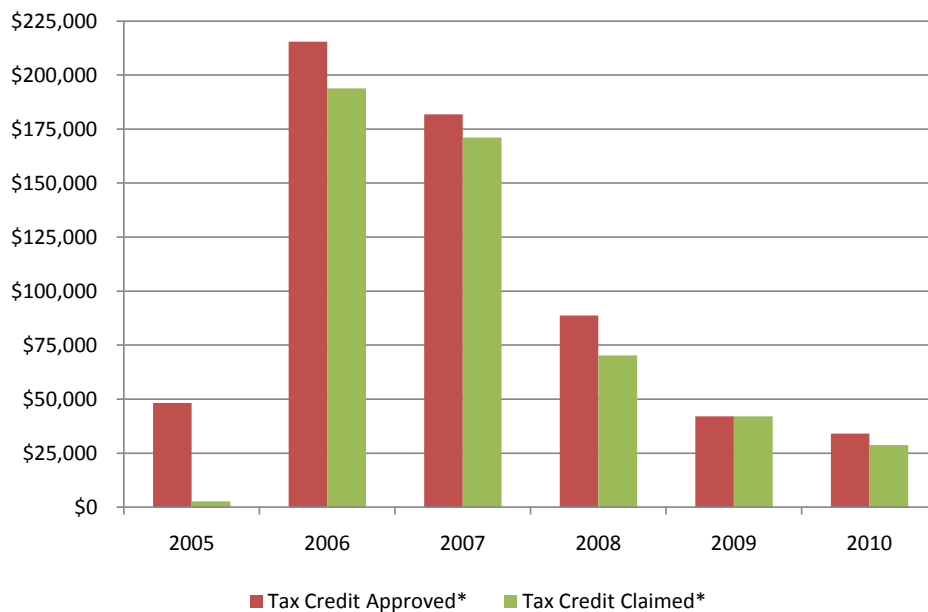
When the Department of Revenue receives the submission of cost records from the production company, staff reviews all expenditures and payroll records to ensure the expenses are eligible for the tax credit. Once the Department of Revenue verifies payroll and expenditure records, staff notifies the production company of the approved credit amount.

When a certified production company files its Montana income tax return, it must include:

- ◆ A Film Production Credit Form with the approved credit amounts,
- ◆ A \$500 application fee, along with the Film Production Credit Application Fee Form, and
- ◆ The correct tax credit on the appropriate line.

As required by statute, pass-through entities (partnerships, LLCs, etc.) must pass the tax credits through to its members, shareholders, or partners in the same proportion used to report income or loss for the company. Therefore, the company must file a Montana tax return to establish the amount of the tax credit available, and each member, shareholder, or partner must file a Montana income tax return to claim their portion of the tax credit. The following figure compares the amount of tax credit approved by Department of Revenue staff and the total amount of tax credits claimed by the production company.

Figure 1
Tax Credits Approved vs. Tax Credits Claimed
 Calendar Years 2005-2010



*Approved credits are those Department of Revenue authorized production companies to claim. Claimed credits are those production companies actually claimed on their tax returns.

Source: Compiled by the Legislative Audit Division from Department of Commerce and Department of Revenue data.

To claim the tax credit, in addition to being certified by the Department of Commerce, the production company must also meet specific tax requirements as outlined in statute. The Department of Revenue is responsible for ensuring these tax requirements are met. These requirements are outlined in §15-31-905 through §15-31-910, MCA, and will be discussed throughout this chapter.

Production Companies Must Submit Documentation in a Timely Manner

Section 15-31-905, MCA, states, within 60 days of completion of principal photography, the production company must submit a statement of all expenditures and compensation paid to Montana residents to the Department of Revenue.

During file review, for seven of the twelve productions that claimed a tax credit, we could not verify when the Department of Revenue received the company's submission of costs form. For the other five productions, the submission of costs form was

date-stamped by the Department of Revenue. For three of these five productions, we determined the company submitted its submission of costs form more than 60 days after the end of principal photography. These three productions claimed a total of \$22,176 in tax credits.

Steps Could Be Taken to Ensure Compliance With Timely Submission Requirement

If the company does not submit its documentation within 60 days of the end of principal photography, the company is not complying with statutory requirements. However, statutory language does not stipulate the department should deny the production company the credit if it submits its documentation after 60 days. Additionally, the Department of Revenue has not established controls to determine whether production companies submit documentation within 60 days of the end of principal photography.

Department of Revenue staff indicated, production companies' contacts change from project to project, if the department does not receive timely submission of expenditures and payroll information, it may be difficult to contact the production company. By requiring and ensuring companies submit documentation in a timely manner the Department of Revenue will be better able to obtain missing documentation or other information from the company. The Department of Revenue should establish controls to ensure production companies submit a statement of all expenditures and payroll within 60 days of the end of principal photography.

RECOMMENDATION #5

We recommend the Department of Revenue reevaluate §15-31-905, MCA, and determine whether statute is needed and if so, require production companies meet the 60-day requirement before issuing a tax credit.

Review of Expenditures Ensures Accuracy

During audit work, we randomly selected 115 qualified expenditure receipts for review. These expenditures totaled \$101,805, and ranged from \$4 to \$20,000. Examples of the type of expenditures reviewed included car washes, restaurants, sporting good stores, and rental companies. We also reviewed all 51 payroll records.

Through file review, we determined the Department of Revenue reviews every receipt and payroll record used to support and calculate the tax credit. Once the department completes its review of expenditure and payroll records, staff notifies the production

company of any expenditure or payroll records that are denied or that need additional documentation.

Based on our review of the department's records, we determined the Department of Revenue has controls in place to ensure the amount of expenditures and payroll records submitted for the tax credit are supported and accurate.

CONCLUSION

We conclude the Department of Revenue has controls in place to ensure all expenditures and payroll records used to calculate the tax credit are accurate and only include eligible expenditures.

Production Companies Must Pay Application Fee

Before the production company is able to receive the tax credits, §15-31-906, MCA, requires the company to apply to the Department of Revenue on a specific form. A \$500 application fee must accompany the form at the time the production company files its tax return. This fee is used to administer the Act.

For 11 of the 12 files we reviewed, we were able to verify the company paid the application fee by reviewing a copy of the check located in Department of Revenue's files. However, for one production, the file did not contain documentation verifying the company paid the application fee. After following up with the Department of Revenue, we determined the production company did not pay the application fee when filing its taxes. Since the production company did not pay the application fee when filing its taxes, based on statutory requirements, it is ineligible for the tax credits. The production company received \$16,837 in tax credits. When we brought this issue to the department's attention, they contacted the production company and requested the fee be paid. The production company then paid the fee.

Controls Over Application Fee Requirements Could Be Improved

During file review we determined the Department of Revenue had informal procedures for obtaining a copy of the production company's check and including it in the file. However, this procedure was not included in the Department of Revenue's written procedures. The Department of Revenue should ensure the tax credit is not issued prior to receiving the \$500 application fee.

RECOMMENDATION #6

We recommend the Department of Revenue establish controls to ensure compliance with §15-31-906, MCA, and require the application fee be paid prior to issuing a tax credit.

Production Companies Must Certify All Montana Vendors Are Paid

As discussed in Chapter II, the legislature amended statute in 2007 to require the taxpayer certify, in writing to the Department of Revenue, that they paid each Montana vendor in full for all goods and services purchased in connection with the state certified production. Section 15-31-908(2)(b), MCA, states a credit may not be claimed unless the taxpayer has paid all Montana vendors in full.

Audit Work Revealed Certification Statements Were Not Signed

During our file review at the Department of Revenue, we determined the department requires the production company to certify, in a statement, that it has paid all Montana vendors in full. For the 12 productions that claimed tax credits, we determined six of these productions did not sign the certification statement. Therefore, there is no documentation certifying the production company paid all Montana vendors in full.

Based on discussions with the Department of Revenue, when the 2007 amendment was established, staff determined the most efficient way to verify all Montana vendors were paid was to provide a certification statement on the tax form. While the Department of Revenue's form includes a certification statement, the department has not established controls to ensure the statement is signed for all productions. By implementing controls to ensure all certification statements are signed, the Department of Revenue will have better assurance that all Montana vendors have been paid in full before issuing the tax credit.

RECOMMENDATION #7

We recommend the Department of Revenue establish controls to ensure compliance with §15-31-908(2)(b), MCA, and not issue a tax credit unless the taxpayer has certified it paid all Montana vendors in full.

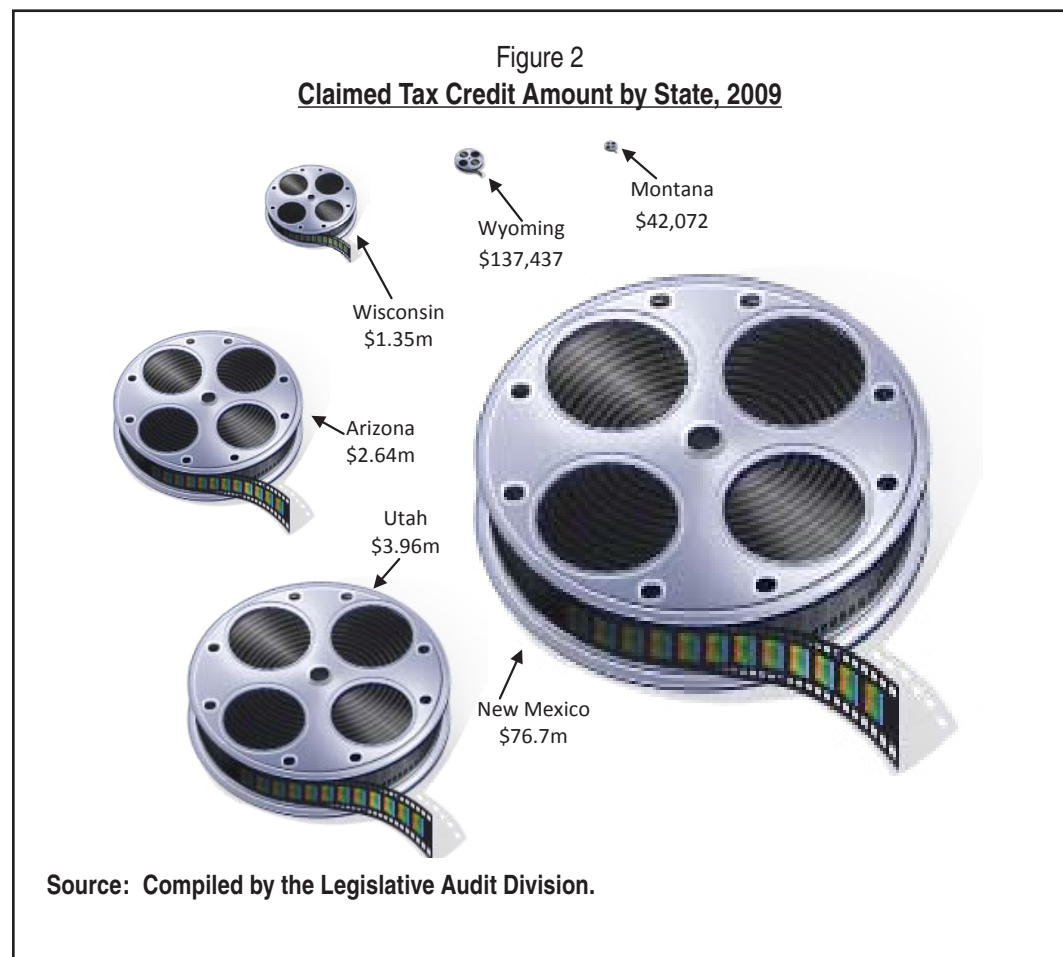
Chapter V – Other States' Comparison

Introduction

As stated in the previous chapters, states currently offer film incentives to encourage in state film production. Since many states offer film incentives, various factors influence the production companies' decision to film in a state. Among these factors are the type of incentive, the percentage of incentive, and funding limits. Companies also consider other factors including whether the state has a sales tax, location fees, and the overall film infrastructure of the state. This chapter addresses our third objective related to how Montana's Big Sky on the Big Screen Act compares to other states' film incentive programs.

Selection of Comparable States

To address our objective we conducted research to identify five states comparable to Montana in terms of geography, population size, and structure of film production incentive programs: Arizona, Utah, New Mexico, Wyoming, and Wisconsin. The following figure depicts the amount of film incentives paid out by the states in 2009.



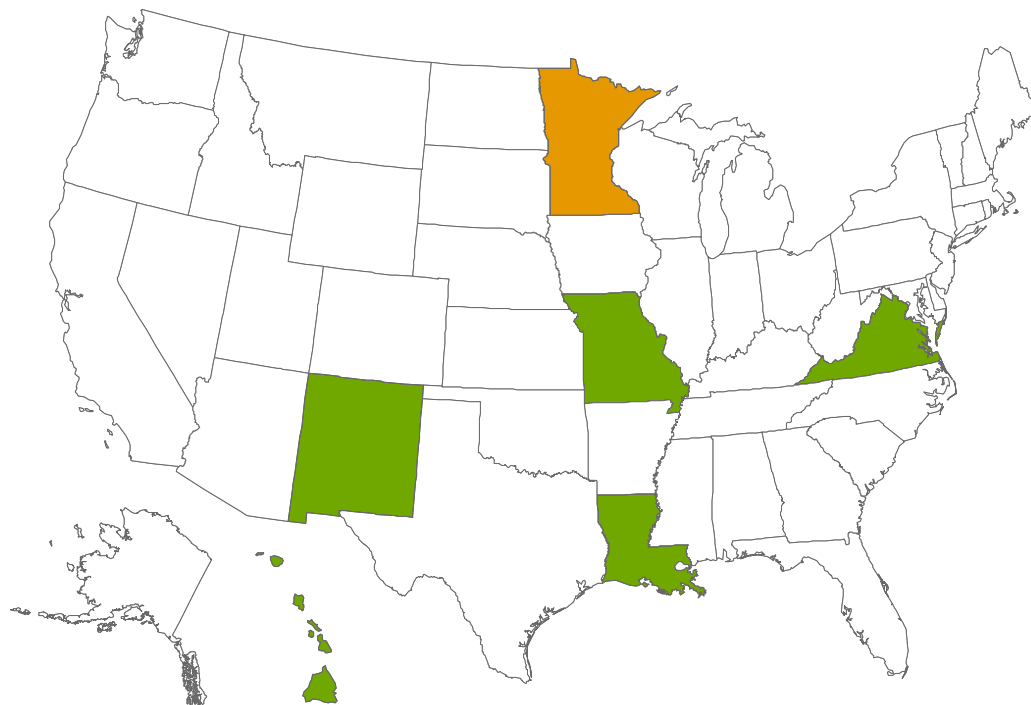
We also contacted these states to identify how the programs' overall structure and results compare to Montana. Areas reviewed are discussed throughout this chapter.

Overall Structure of Film Incentive Programs

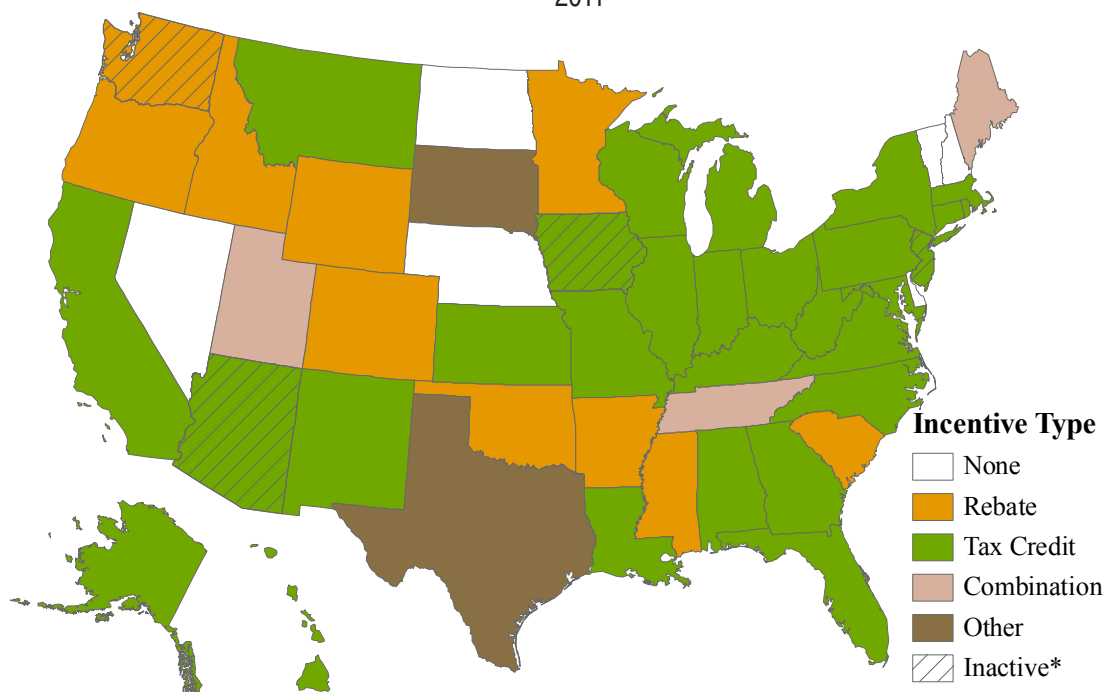
States began offering incentives in the early 2000s in response to production companies filming in other countries, in particular Canada. While Montana was one of the first states that began offering film incentives, over 40 states currently offer incentives. The following maps depict the growth in film incentives between 2002 and 2011.

Figure 3
Number of States Offering Film Incentives

2002



2011



*Inactive means the state suspended its film incentive or the sunset date took effect.

*Virginia's film program was established in 2001 but not funded regularly until 2006.

Source: Compiled by the Legislative Audit Division using data from the Tax Foundation and Cast and Crew Entertainment Services.

During our review, we determined, outside of sales tax exemptions/refunds, states generally offer one of two film incentives; rebates or tax credits. Rebates, in the form of cash payments, are paid to eligible production companies. Rebates differ from tax credits because the incentive is not tied to the production company filing an income tax return with the state. The maps in Figure 3 depict what types of incentives states are currently offering. Inactive means the state suspended its film incentive or the sunset date took effect. As discussed throughout this report, Montana offers a tax credit. For the five states we reviewed, Arizona, Wisconsin, and New Mexico offer tax credits, Wyoming offers a rebate, and Utah offers a rebate or tax credit depending on the size of production. Arizona's sunset date took effect on December 31, 2010.

Percentage of Incentives Varies by State

As can be seen in the following table, states offer varying levels of incentives. The table shows a percentage for each state, which represents the percent of expenditures the production company is offered in the form of a tax credit or rebate. For example, Wisconsin offers a tax credit equivalent to 25 percent of expenditures while Wyoming's rebate percentage varies from 12-15 percent of expenditures.

Table 2
Summary of Sampled States' Film Incentives

	Montana	Arizona	Utah	New Mexico	Wisconsin	Wyoming
Type	Tax Credit	Tax Credit	Tax Credit or Rebate	Tax Credit	Tax Credit	Rebate
Incentives	14% Resident Wages 9% Spending	20% (\$250k-\$1m) 30% (>\$1m)	20%+5%	25%	25%	12%-15%

Source: Compiled by the Legislative Audit Division.

As seen in the table, Arizona offered 30 percent if in state expenditures were greater than \$1 million and 20 percent if in state expenditures were between \$250,000 and \$1 million. States can also define expenditures differently. Montana offers a 14 percent incentive for Montana residents' wages and 9 percent of all other qualifying in state expenditures. Some states include out-of-state purchases and wages in the definition of expenditures, increasing the amount of incentive payment available to the company.

States' Minimum Spending Requirements

Based on our review of comparable states, we determined some states require the production to spend a minimum amount in the state to qualify for the film incentive. Table 3 summarizes minimum spending requirements for the states we reviewed.

As can be seen in Table 3, four of the six states have a minimum spending requirement.

Table 3 Minimum Spending Requirements by State	
	Minimum Spending
Montana	\$0
Arizona	\$250,000
Utah	\$1,000,000
New Mexico	\$0
Wisconsin	\$50,000
Wyoming	\$200,000

Source: Compiled by the Legislative Audit Division.

Other economic requirements we identified while reviewing other states included:

- ◆ To qualify for the additional 5 percent of Utah's film incentive, the production must meet specific criteria including:
 - ◇ Employing a significant percentage of cast and crew from Utah,
 - ◇ Highlighting the state and the Utah Film Commission in the motion picture credits, or
 - ◇ Other promotion opportunities as agreed upon by the office and the production company.
- ◆ Wisconsin requires the production company spend at least 35 percent of the project's total budget in Wisconsin.
- ◆ Wyoming requires the storyline be set in Wyoming to earn the full 15 percent rebate. Fourteen percent is provided when footage highlights Wyoming locations.

As discussed throughout this section, states offer different levels of incentives. While the film incentive is not the only factor production companies consider when determining where to film a production, the company will generally consider the different levels and requirements of film incentive programs. Additionally, consulting companies have put together multiple publications summarizing film incentive programs by state to assist production companies in their decision making process.

CONCLUSION

Montana's film incentives are similar to those in comparable states.

Other States Limit Level of Film Incentives Offered

States have issued caps on the amount of incentives awarded under their film incentive programs. Some states have program caps limiting the total amount of incentives paid out by the program in a specific timeframe. Other states have a cap on the amount awarded on a specific production. The following table lays out production and program caps for each of the states we reviewed.

Table 4 <u>Production and Program Caps by State</u>		
	Production Cap	Program Cap
Montana	No Cap	No Cap
Arizona	\$9,000,000	\$70,000,000
Utah	No Cap	\$6,790,000 per fiscal year - tax credit \$3,010,000 remaining for rebate
New Mexico	No Cap	\$50,000,000
Wisconsin	No Cap	\$500,000 per fiscal year
Wyoming	No Cap	\$1,000,000 per biennium

Source: Compiled by the Legislative Audit Division.

As can be seen in the chart, Montana does not have production or program caps; therefore, there is no limitation to the amount of tax credit a production company can be awarded.

CONCLUSION

Montana does not have production or program caps; however, other states we reviewed have caps that limit the fiscal impact on the state.

Legislative Changes Occurring

Section 15-31-902, MCA, outlines the purpose of the Big Sky on the Big Screen Act. As stated in statute, the purpose of the Act is to enhance Montana's economy by revitalizing and expanding the motion picture and television industries. Specific areas include:

- ◆ Renewing interest in Montana as a premier location for productions,
- ◆ Encouraging the creation of jobs that pay well for Montana workers,
- ◆ Enhancing the growth of Montana businesses that provide goods and services to these productions, and
- ◆ Helping promote the tourism industry in Montana.

While other states began offering film incentives for similar purposes, some have been reevaluating their film incentive programs and in some cases have eliminated the program. Some of these evaluations were conducted due to budgetary shortfalls, sunset dates enacted on the programs, or the detection of fraud within the program. The following section discusses recent legislative changes for the programs we reviewed, as well as sunset dates.

Recent Legislative Changes

During our review of other states, we determined whether the states had any recent legislative changes. Based on our discussions with other states' program staff, we determined the following changes occurred or are occurring with the film incentive programs:

- ◆ New Mexico recently codified the tracking of economic data and reporting to the state legislature.
- ◆ Effective July 1, 2011, New Mexico's program could potentially have a fiscal year cap of \$50 million.
- ◆ Utah did not appropriate any new moneys to its rebate fund.
- ◆ Wyoming lowered its minimum spending requirement in 2009 from \$500,000 to \$200,000 and the sunset date was extended.

Many States Will Need to Reevaluate Their Programs Due to Sunset Dates

During our review of other states, we reviewed whether film incentive programs have sunset dates. The following table shows the results of our review.

Table 5
Comparison of Sunset Dates

	Sunset Date
Montana	12/31/2014
Arizona	12/31/2010
Utah	10/1/2014*
New Mexico	None
Wisconsin	None
Wyoming	6/30/2016

*The program will be reviewed on or before October 1, 2014 and every five years thereafter to determine if the tax credit should be continued, modified, or repealed.

Source: Compiled by the Legislative Audit Division.

As seen in the table, the majority of states we reviewed had a sunset date, which means the program will end on that date unless the legislature amends the sunset date. Currently, without legislative action, Montana's film incentive program will sunset January 1, 2015

CONCLUSION

Without legislative action, the Big Sky on the Big Screen Act will sunset January 1, 2015.

The Big Sky on the Big Screen Act

Pre-Certification Application

Montana Film Office—Department of Commerce

Office use only:

Certification number:



Completion of this form constitutes application for certification by the Montana Film Office, Department of Commerce.

PRODUCTION TITLE				
Title of production:				
PRODUCTION TYPE				
<input type="checkbox"/> Theatrical film	<input type="checkbox"/> Made-for-TV film	<input type="checkbox"/> Short film	<input type="checkbox"/> Commercial	
<input type="checkbox"/> Documentary	<input type="checkbox"/> Industrial or Educational	<input type="checkbox"/> Music video	<input type="checkbox"/> Still shoot	
<input type="checkbox"/> Miniseries	<input type="checkbox"/> Television pilot	<input type="checkbox"/> Television segment/series	<input type="checkbox"/> Multimedia/Web	
PRODUCTION COMPANY INFORMATION (Company to receive tax credit by filing Montana tax return)				
Company name:				
Contact Name:			Title:	
Business address:				
City:		State:		Zip:
Phone:		Fax:		Email:
<input type="checkbox"/> Sole proprietorship	<input type="checkbox"/> Partnership	<input type="checkbox"/> C Corporation	<input type="checkbox"/> S Corporation	<input type="checkbox"/> LLC
Date business commenced:		Federal Tax ID (FEIN) or SSN:		
Note: If the applicant is an LLC, a partnership, or an S corporation, list the names, addresses, and FEINs or SSNs or all members, partners, or shareholders and their respective percentages. Attach more pages if needed.				
Name	Address	FEIN or SSN	% of ownership	
Check if applicable: <input type="checkbox"/> Members, partners, and shareholders will file Montana tax returns separately.				
PRODUCTION COMPANY CERTIFICATION				
<input type="checkbox"/> This is to certify the above named company is engaged in the business of producing nationally or regionally distributed productions.				
PRODUCTION CREW INFORMATION				
	Name	Phone	Email	
Director:				
Producer:				
Line Producer:				
Unit Production Manager:				
Production Accountant:				
TAX PREPARER INFORMATION				
Name of tax preparer:		Company name:		
Address:				
City:		State:		Zip:
Phone:		Email:		

REGISTRATION WITH MONTANA SECRETARY OF STATE

☐ This is to certify that this production company has registered the above name with the Montana Secretary of State and has received certification as a company in good standing to transact business in Montana.

MONTANA PRODUCTION OFFICE INFORMATION

Company name:

Local address:

City:

State:

Zip:

Phone:

Fax:

Email:

BUDGET INFORMATION

Total projected budget:

Estimated local expenditures in Montana:

MONTANA PRODUCTION DATES / LOCATIONS

Start date-Montana pre-production:

Completion date-principal photography:

Estimated days-principal photography:

End date-Montana post-production:

Montana filming locations:

SCRIPT / SYNOPSIS / STORYBOARDS

☐ Copy of script is attached

OR

☐ Copy of synopsis is attached

OR

☐ Copy of storyboard is attached

DISTRIBUTION

☐ Intended plan for distribution is attached

BANKRUPTCY CERTIFICATION

☐ This is to certify this production company does not include any company owned, affiliated, or controlled, in whole or in part, by any company or person which is in default on a loan made by the state of Montana or a loan guaranteed by the state, or any company or person who has ever declared bankruptcy under which an obligation of the company or person to pay or repay public funds or monies was discharged as a part of such bankruptcy.

OBSCENITY CERTIFICATION

☐ This is to certify this production does not contain any material or performance defined as obscene by Montana Code Annotated, section § 45-8-201.

NON-TOBACCO CERTIFICATION

☐ This is to certify that this production will not receive any money for tobacco product placement, advertisement, or other tobacco use in the production.

FILM CREDITS CERTIFICATION

☐ If this production is a feature-length film, this is to certify the production will include a line in the production's film credits that the production was filmed in Montana.

CERTIFYING SIGNATURE

Authorized representative's printed name:

Title:

Authorized representative's signature:

Date:

Phone:

Email:

PRINT FORM

SUBMIT FORM

CLEAR FORM

Submit completed application to:

MONTANA FILM OFFICE

Department of Commerce
301 S. Park
PO Box 200533
Helena, MT 59620

Phone: 406-841-2876
800-553-4563
Fax: 406-841-2877
montanafilm@mt.gov
www.montanafilm.com



DEPARTMENT OF
COMMERCE
DEPARTMENT OF REVENUE

DEPARTMENTS' RESPONSES

MONTANA

Department of Commerce

Dore Schwinden, Director

301 S. Park Ave. ★ P.O. Box 200501 ★ Helena, Montana 59620-0501
Phone 406-841-2700 ★ Fax 406-841-2701 ★ TDD: 406-841-2702 ★ <http://commerce.mt.gov>

RECEIVED

SEP 14 2011

LEGISLATIVE AUDIT DIV.

September 13, 2011

Tori Hunthausen, Legislative Auditor
Legislative Audit Division
PO Box 201705 (VIA DEADHEAD MAIL)
Helena, MT 59620

Dear Ms. Hunthausen:

Attached you will find the response of the Department of Commerce to the performance audit performed by your office on the Big Sky on the Big Screen Act: Montana's Film Incentive Program.

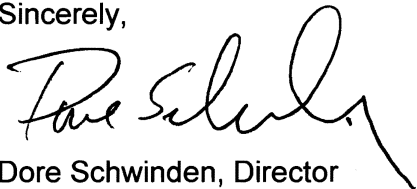
We appreciate you and the other members of your staff for the time you spent at the Department.

Your staff was very professional and their comments and suggestions helpful.

Please don't hesitate to call if you have any questions concerning our response. I can be reached at 841-2704 and Jeri Duran, Montana Promotion Division Administrator, can be reached at 841-2873.

We welcome your comments or suggestions.

Sincerely,



Dore Schwinden, Director
Department of Commerce

BRIAN SCHWEITZER, GOVERNOR

Department of Commerce Response to the Big Sky on the Big Screen Act: Montana's
Film Incentive Program

Recommendation # 1:

We recommend the Department of Commerce comply with §15-31-904(2)(g), MCA, be requiring a start date of principal photography on its application.

Response:

We Concur. The Big Sky on the Big Screen Act application was amended in July 21, 2011 to clearly reflect the start date of Montana pre-production, start date of principal photography and completion date of principal photography. A copy of the revised application is attached for your reference as Attachment A.

Recommendation # 2:

We recommend the Department of Commerce strengthen controls to ensure the production company, for each production, meets statutory requirements and is eligible to received the tax credit as outlined in §15-31-904, MCA.

Response:

We Concur. The Department of Commerce has formally adopted a policy and procedure for certification of the Big Sky on the Big Screen Act applications. This procedure was formally adopted July 20, 2011 and subsequently amended on September 13, 2011. The procedure clearly states what information must be completed in order for an application to be granted certification. Additionally it requires two reviews to ensure that an application is complete. A copy of this policy is attached for your reference as Attachment B.

Recommendation # 3:

We recommend the Department of Commerce revise its application to align with §15-31-903(3)(b), MCA.

Response:

We Concur. The Big Sky on the Big Screen Act application was amended in July 21, 2011 to reflect the actual language stated in §15-31-903(3)(b), MCA. A copy of the application is attached for your reference as Attachment A.

Recommendation # 4:

We recommend the Department of Commerce comply with §15-31-904(6), MCA, by developing rules for the certification process.

Response:

We Concur. Although the Department of Commerce does not have the authority to develop Administrative Rules, it has formally adopted a policy and procedure for certification of the Big Sky on the Big Screen Act applications. This procedure was formally adopted July 20, 2011 and subsequently amended on September 13, 2011. The procedure clearly states what information must be completed in order for an application to be granted certification. Additionally it requires two reviews to ensure that an application is complete. A copy of this policy is attached for your reference as Attachment B.



Dan Bucks
Director

Montana Department of Revenue



Brian Schweitzer
Governor

September 19, 2011

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SEP 22 2011

LEGISLATIVE AUDIT DIV.

Tori Hunthausen
Legislative Auditor, Legislative Audit Division
Room 160, State Capitol
P.O. Box 201705
Helena, MT 59620-1705

Dear Ms. Hunthausen:

Thank you for the opportunity to respond to the recommendations in the Big Sky on the Big Screen Act: Montana's Film Incentive Program Performance Audit of the Department of Revenue and Department of Commerce. Our response to the recommendations raised in the report is as follows:

Recommendation #5

We recommend the Department of Revenue reevaluate §15-31-905, MCA, and determine whether statute is needed and if so, require production companies meet the 60-day requirement before issuing a tax credit.

Concur. The department agrees that there is always room for improvement and will establish additional controls to monitor that the submission of costs are filed timely. One improvement step the department will take is to develop a "welcome" letter. The "welcome" letter will give the film production companies specific information on what is required and when it is required in order to qualify for the tax credit. The "welcome" letter will make it clear that the production company must submit the statement of costs within 60 days. The department will also review our administrative rule to ensure that it is clear that the statement of costs is required within 60 days of the end of principal production. Although these additional controls will be established, as discussed in the audit report, there is no penalty if the production company does not file the statement of costs timely.

The department does not have a recommendation on whether the statute is required or not.

Recommendation #6

We recommend the Department of Revenue establish controls to ensure compliance with §15-31-906, MCA, and require the application fee be paid prior to issuing a tax credit.

Concur. The department agrees that additional controls are needed to ensure that the application fee is paid before the tax credit is issued. The department has included in its written procedures the requirement that the application fee must be paid prior to the issuance of any tax credit. The department will also investigate whether changes can be made to our tax software system to ensure that no film credit is paid until the application fee is received.

Tori Hunthausen
Page 2
September 19, 2011

Recommendation #7

We recommend the Department of Revenue establish controls to ensure compliance with §15-31-908(2)(b), MCA, and not issue a tax credit unless the taxpayer has certified it paid all Montana vendors in full.

Concur. The department will review our forms and procedures to make sure that Montana vendors have been paid prior to the approval of the tax credit. Currently the department requires the film production company to certify that all vendors have been paid by signing a certification statement. The department is reviewing whether the certification statement should be located on a new separate form or be relocated to another location on existing forms. By moving the location of the certification statement, the department believes that the requirements for the certification signature would be more visible thereby making it clear that the signature is required. Also, the department will update our written procedures to make sure that the department employee reviewing the application forms specifically verifies that the certification statement has been signed. If not, the employee will contact the film production company requesting the required signature.

Thank you for allowing us to respond to the performance audit report and the opportunity to discuss the issues with you and your staff. I would also like to thank your staff who conducted the audit for their professionalism and their fairness in working through the issues that were raised.

Sincerely,



Dan Bucks
Director
PO Box 5805
Helena, MT 59604-5805