Louisiana Department of Economic Development and Louisiana Department of Revenue Motion Picture Tax Credit Program

Performance Audit
Issued April 24, 2013

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LOUISIANA LEGISLATIVE AUDITOR
DARYL G. PURPERA, CPA, CFE

April 24, 2013

The Honorable John A. Alario, Jr.,
President of the Senate
The Honorable Charles E. "Chuck" Kleckley,
Speaker of the House of Representatives

Dear Senator Alario and Representative Kleckley:

This report provides the results of our performance audit on the Motion Picture Tax Credit program administered by the Louisiana Department of Economic Development (LED) and the Louisiana Department of Revenue (LDR).

The report contains our findings, conclusions, and recommendations. Appendix A and Appendix B contain LED and LDR management responses to this report. I hope this report will benefit you in your legislative decision-making process.

We would like to express our appreciation to the management and staff of LED and LDR for their assistance during this audit.

Sincerely,

Daryl G. Purpera

Daryl G. Purpera, CPA, CFE
Legislative Auditor

DGP/dl

MOTION PICTURE TAX CREDIT PROGRAM 2013

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Louisiana Legislative Auditor

Daryl G. Purpera, CPA, CFE

Louisiana Department of Economic Development and Louisiana Department of Revenue Motion Picture Tax Credit Program

April 2013

Audit Control # 40120006

Executive Summary

This report provides the results of our performance audit on the Motion Picture Tax Credit (MPTC) program administered by the Louisiana Department of Economic Development (LED) and the Louisiana Department of Revenue (LDR). According to state law, the purpose of motion picture tax credits (credits) is to encourage the development of a strong capital and infrastructure base for motion picture production to achieve an independent, self-supporting industry. LED is responsible for determining the economic impact of the credits, certifying eligible productions, granting credits, and purchasing credits transferred (sold) back to the state. LDR is responsible for ensuring the validity of the credits claimed by taxpayers on their tax returns, including verifying that taxpayers have the rights to the credits they are claiming.

We conducted this audit to follow up on two previous Louisiana Legislative Auditor reports. In April 2007 a performance audit[1] identified issues with the calculation of credits and the claiming of credits by taxpayers. In March 2012 an investigative audit[2] identified one production in which credits were issued for ineligible expenditures. The purpose of this audit was to determine how LED measures the economic impact of the MPTC program and to evaluate the processes LED and LDR use to administer the program. Appendix C details our scope and methodology. The audit objectives and results of our work are as follows:

Objective 1: How does LED determine the economic impact of the Motion Picture Tax Credit program?

Results: LED determines the economic impact of the program through a fiscal and economic impact analysis produced by a third-party consultant. The most recent impact analysis, issued in April 2011, showed an estimated economic output of $5.40 for every $1 of credit awarded in calendar year 2010. Economic output is the total value of goods and services produced across all industry sectors and all stages of production. The estimated impacts include employment of a local workforce, purchase of materials and supplies, use of services, increases in restaurant and retail revenues, and taxes and fees.

[1] This report can be viewed on the Louisiana Legislative Auditor's website: http://app1.lla.state.la.us/PublicReports.nsf/6D2D6FD1889090BE862572C1006E6841/$FILE/00000EF3.pdf.
[2] This report can be viewed on the Louisiana Legislative Auditor's website: http://app1.lla.state.la.us/PublicReports.nsf/0F6F840E2495ABC0862579BA00559982/$FILE/00027718.pdf.

While the economic output of the program was positive, the fiscal impact to state government was negative. According to the impact analysis, LED granted an estimated $196.8 million in motion picture tax credits during calendar year 2010. In turn, the state received $27 million in tax revenue from the program. The result is a net cost to the state of $169.8 million for calendar year 2010. According to LED, the next impact analysis for the MPTC program is scheduled to be released by April 2013.

Objective 2: Did LED's process for granting motion picture tax credits provide reasonable assurance that credits were granted for only eligible expenditures?

Results: Based on a sample of motion picture productions, we determined that LED's process for granting credits provided reasonable assurance that credits were granted for only eligible expenditures. Specifically, LED relied on the work of certified public accountants (CPAs) to audit cost reports of the production companies' expenditures and verify them as eligible. In addition, LED conducted its own review of the cost reports and the work conducted by the CPAs, sometimes disallowing expenses that the CPAs deemed eligible. However, a process that provides reasonable assurance cannot completely eliminate all occurrences of fraud. This is especially true if the fraud scheme involves collusion. LED's process could be strengthened if it had more authority in selecting the CPAs used by the production companies to audit their cost reports.

Objective 3: Did LED accurately calculate the amount of motion picture tax credits granted to investors and transferred (sold) back to LED?

Results: Based on a sample of letters from LED granting credits to investors, we determined that LED accurately calculated the credits it granted for productions, except in cases when a production's expenditures spanned statutory changes to the rates. LED calculated the granted amount of credits for $5,743.53 less than should have been authorized.

In addition, based on a sample of credits sold back to LED, we determined that LED accurately calculated the purchase amount for these credits, except in cases when a production's credits were granted using an incorrect rate. LED purchased them for $8,065.96 less than it should have. We also determined that LED did not collect all MPTC transfer fees, as required by state law. We are unable to calculate the total amount of uncollected fees; however, we estimate that a minimum of $408,400 was not collected in fees for the 2007 tax year alone.

Objective 4: Did LDR ensure the validity of the motion picture tax credits claimed by taxpayers on their tax returns?

Results: Based on a sample of tax returns claiming credits, we determined that LDR ensured the validity of the credits claimed by taxpayers on their tax returns. Specifically, LDR ensured taxpayers submitted the statutorily required documentation when claiming credits, had ownership of the credit via proper transfer documentation, and claimed an amount of credits they were entitled to claim.

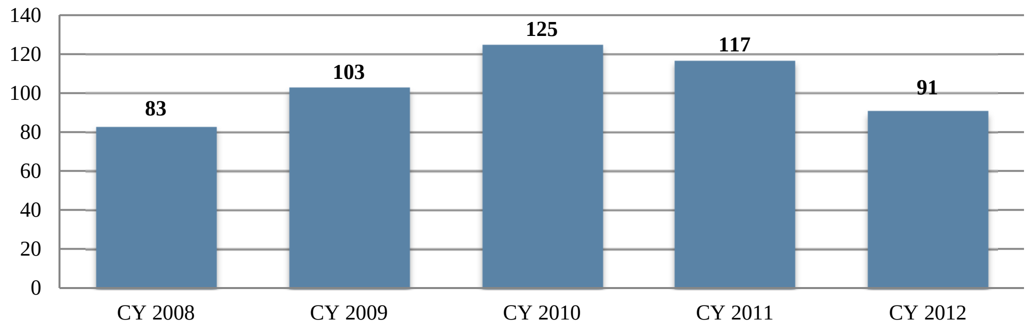
Overview of Motion Picture Tax Credits

Legal Authority and Purpose. Revised Statute (R.S.) 47:6007 authorizes a tax credit, herein referred to as Motion Picture Investor Tax Credits (credits), against the state income tax of Louisiana taxpayers for investment in state-certified productions. The primary objective of the MPTC program is to encourage development in Louisiana of a strong capital and infrastructure base for motion picture production to achieve an independent, self-supporting industry.

- Louisiana Department of Economic Development (LED) - R.S. 47:6007 requires LED to certify motion picture productions as eligible to earn credits before film production and the amount of credits an investor is granted after production. State law also grants LED the ability to purchase the credits granted to the production's initial investors for a percentage of the face value of the credits. In addition, LED is also responsible for evaluating and reporting on the economic impact of the credits. LED accomplishes these functions through the Office of Entertainment Industry Development.
- Louisiana Department of Revenue (LDR) - R.S. 36:451 creates LDR and establishes its responsibility for assessing, evaluating, and collecting state taxes. Through this authority, LDR is responsible for motion picture tax credits claimed by taxpayers through a reduction in the taxpayer's income tax liability as a non-refundable tax credit or a direct check payment when purchased by LED. LDR accomplishes these functions through the Office Audit.

State-Certified Productions. State law[3] defines a state-certified production as a production approved by LED which is produced by a motion picture production company domiciled and headquartered in Louisiana and which has a viable multi-market commercial distribution plan. Exhibit 1 outlines the number of productions certified as a state-certified production for the past five calendar years.

Exhibit 1
Number of Productions Certified as a State-Certified Production
CY 2008 - CY 2012

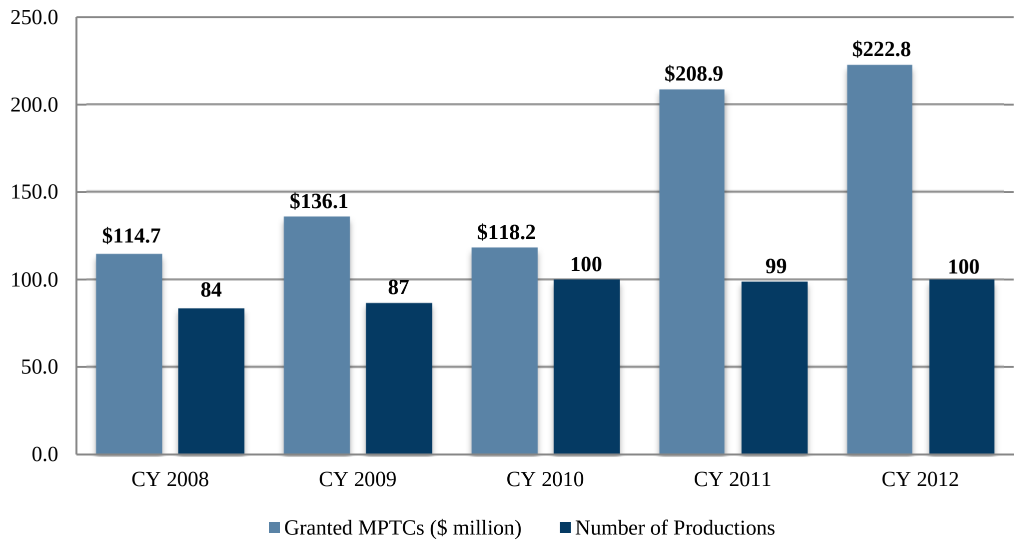


Source: Prepared by legislative auditor's staff using unaudited data provided by LED.

[3] R.S. 47:6007(B)(14)

Motion Picture Tax Credits Granted by LED. Currently, state law[4] provides for two types of credits, including an income tax credit for 30% of eligible Louisiana related production expenses and an additional income tax credit for 5% of eligible payroll expenses incurred for Louisiana residents employed by the production. Exhibit 2 outlines the number of productions for which LED granted credits and the amount of credits granted to these productions for the past five calendar years.

Exhibit 2
Amount of Motion Picture Tax Credits Granted to Production Companies
(in millions)
CY 2008 - CY 2012

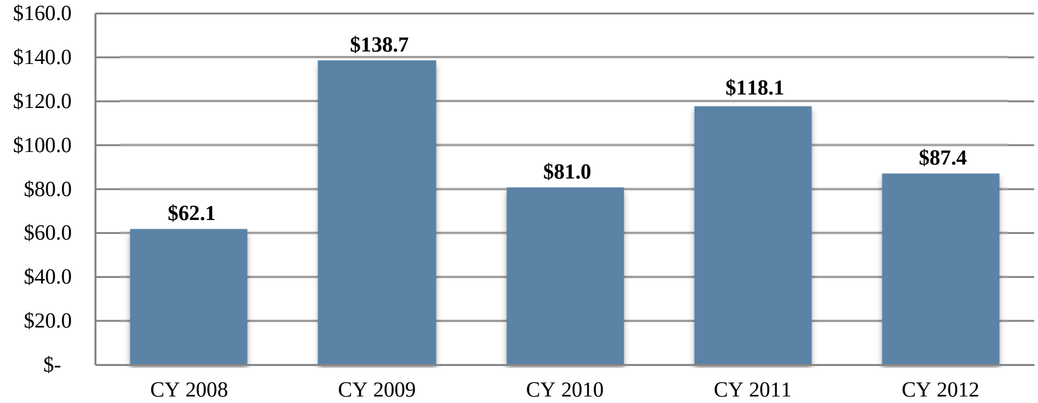


Source: Prepared by legislative auditor's staff using unaudited data provided by LED.

Motion Picture Tax Credits Claimed by Taxpayers. Credits can be claimed by taxpayers on their tax returns to offset their tax liabilities. They may carry forward any unclaimed credits for 10 years from the date they were earned by the production; therefore, all credits may not be claimed on a tax return in the year they were granted by LED. Exhibit 3 outlines the amount of credits taxpayers claimed to offset their tax liabilities over the past five calendar years.

[4] R.S. 47:6007(C)(1)

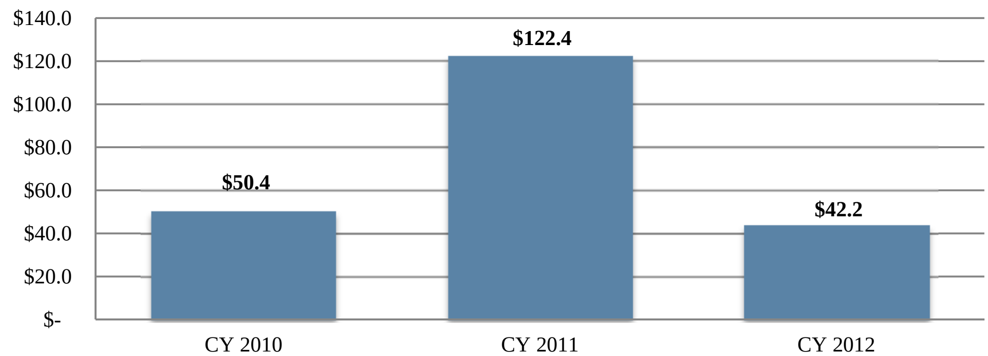
Exhibit 3
Motion Picture Tax Credits Claimed on Tax Returns
(in millions)
CY 2008 - CY 2012



Source: Prepared by legislative auditor's staff using unaudited data provided by LDR.

Transferred/Sold Motion Picture Tax Credits. State law[5] also provides for the transfer of credits. Specifically, any credits not previously claimed by a taxpayer may be transferred or sold to another Louisiana taxpayer or to LED. This allows taxpayers unaffiliated with the production of a motion picture in Louisiana to offset their Louisiana state tax liabilities by purchasing motion picture tax credits. Currently, the original investor who earned the credits may transfer (sell) them back to LED at a purchase rate of 85% of the face value of the credits. Exhibit 4 shows the amount of money investors received over the past three calendar years from selling their credits back to LED.

Exhibit 4
Rebate Amount of Motion Picture Tax Credits Sold to the State
(in millions)
CY 2010 - CY 2012*



*While the provisions for the transfer (sale) of MPTCs to LED went into effect in January 2007, according to LDR records, no credits were transferred to LED prior to 2010.
Source: Prepared by legislative auditor's staff using unaudited data provided by LDR.

[5] R.S. 47:6007(C)(4)

Objective 1: How does LED determine the economic impact of the Motion Picture Tax Credit program?

LED determines the economic impact of the Motion Picture Tax Credit (MPTC) program, as required by state law, through a fiscal and economic impact analysis produced by a third-party consultant. The most recent impact analysis contracted by LED, issued in April 2011, shows an estimated economic output of $5.40 per $1 of credit given in calendar year 2010. While the economic output of the MPTC program is positive, the state government's fiscal impact is negative. According to the impact analysis, LED granted an estimated $196.8 million in credits during calendar year 2010. In turn, the state received $27 million in taxes from the motion picture industry. The result is a net cost to the state of $169.8 million for calendar year 2010. According to LED, the next impact analysis is scheduled to be released by April 2013.

LED determines the economic impact through an impact analysis produced by a third-party consultant.

R.S. 47:6007 (D)(6) states that with input from the Legislative Fiscal Office, the Office of Entertainment Industry Development within LED shall prepare a written report to be submitted to the Senate Committee on Revenue and Fiscal Affairs and the House Committee on Ways and Means no less than 60 days prior to the start of the Regular Session of the Legislature in 2007, and every second year thereafter. State law further requires that the report include the overall impact of the tax credits, the amount of tax credits issued, the number of net new jobs created, the amount of Louisiana payroll created, the economic impact of the tax credits and film industry, and any other factors that describe the impact of the program. LED contracted with a third-party consultant, BaxStarr Consulting Group, to produce the most recent report which was issued in April 2011. The report contained all of the provisions required by law.

The MPTC program produced a positive economic output but negative fiscal impact for Louisiana state government.

The April 2011 fiscal and economic impact study states that for every $1 of tax credit issued by LED in calendar year 2010, the total economic output is estimated to be $5.40. Economic output is the total value of goods and services produced across all industry sectors and all stages of production. The estimated impacts include employment of a local workforce, purchase of materials and supplies, use of services, increases in restaurant and retail revenues, and taxes and fees.

While the economic output of the MPTC program is positive and shows that the industry is growing, the direct cost, or fiscal impact, to state government is negative. Fiscal impact is the total value of state taxes collected as a result of the program minus the total value of credits granted for the program. According to the impact analysis, LED granted an estimated $196.8 million in credits during calendar year 2010. In turn, the state received $27 million in tax revenue from the program. The result is a net cost to state government of $169.8 million for calendar year 2010. According to LED, the next impact analysis is scheduled to be released by April 2013. Exhibit 5 is an excerpt of the April 2011 impact study that shows the economic output and fiscal cost of the motion picture tax credit program for calendar years 2008 through 2010.[6]

Exhibit 5
Economic/Fiscal Cost Benefit Comparisons of the Motion Picture Tax Credit Program
Calendar Years 2008 - 2010

	CY 2008	CY 2009	CY 2010*
Benefits			
Economic Output ($ millions)	812.3	592.6	1,057.7
Total Employment (Jobs)	6,130.5	4,471.1	7,990.4
State Taxes ($ millions)	20.7	15.1	27.0
Local Taxes ($ millions)	13.3	9.7	17.3
Costs			
Certified Tax Credits - Cost after buy-back**($ millions)	128.6	106.1	196.8
Output Multiplier			
Economic output divided by tax credits certified	6.3	5.6	5.4
Net State Fiscal Impact			
State Taxes - Certified Tax Credits ($ millions)	-107.9	-91	-169.8

*****Since the accounting and reporting for calendar year 2010 was not complete at the time of the analysis, 2010 numbers were estimated based on trends in prior years and preliminary data on 2010 program activity.
******Credits are transferred back to the state at a rate lower than the face value. This savings is reflected in the costs illustrated.
Source: Prepared by legislative auditor's staff using p. 25 of the 2011 Fiscal & Economic Impact Analysis of Louisiana's Entertainment Incentives report.

[6] The full report can be viewed on the Louisiana Economic Development website: http://www.louisianaeconomicdevelopment.com/downloads/2011_Entertainment_Economic_Impact_Analysis.pdf.

Objective 2: Did LED's process for granting motion picture tax credits provide reasonable assurance that credits were granted for only eligible expenditures?

Based on a sample of motion picture productions, we determined that LED's process for granting motion picture tax credits (credits) provided reasonable assurance that credits were granted for only eligible expenditures. However, a process that provides reasonable assurance cannot completely eliminate all occurrences of fraud. This is especially true if the fraud scheme involves collusion.[7] LED's process could be strengthened if it had some authority or role in selecting the certified public accountants (CPAs) used by the production companies to audit their cost reports.

LED's process provided reasonable assurance that credits were granted for only eligible expenditures.

LED grants credits based upon a percentage of eligible Louisiana expenditures incurred by a motion picture production. LED's current process provided reasonable assurance that credits were granted on only eligible expenditures for productions initially certified between July 2009 and December 2011 and granted credits by June 2012. Specifically, LED relied on the work of CPAs to audit cost reports of the production companies' expenditures and to verify them as eligible. State law[8] requires the production company to hire a CPA to conduct an audit of its expenditures before submitting them to LED to earn credits. We tested a sample of 29 cost reports used by LED to grant credits for their compliance with statutory requirements. All 29 cost reports met the requirements of state law, including the CPA's statement of independence from the production company and the CPA's opinion.

LED also conducted its own review of the cost reports and the work conducted by the CPAs. We evaluated these processes by reviewing the Film Questions form answered by the production companies and CPAs for all 29 cost reports in our sample. During this review, we determined that LED disallowed expenses that the CPAs certified as eligible Louisiana expenditures for 11 (37.9%) of the cost reports. According to LED, it will also request an additional report or hire a forensic accountant to review the CPA's work and submitted expenses if it questions the quality of the CPA's work or if the CPA encountered issues during the audit. The CPA audits along with LED's internal review process provided reasonable assurance that credits were granted for only eligible production expenditures.

[7] Charges were filed recently by U.S. Attorneys against two individuals for a conspiracy to defraud LED of approximately $1.2 million of tax credits to which they were not entitled through the use of interstate wire communications.
[8] R.S. 47:6007(D)(2)(d)

LED's process could be strengthened if it had some authority or role in selecting the CPAs used by production companies to audit their cost reports.

Currently, state law[9] allows the production company to choose the CPA it wants to audit its cost reports. As noted previously, LED identified expenditures disallowed by law but approved by the CPA for 11 (37.9%) of the 29 cost reports in our sample. If LED had some authority or role in selecting the CPAs used by the production companies, such as choosing the CPA, approving the CPA, or developing a list of acceptable CPAs, the department could eliminate the production company's use of CPAs that consistently submit reports with errors. This would assist LED to ensure it granted credits for only eligible expenditures.

> **Matter for Legislative Consideration 1:** The legislature may wish to consider giving LED more authority in selecting the CPAs used by production companies to audit their cost reports.

[9] R.S. 47:6007(D)(2)(d)(ii)

Objective 3: Did LED accurately calculate the amount of motion picture tax credits granted to investors and transferred (sold) back to LED?

Based on a sample of letters from LED granting motion picture tax credits (credits) to investors, we determined that LED accurately calculated the credits it granted for productions, except in cases when a production's expenditures spanned statutory changes to the rates. In addition, based on a sample of credits sold back to LED, we determined that LED accurately calculated the purchase amount for these credits, except in cases when a production's credits were granted using an incorrect rate. We also determined that LED did not collect all MPTC transfer fees, as required by R.S. 47:6007.

LED accurately calculated credits granted to investors except in cases when a production's expenditures spanned statutory changes to the rates.

We tested a sample of 29 letters issued by LED granting credits to the original investor(s) in productions that were initially certified between July 2009 and December 2011 and granted credits by June 2012. Based on our review, we determined that LED accurately calculated the correct amount of credits granted on the productions' eligible expenditures, using the correct 30% rate, for all 29 letters in our sample.

However, during a later review of transactions in which credits were sold back to LED, we determined that LED used incorrect rates when calculating credits granted for some productions which incurred expenditures that spanned a change in the statutory rate. For example, we identified two productions that had an initial certification date after July 1, 2009, but had incurred expenditures before this time. According to state law,[10] LED should have calculated the credits for these productions at 30%, the rate that was in effect based on the initial certification date. Instead, LED calculated the credits for these productions using two different rates. Specifically, LED calculated the credits granted for eligible expenditures incurred prior to July 1, 2009, using a rate of 25%. For eligible expenditures incurred on or after that date, LED calculated credits using a rate of 30%.

According to LED, the 25% rate was used for expenditures incurred prior to July 1, 2009, because that was the rate that would have applied at the time the expenditures were incurred. However, according to state law, the rate at which credits are granted is determined by the initial certification date of the production, not the date the expenditures were incurred by the production company. We were unable to determine how many productions this issue may affect; however, for the two productions identified, LED calculated the granted amount of credits for $5,743.53 less than should have been authorized. Exhibit 6 outlines the rates for which credits are calculated, based on the production's initial certification date as stipulated by state law.

[10] R.S. 47:6007(C)(1)(c)

Exhibit 6
Historical Timeline of Motion Picture Tax Credit Statutory Rates

MPTC Credit Type	Initial Certification Date of Production		
	Before 1/1/2006	**Between 1/1/2006 and 6/30/2009**	**On or After 7/1/2009**
Investor Tax Credit	10% or 15%*	25%	30%
Additional Payroll Tax Credit	10% or 20%*	10%	5%

*Rate depends on the production's base investment.
Source: Prepared by legislative auditor's staff using R.S. 47:6007.

Recommendation 1: As stipulated by R.S. 47:6007(C), LED should grant all motion picture tax credits using the rate determined by the production's initial certification date.

Summary of Management's Response: LED agrees with the recommendation, but disagrees with the finding that it incorrectly calculated credits. Act 478 of 2009 [R.S. 47:6007] provides that the credit "shall be earned by the investors at the time expenditures are made," raising a legal issue of statutory interpretation of whether an additional 5% should be added to tax credits earned by expenditures made prior to July 1, 2009. LED and LDR concluded the higher rate only applied to credits earned after the effective date of Act 478, and cite Revenue Information Bulletin No. 09-041 which states, "Projects which receive initial certification on or after July 9, 2009, but incurred qualifying expenditures prior to that date will be granted a credit of 25% for expenditures incurred prior to the effective date of Act 478." See Appendix A of the report for LED's full response.

LLA Additional Comments: While Act 478 (R.S. 47:6007) of the 2009 Regular Session does state that the credit "shall be earned by investors at the time expenditures are made," it also states that "credits cannot be applied against a tax or transferred until the expenditures are certified by the office and the secretary." R.S. 47:6007(C)(1)(c) further states that "For state-certified productions approved by the office and the secretary on or after July 1, 2009… each investor shall be allowed a tax credit of thirty percent…" In addition, while LDR's Revenue Information Bulletin No. 09-041 contains provisions for expenditures made prior to July 1, 2009 to be granted at 25%, this bulletin does not supersede state statute. According to the bulletin itself, it is "an informal statement of information issued for the public and employees that is general in nature, and does not have the force and effect of law."

LED accurately calculated credits transferred (sold) back to LED except in cases when a production's credits were granted using an incorrect rate.

We tested a sample of 61 transactions in which credits were sold back to LED between July 2009 and December 2011. Based on our review, we determined that LED accurately calculated the purchase amount, using the correct rate as stipulated by law, for 60 (98.4%) of the 61 transactions.[11] The one production for which LED incorrectly calculated the purchase amount had an initial certification date after July 1, 2009. As a result, LED should have calculated the credits using a purchase rate of 85%. Instead, LED calculated the purchase amount using a rate of 76%.

According to LED and as described in the previous finding, the department used the date the expenditures were incurred by the production, not the initial certification date, to determine the rate at which to grant the credits for this production. As a result, LED used the same reasoning to calculate the purchase rate. We are unable to determine how many productions this issue may affect. However, we identified one other production where the purchase amount on the credits sold back to LED was calculated using an incorrect rate. For these two productions combined, investors received $8,065.96 less than they should have from selling their credits to LED. Exhibit 7 outlines the purchase rates for credits sold to LED, based on the production's initial certification date as stipulated by state law.

Exhibit 7
Purchase Rate of Motion Picture Tax Credits Sold to LED

Date Production was Initially Certified					
Before 7/1/2009					**On or After 7/1/2009**
Credits Sold 1/1/2007 - 12/31/2008	Credits Sold 1/1/2009 - 12/31/2010	Credits Sold 1/1/2011 - 12/31/2012	Credits Sold 1/1/2013 - 12/31/2014	Credits Sold 1/1/2015 or After	Credits Sold 7/1/2009 or After
72%	74%	76%	78%	80%	85%

Source: Prepared by legislative auditor's staff using R.S. 47:6007.

Recommendation 2: As stipulated by R.S. 47:6007(C), LED should purchase all motion picture tax credits using the rate determined by the production's initial certification date.

Summary of Management's Response: LED agrees with this finding and recommendation. See Appendix A of the report for LED's full response.

[11] We also tested to ensure that LDR issued a rebate amount to the taxpayer that matched the purchase amount authorized by LED and determined that LDR issued a rebate for the proper amount for all transactions in the sample.

LED did not collect all required transfer processing fees as required by state law.

As stated previously, state law[12] allows for credits to be transferred or sold to another Louisiana taxpayer or to LED. According to the statute, the transferor and transferees shall submit to LED a notification of any transfer or sale of credits and a transfer processing fee of up to $200 per transferee. We tested a sample of 29 credits transferred (sold) to LED for proof of this processing fee and determined that LED did not collect the transfer processing fee for 10 (34.5%) of the transfers.

According to LED, the department did not collect the transfer processing fee for any credits transferred to LED or another taxpayer because the statute's wording was unclear on whether the fee should be collected by LED or the Louisiana Department of Revenue (LDR), the purpose of the fee, and the amount to be collected. LED started collecting the transfer processing fee beginning on October 1, 2010, after Act 633 of 2010 dedicated the fees to the Louisiana Filmmaker's Grant Fund and LED promulgated the fee amount and its purpose in the Administrative Code. According to LDR, proof of the paid transfer processing fee is now required before it issues a check for state purchased credits or allows a claim of credits to offset a taxpayer's tax liability. All credits with a purchase date after October 1, 2010, in our sample of credits sold back to the state had proof of the paid transfer fee on file with LED and LDR.

Neither LED nor LDR is required by law to track third-party transfers of credits. Therefore, we were unable to accurately calculate the amount of revenue lost as a result of LED not collecting transfer processing fees until October 1, 2010. During the 2007 tax year, approximately 2,042 individual, corporate, and franchise taxpayers claimed credits on their tax returns. If the $200 fee was not collected for each of these taxpayers, assuming at least one transfer of credits per taxpayer, we estimate that at least $408,400 was not collected in fees for tax year 2007 alone.

> **Recommendation 3:** LED should ensure that it consistently collects the transfer processing fee for any credits transferred to LED or another taxpayer.
>
> **Summary of Management's Response:** LED disagrees with this conclusion and states that it began collecting transfer processing fees as soon as it was authorized to do so. The statute did not fix the amount of the fee at $200, but rather left that to be accomplished by promulgated rule. The first MPTC program rules were promulgated in January 2010, but a rule fixing the transfer fee at $200 was not promulgated until September 20, 2010. LED began collecting the $200 fee thereafter. See Appendix A of the report for LED's full response. LED agreed with the recommendation on the Checklist for Audit Recommendations.

[12] R.S. 47:6007(C)(4)

LLA Additional Comments: We agree that the amount of the fee to be collected had to be promulgated in the Administrative Code before it could be collected. Based on the language in the various changes to the statute, it appears that the fee is statutorily authorized and limited to $200, but should have been implemented by LED by rule clarifying the exact amount of the fee to be paid. It was therefore incumbent on LED to implement the fee by rule when the statute passed in 2004, but LED failed to do so until 2010.

Matter for Legislative Consideration 2: The legislature may wish to consider requiring a specific agency to track the transfer of credits.

Objective 4: Did LDR ensure the validity of the motion picture tax credits claimed by taxpayers on their tax returns?

Based on a sample of tax returns claiming motion picture tax credits (credits), we determined that LDR ensured the validity of the credits claimed by taxpayers on their tax returns to offset their outstanding tax liabilities. LDR's process for ensuring the validity of the credits involves verifying that taxpayers have proper ownership of the credits and that they are not taking more credits than they are entitled to claim.

To test these processes, we analyzed a sample of 29 tax returns claiming credits during the 2007 tax year.[13] We found that LDR ensured that all 29 claims were supported by the necessary documentation, including the letter issued by LED granting the credits to the original investor(s) in the production and all notice of credit transfer letters from the initial investor(s) to the claiming taxpayer. In addition, this documentation contained all key provisions of state law needed by LDR to ensure that the taxpayer had rights to the credit, including:[14]

- The transferor's credit balance prior to transfer
- The transferor's remaining credit balance after transfer
- Tax identification numbers or other identifying information for both the transferor and transferee
- The date of transfer
- The amount transferred

We also reviewed the taxpayers' tax returns and determined that LDR ensured all 29 taxpayers in our sample did not take more credits than they were entitled to claim as specified on the notice of transfer documents.

[13] LDR has a three-year period to audit a tax return before it becomes final. LDR does not verify all claims to motion picture tax credits until the end of this three-year period; therefore, we used the most recently completed tax year, 2007, to test credits claimed on tax returns.

[14] R.S. 47:6007(C)(2)(b)

APPENDIX A: LED MANAGEMENT'S RESPONSE

March 19, 2013

Daryl G. Purpera, CPA, CFE
Louisiana Legislative Auditor
Post Office Box 94397
Baton Rouge, LA 70804-9397

Re: Performance Audit – Motion Picture Tax Credit Program

Dear Mr. Purpera:

We have received your exit report and thank you for this opportunity to respond to the performance audit of the Louisiana Motion Picture Tax Credit (MPTC) program. We are pleased to note the report finds that LED has administered the MPTC program in accordance with state law and in a manner ensuring that only eligible expenditures are receiving tax credits.

We appreciate your efforts to further improve the functioning of the MPTC program, and offer the following comments upon the results of your performance audit of the program:

(1) **LLA Objective 1:** How does LED determine the economic impact of the Motion Picture Tax Credit program?

LLA Conclusions to Objective 1:

- "LED determines the economic impact through an impact analysis produced by a third-party consultant."
- "The MPTC program produced a positive economic output but negative fiscal impact for Louisiana state government."

LED Response: We agree with the findings. The MPTC program was designed to cultivate and sustain a thriving film production industry in Louisiana – and it's been very successful. Louisiana is now one of the top states in the country in film production activity, and the industry supports thousands of jobs in Louisiana that previously did not exist. An economic impact analysis performed by the BaxStarr Consulting Group on the MPTC program in 2011 determined that for every $1 issued in tax credits, an estimated $5.71 in economic output was generated in Louisiana. That report also determined that the direct and indirect State tax revenue generated by the film production spending associated with the MPTC program was about 15 cents per dollar of issued tax credits. Accordingly, the MPTC program has a substantially positive return on investment (ROI) from a state economic-impact perspective (gain of nearly $6 per $1 in tax credits), but a substantially negative ROI from a State fiscal perspective (loss of approximately 85 cents per $1 in tax credits).

(2) **LLA Objective 2:** Did LED's process for granting motion picture tax credits provide reasonable assurance that credits were granted for only eligible expenditures?

LLA Conclusions to Objective 2:

- "LED's process provided reasonable assurance that credits were granted for only eligible expenditures."
- "LED's process could be strengthened if it had some authority or role in selecting the CPAs used by production companies to audit their cost reports."

LLA Matter for Legislative Consideration 1: "The Legislature may wish to consider giving LED more authority in selecting the CPAs used by production companies to audit their cost reports."

LED Response: We agree with these findings.

(3) **LLA Objective 3:** Did LED accurately calculate the amount of motion picture tax credits granted to investors and credits transferred (sold) back to LED?

LLA Conclusions to Objective 3 (part 1 of 3):

- "LED accurately calculated credits granted to investors except in cases when a production's expenditures spanned statutory changes to the rates."

LLA Recommendation 1: "As stipulated by R.S. 47:6007(D), LED should grant all motion picture tax credits using the rate determined by the production's initial certification date."

LED response: LED agrees in part and disagrees in part. LED agrees it correctly calculated credits granted to investors in at least all but one of the productions sampled by the LLA, and disagrees with the LLA's finding that it incorrectly calculated credits in that one production. Act 478 of 2009, effective July 9, 2009, increased the tax credit from 25 percent to 30 percent for productions certified after July 1, 2009. However, the Act also provided that the tax credit "shall be earned by investors at the time expenditures are made," raising a legal issue of statutory interpretation: should an additional 5 percent be added to tax credits earned by expenditures made prior to July 1, 2009? The LLA concluded in their performance audit that an additional 5 percent should be added to previously earned credits. In contrast, LED and the Louisiana Department of Revenue (LDR) concluded the higher rate only applied to credits earned after the effective date of Act 478. Revenue Information Bulletin (RIB) No. 09-041, as reissued by LDR on April 30, 2010, states that "Projects which receive initial certification on or after July 9, 2009, but incurred qualifying expenditures prior to that date will be granted a credit of 25 percent for expenditures incurred prior to the effective date of Act 478." Following this interpretation, on June 21, 2010 LED certified the production *Rivka*, and indicated that its expenditures made prior to July 1, 2009 would earn credits at the 25 percent rate while expenditures after that date would earn 30 percent credits. (While the LLA's draft report appears to identify two such productions, the other production identified was certified prior to the RIB reissuance and received the 30 percent credit on earlier expenditures, which the LLA concludes to be correct.)

LLA Conclusions to Objective 3 (part 2 of 3):

- "LED accurately calculated credits transferred (sold) back to LED except in cases when a production's credits were granted using an incorrect rate."

  LLA Recommendation 2: "As stipulated by R.S. 47:6007(C), LED should purchase all motion picture tax credits using the rate determined by the production's initial certification date."

LED Response: LED agrees with this finding but notes the statutory changes created significant ambiguity in the case of the *Rivka* production as noted above.

LLA Conclusions to Objective 3 (part 3 of 3):

- "LED did not collect all required transfer processing fees as required by state law."

  LLA Recommendation 3: "LED should ensure that it consistently collects the transfer processing fee for any credits transferred to LED or another taxpayer."

LED Response: LED disagrees with this conclusion and submits that it began collecting transfer processing fees as soon as it was authorized to do so. Since its enactment in 2004 the MPTC program has mandated a transfer fee be paid (in 2004, to LDR; in 2005, to the Governor's Office of Film and Television Development; in 2007, to the Office of Entertainment Industry Development in LED) and authorized assessment of a fee up to an amount of $200. It is important to note the statute did not fix the amount of the fee at $200, but rather left that to be accomplished by promulgated rule. After years of repeated drafts, negotiations with stakeholders, and oversight committee hearings, the first MPTC program rules were finally promulgated in January 2010, but a rule fixing the transfer fee at $200 was not promulgated until September 20, 2010. LED began collecting the $200 fee thereafter.

Thank you for your team's commitment to high standards and professionalism in working with our department over the past 12 months during this performance audit.

Sincerely,

Stephen Moret

Stephen Moret
Secretary

Louisiana Legislative Auditor
Performance Audit Division

Checklist for Audit Recommendations

Instructions to Audited Agency: Please check the appropriate box below for each recommendation. A summary of your response for each recommendation will be included in the body of the report. The entire text of your response will be included as an appendix to the audit report.

RECOMMENDATIONS	AGREE	DISAGREE
Recommendation 1: As stipulated by R.S. 47:6007(C), LED should grant all motion picture tax credits using the rate determined by the production's initial certification date. **(p. 12 of the report)**	X	
Recommendation 2: As stipulated by R.S. 47:6007(C), LED should purchase all motion picture tax credits using the rate determined by the production's initial certification date. **(p. 13 of the report)**	X	
Recommendation 3: LED should ensure that it consistently collects the transfer processing fee for any credits transferred to LED or another taxpayer. **(p. 14 of the report)**	X	

APPENDIX B: LDR MANAGEMENT'S RESPONSE

BOBBY JINDAL
Governor

TIM BARFIELD
Executive Counsel

State of Louisiana
Department of Revenue

March 13, 2013

Mr. Daryl G. Purpera, Legislative Auditor
Louisiana Legislative Auditor
P.O. Box 94397
Baton Rouge, Louisiana 70804-9397

RE: Motion Picture Tax Credit Preliminary Audit Report: Louisiana Department of Revenue

The purpose of this correspondence is to respond to the audit findings as discussed in the preliminary audit report of the performance audit performed by the Louisiana Legislative Auditor on the Louisiana Motion Picture Credit program. More specifically, this response pertains to the audit findings of the audit on the responsibilities of the Louisiana Department of Revenue in the administration of this credit program.

Objective 4 of the Scope and Methodology of this performance audit asked the question "Did LDR ensure the validity of the motion picture tax credits claimed by taxpayers on their tax returns?" The results of the audit in this respect finds that LDR did ensure the validity of the motion picture credits claimed by securing the necessary documentation, as well as by various control processing procedures, including confirming the transferor's credit balance prior to transfer; the transferor's remaining credit balance after the transfer; the tax identification numbers or other identifying information for both the transferor and transferee; the date of the transfer; and the amount transferred.

Upon review of the findings outlined in this report regarding LDR's responsibilities, I am in agreement with the results of the audit as it was performed for compliance of Objective 4 of the "Scope and Methodology" of this performance audit. I want to thank and commend the staff of the Louisiana Legislative Auditor for the professionalism, courtesy, and efficiency exercised and displayed during the course of the audit.

Sincerely,

Joseph Vaughn

Joseph Vaughn, Assistant Secretary, Group III
Louisiana Department of Revenue
Field Audit Services, Office Audit Division, &
Criminal Investigations Division
225-219-2150

c: Tim Barfield
Executive Counsel

Jarrod Coniglio
Chief of Staff

Dawn Bankston
Director, Office Audit Division

APPENDIX C: SCOPE AND METHODOLOGY

We conducted this performance audit under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended. We conducted this audit to follow up on two previous Louisiana Legislative Auditor reports. In April 2007, a performance audit[15] identified issues with the calculation of credits and the claiming of credits by taxpayers. In March 2012, an investigative audit[16] identified one production in which motion picture tax credits (credits) were issued for ineligible expenditures. Our audit focused on the Motion Picture Tax Credit program and covered the time period January 1, 2007, through June 30, 2012. The audit objectives were to answer the following questions:

1. How does LED determine the economic impact of the Motion Picture Tax Credit program?

2. Did LED's process for granting motion picture tax credits provide reasonable assurance that credits were granted for only eligible expenditures?

3. Did LED accurately calculate the amount of motion picture tax credits granted to investors and transferred (sold) back to LED?

4. Did LDR ensure the validity of the motion picture tax credits claimed by taxpayers on their tax returns?

We conducted this performance audit in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide reasonable basis for our findings and conclusions based on our audit objectives. We believe the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. To answer our objectives, we reviewed internal controls relevant to the audit objectives and performed the following audit steps:

- Researched relevant state laws, rules, and regulations related to the MPTC program.

- Analyzed alternative methods of measuring the impact of the MPTC program.

[15] This report can be viewed on the Louisiana Legislative Auditor's website: http://app1.lla.state.la.us/PublicReports.nsf/6D2D6FD1889090BE862572C1006E6841/$FILE/00000EF3.pdf.
[16] This report can be viewed on the Louisiana Legislative Auditor's website: http://app1.lla.state.la.us/PublicReports.nsf/0F6F840E2495ABC0862579BA00559982/$FILE/00027718.pdf.

- Obtained MPTC program data from both LED and LDR. A majority of the data originated from an LED Excel database and from LDR's Gentax data system, a system used to process taxpayers' income, franchise, and corporate tax forms.

- Conducted internet research and conducted phone interviews with individuals from the American Institute of Certified Public Accountants to determine best practices for related CPA reports.

- Interviewed both LED and LDR staff dedicated to the MPTC program to determine how each agency processes and monitors the granting of credits, transfer of credits among third parties, selling of credits back to the state, and claiming of tax credits on taxpayers' forms.

- Interviewed LED management assigned to the MPTC program to determine existing methods of measuring the impact of the MPTC program.

- Performed sampling on various internal control processes used by both LDR and LED to monitor the program. The audit team conducted an initial sample of 29 items, if there was a single error then the sample was expanded to 61 items. If at any time, the audit team encounters two or more errors, then the internal control process is deemed insufficient for that internal control. However, one error identified in certain processes with high risk may deem the internal controls for that process insufficient. The audit team conducted separate samples for objectives 2, 3, and 4. Using these samples, the audit team reviewed and verified the reliability of LED and LDR internal documentation to ensure credits are granted properly, purchased properly when sold back to the state, and claimed properly on taxpayers' returns.