



FOLLOW-UP REVIEW • REPORT NUMBER 22-05A • July 2022

Administration of the Georgia Film Tax Credit

Controls over credit administration have been strengthened

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Why we did this review

This follow-up review was conducted to determine the extent to which the Department of Revenue (DOR) and the Department of Economic Development (GDEcD) addressed the findings presented in our January 2020 performance audit (Report #18-03A).

The 2020 audit evaluated the administration of the film tax credit, including the extent to which GDEcD and DOR enforce statutory and regulatory eligibility requirements.

A companion report on the impact of the credit was also released in January 2020. A separate follow-up report on the credit's impact will be released.

About the Film Tax Credit

First passed in 2005, Georgia's film tax credit provides an income tax credit to production companies that spend at least \$500,000 on qualified productions. The base credit rate was raised to 20% in 2008, with an additional 10% for a qualified promotion of the state (e.g., Georgia logo). The credit is transferable, and most credits are sold by production companies to other taxpayers.

The value of the annual credit amount generated grew from \$669.4 million in 2016 to approximately \$961.0 million in 2019, a 44% increase.

Administration of the Georgia Film Tax Credit

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What we found

During the 2020 session, the General Assembly passed House Bill 1037 to strengthen oversight of the film tax credit. These improvements, combined with changes to agency procedures, have fully or partially addressed all the findings in our performance audit that reviewed the credit's administration.

DOR Audits

House Bill 1037 mandated audits for all film¹ projects before they can receive the credit. The audits are being phased in over a three-year period based on the size of the credit and the year in which it was certified by the Department of Economic Development (GDEcD). By 2023, audits will be required for all film projects. The credit cannot be utilized (e.g., claimed, sold) until the Department of Revenue (DOR) approves the audit.

The required audit may be conducted by DOR or a third-party auditor. As recommended in our report, House Bill 1037 gave DOR responsibility to oversee third-party audits. To conduct a film tax credit audit, the audit firm must be certified by DOR, a process that includes undergoing DOR-provided training, maintaining registration with the Georgia State Board of Accountancy, and agreeing to follow DOR audit requirements. Prior to issuing the final certification, DOR reviews each audit submitted by a third-party auditor and performs additional audit procedures as necessary.

To address insufficient audit procedures, DOR published a detailed manual for film tax credit audits, which includes agreed-upon procedures to be used for any mandatory audits. Under the agreed-upon procedures, auditors must test (i.e., verify eligibility using supporting documents) all expenditures above \$100,000 and select a statistical sample

¹ Qualified interactive entertainment production companies are not subject to the audit provision.

of those under \$100,000 for testing. As recommended in our report, disallowances from the sample are projected to the broader population. DOR has also taken steps to identify and disallow expenditures that are ineligible under statute or that have limited economic benefit to the state. For example, DOR audit procedures now define the qualifying time period for eligibility and require auditors to check a transaction's date. Additionally, DOR no longer allows expenditures for interstate shipping or for items shipped from another state, and auditors must review supporting documents to verify that services were performed in Georgia. Per House Bill 1037, auditors also verify that sales and use tax was collected on taxable sales and leases.

DOR Taxpayer Services Division

The audit provision in House Bill 1037 led to procedural changes in DOR's Taxpayer Services Division, which reduced or eliminated many issues identified in our report. Previously, companies received the credit after submitting an estimate of expenditures, and amounts were not always adjusted if tax forms reflected a different amount (and companies still retained the credit even if they did not submit the forms). For projects subject to mandatory audits under House Bill 1037, the company does not receive the credit from DOR until after the audit (which requires verifying expenditures) has been completed.

DOR also updated the manual and training materials for tax examiners who process the credit. The updated guidance helps clarify tax examiners' responsibilities, particularly for projects not subject to the audit provision. These responsibilities include ensuring the system's credit amounts match those on tax form IT-FC.

Additionally, DOR has made information system changes to address identified issues. For example, the system will automatically reject a company's tax return if it has a film tax credit in the system but fails to submit form IT-FC with the return. DOR also created reporting to help identify problems such as duplicate records.

GDEcD

GDEcD has taken some steps to address identified issues with approving ineligible or potentially ineligible projects. In particular, GDEcD updated its rules to clarify that commercials must be televised, and House Bill 1037 added language that more explicitly excluded projects not intended for multimarket commercial distribution. The original report noted that GDEcD had broadly interpreted the statute's provisions, approving projects with questionable eligibility or economic benefit (e.g., shows that could be considered local interest and live events that likely would have taken place without the credit). We recommended the General Assembly provide additional clarification for these areas. GDEcD stated it sought feedback in one area; however, no additional clarification was requested or provided for others.

House Bill 1037 also altered administration of the additional 10% credit (known as the uplift) by not granting it until GDEcD certifies that requirements have been met. Uplift requirements generally involve placement of the Georgia peach logo in the credits, multimarket distribution, and a link on the project's website. Our 2020 audit found GDEcD did not always verify that projects had met all requirements, and some undistributed projects had received the uplift. Under House Bill 1037, DOR does not provide the uplift credit until after GDEcD has certified that the company has submitted evidence of full compliance. The legislation also prohibits undistributed projects from receiving the uplift.

DOR's Response: *DOR agreed with the current status as presented in the following table and indicated it would address the remaining issue directed to DOR.*

GDEcD's Response: *GDEcD agreed with the current status as presented in the following table.*

However, they expressed continued disagreement with some recommendations from the original report. For these recommendations, GDEcD's responses are included in the table below the relevant finding status.

The following table summarizes the findings and recommendations in our 2020 report and actions taken to address them. A copy of the 2020 performance audit report 18-03A may be accessed at <https://www.audits.ga.gov/ReportSearch/download/23486>.

Administration of the Georgia Film Tax Credit Follow-Up Review, July 2022

Original Findings/Recommendations	Current Status
<p>Administration of the film tax credit must be strengthened to ensure that companies only receive the credits to which they are entitled.</p> <p>Specific recommendations to address these issues were discussed in other findings.</p>	<p>No recommendations.</p>
<p>Current audit coverage does not ensure only eligible expenses earn the credit.</p> <p>Unlike most other states with a film incentive, Georgia did not require an audit for a project to receive the film tax credit. Our review found that DOR had audited nearly half of the credit amount issued in 2016 but only 12% of projects. Most audits were conducted at the company’s request to help them sell the credit. Projects were unlikely to be audited if the company did not request a voluntary audit.</p> <p>We recommended that the General Assembly require audits for all projects receiving the film tax credit. We also recommended that DOR oversee the use of any third-party auditors.</p>	<p>Fully Addressed – In 2020, the General Assembly passed House Bill 1037, which required film projects to undergo an audit to receive the credit and mandated DOR oversight of the audit process.</p> <p>Audits are being phased in over a three-year period, starting with the largest projects. Beginning in 2021, audits were required for projects requesting credits larger than \$2.5 million, for credits larger than \$1.25 million in 2022, and for all film projects beginning in 2023. DOR or a third-party auditor may conduct the audit. However, third-party auditors must be certified by DOR and follow DOR-specified procedures. The production company can request a specific audit firm, but DOR makes the final selection. After the audit is completed, the third-party auditor sends the complete documentation to DOR. DOR reviews the audit work, conducts additional audit procedures as necessary, and approves the final credit amount. Only then does DOR issue the credit to the company. The cost of the audit is paid by the production company, but it is not an eligible expenditure for the credit.</p> <p>The new audit requirement replaces the previous reliance on voluntary audits and voluntary compliance. It brings Georgia in line with other states. In our original report, we noted that 29 of 31 (94%) other states with a film incentive required an audit, and the remaining two states required more documentation than Georgia.</p> <p>It should be noted that qualified interactive entertainment production companies (QIEPCs) are exempt from the audit requirement, likely due to their smaller credit size. Annual credits to QIEPCs are capped at \$1.5 million per company and \$12.5 million in aggregate. QIEPCs represented 1.3% of the \$961 million in credits earned in 2019.</p>

Administration of the Georgia Film Tax Credit Follow-Up Review, July 2022

Original Findings/Recommendations	Current Status
<p>DOR's current audit procedures do not provide assurance that ineligible expenditures will be identified and disallowed.</p> <p>We identified ineligible expenditures that were not disallowed during DOR audits, such as work performed outside the state and employee wages over \$500,000. We also identified expenditures allowed by DOR that had minimal economic benefit for the state, such as goods shipped from other states by Georgia vendors.</p> <p>We recommended that DOR improve its film tax credit audit procedures to address the issues noted in the finding. We also recommended that DOR begin sampling transactions for eligibility and project the disallowances to the larger population of transactions.</p>	<p>Fully Addressed – DOR has published a detailed Audit Procedures Manual that addresses the issues discussed in the report. These procedures are used by both DOR and third-party auditors for the film tax credit audits mandated by House Bill 1037.</p> <p>DOR's Audit Procedures Manual established various improvements, including a sampling method created in cooperation with the Multistate Tax Commission, an intergovernmental agency focused on state taxation. The manual includes procedures to test for specific ineligible expenditures discussed in the report, such as employee wages over \$500,000 and excess airfare. DOR has also implemented new standards for expenditure eligibility that better consider economic impact, such as requiring auditors to assess where services were performed and disallowing goods shipped from out-of-state by an in-state vendor (unless typically held in the vendor's Georgia inventory).</p> <p>DOR also requires third-party auditors to undergo training regarding film tax credit audit procedures, which should improve consistency in how the procedures are applied. The audit firm must complete training prior to initial certification and participate in future training or compliance discussion groups, as required by DOR. Additionally, DOR indicated that both DOR and third-party auditors have undergone training in the newly developed sampling methodology.</p>

Administration of the Georgia Film Tax Credit Follow-Up Review, July 2022

Original Findings/Recommendations	Current Status
<p>Due to weaknesses in DOR's controls, companies could receive credits they are not eligible for or credits higher than earned.</p> <p>We identified inaccurate credit amounts in DOR's tax system, duplicate credit records, and a company that received the credit without meeting the minimum spend of \$500,000.</p> <p>We recommended that DOR make system and procedural improvements to address these issues. We also recommended the General Assembly consider allowing DOR to share tax information with GDEcD to help with credit administration.</p>	<p>Fully Addressed – Procedural changes resulting from House Bill 1037 will help to prevent the types of issues observed in our original audit.</p> <p>Problems observed during our review generally occurred when DOR staff did not adjust credits to match the final reporting by the company. In these instances, companies instead received, and kept, credits based on their initial estimated reporting. Under the provisions of House Bill 1037, projects subject to the audit requirement do not receive the credit in DOR's system until after the audit is complete and DOR has issued its final certification. This change eliminates the estimated reporting step and the need for later adjustments. Additionally, DOR created reporting to check for duplicate credit records, and new training materials instruct staff to verify the production company has met the \$500,000 minimum spend. While the General Assembly did not pass changes to allow GDEcD access to additional tax information, the procedural changes at DOR should prevent the observed issues from reoccurring.</p>
<p>DOR allows companies to receive the credit without submitting required documentation.</p> <p>Our review found that companies frequently did not submit the tax form IT-FC and supporting documentation as required by statute and regulation. DOR did not identify and rescind tax credits for these companies.</p> <p>We recommended that DOR implement processes to identify and address projects without the required documentation. We also recommended that DOR create written procedures for tax examiners processing the IT-FC.</p>	<p>Fully Addressed – Projects subject to a required audit no longer receive the credit through estimated reporting. Additionally, DOR implemented a system control to identify credits with no IT-FC submission.</p> <p>To receive the credit from DOR, projects subject to House Bill 1037's audit provision must submit documentation of expenditures used to earn the credit. Only after the audit is completed and has received DOR approval does the project receive the credit in DOR's system. At that point, the company can use or sell the credit. For projects not subject to the audit provision, DOR indicated that a system change will reject the company's tax return if the company has received a credit but did not submit the IT-FC with their tax return. DOR also reported that it has instructed tax examiners to reach out to companies that do not submit required supporting documentation with the IT-FC.</p>

Administration of the Georgia Film Tax Credit Follow-Up Review, July 2022

Original Findings/Recommendations	Current Status
<p>Due to weaknesses in DOR's controls, companies could claim credits outside of the eligible carryforward period.</p> <p>Statute allows the credit to be taken in the year in which it is earned and unused amounts to be carried forward for up to five years. We identified projects in DOR's tax system with a certification period (i.e., the time period in which a credit can be used) that did not align with this provision.</p> <p>We recommended that DOR take steps to improve the accuracy and oversight of the credit certification periods in its system.</p>	<p>Fully Addressed – DOR has implemented system changes and updated staff processes to ensure accurate certification periods.</p> <p>DOR took steps to improve the accuracy of the certification period dates. DOR removed the fund year field from the credit application, which had led to discrepancies during estimated reporting and incorrect certification periods. DOR also updated its written procedures to provide instructions for tax examiners to adjust incorrect date values entered by the company.</p>
<p>Weaknesses in DOR's overall processes allow QIEPCs to exceed statutory caps.</p> <p>Statute limits the amount of the film tax credit for QIEPCs to \$12.5 million in total and \$1.5 million per company each year. We identified weaknesses that allow companies to circumvent DOR's IT controls to limit credits to these statutory caps.</p> <p>We recommended that DOR implement an IT control to prevent QIEPCs from taking the uncapped 122 credit, which is used by film production companies. We also recommended that DOR implement processes to identify undisclosed affiliates.</p>	<p>Partially Addressed – DOR created new procedures and reporting to prevent QIEPCs from taking the 122 credit.</p> <p>DOR created written procedures for tax examiners who process QIEPC credits. The procedures instruct staff to change the tax code in DOR's system if a QIEPC incorrectly selects the uncapped 122 credit. DOR also created reporting that allows staff to cross reference the QIEPC list with companies taking the 122 credit.</p> <p>DOR has not implemented processes to identify undisclosed affiliates.</p> <p><i>DOR Response: DOR indicated it would implement a manual review process to identify undisclosed affiliates.</i></p>

Administration of the Georgia Film Tax Credit Follow-Up Review, July 2022

Original Findings/Recommendations	Current Status
<p>DOR's processes allow QIEPCs to receive credits without ever submitting the required GDEcD certification.</p> <p>Statute requires a project to be certified by GDEcD to receive the credit. However, QIEPCs must undergo DOR pre-approval, which allows them to receive the credit prior to GDEcD certification. DOR did not have processes in place to identify QIEPCs that received the credit but were not certified by GDEcD.</p> <p>We recommended that DOR implement a system change to prevent the use or sale of a credit prior to the company providing a GDEcD certification letter.</p>	<p>Fully Addressed – DOR implemented a system change and written procedures to ensure the GDEcD certification letter is obtained.</p> <p>DOR has addressed the issue identified in the original audit by ensuring QIEPCs with a credit submit the required information with their tax return. DOR indicated that it had implemented a system control to reject a QIEPC's tax return if the company received a credit but did not submit the IT-FC with the return. DOR also created a procedure manual for tax examiners who process the credit for QIEPCs. DOR's manual instructs staff to check for the GDEcD certification letter when processing a QIEPC's tax return.</p>
<p>Companies in default on state taxes or loans are not eligible for the credit, but neither GDEcD nor DOR verifies compliance.</p> <p>The original report noted that under state law a company should not receive the credit if it, or any company or person that owns or is affiliated with it, is in default on any state taxes or on a loan made or guaranteed by the state. However, there was no mechanism in place to enforce this provision, and we concluded that full enforcement may not be feasible due to the level of resources that would be required. Instead, we recommended that DOR use the information it has to verify that companies in default on taxes and individuals in default on student loans are not receiving the film tax credit.</p>	<p>Fully Addressed – DOR indicated it has taken steps to prevent the specified companies and individuals in default from taking the credit.</p> <p>DOR is implementing changes to address both groups, as recommended. DOR indicated that the process for mandatory audits will require a tax clearance check to determine whether the company has any state tax defaults. DOR plans to implement the requirement on August 1, 2022. Additionally, DOR said it is currently determining whether it can use the student loan default information it receives for this purpose. If so, it will create a student loan default verification process for film tax credits.</p>

Administration of the Georgia Film Tax Credit Follow-Up Review, July 2022

Original Findings/Recommendations	Current Status
<p>GDEcD has approved productions with questionable eligibility, though the General Assembly should clarify the statute for certain types of productions.</p> <p>We identified projects that received the credit but appeared to be ineligible under statute, such as untelevised commercials, projects not intended for distribution, and postproduction activities for out-of-state footage. We also identified projects that may have fallen under statutory exclusions (e.g., sports coverage, local interest) or that have limited economic benefit to the state (e.g., live events).</p> <p>We recommended that GDEcD ensure it only approves productions that are eligible under state law. We also recommended that the General Assembly clarify the eligibility of certain production types that GDEcD had approved for the credit.</p>	<p>Partially Addressed – GDEcD has taken some steps to ensure ineligible projects are not certified. However, most of our recommendations related to this finding were not addressed.</p> <p>While GDEcD disagreed with the finding overall, it did address some identified issues. GDEcD stated that it sought feedback from a member of the General Assembly regarding Esports and decided to maintain its current practices in this area. Additionally, GDEcD updated its rules to clarify that commercials must be televised to receive the credit. It also updated its application and review process for digital media and interactive entertainment to require the same distribution information as for live action projects. In House Bill 1037, the General Assembly added statutory language to reiterate that projects are ineligible if they are not intended for multimarket commercial distribution. However, other areas such as news, local interest, and live events were not addressed by GDEcD or the General Assembly.</p> <p><i>GDEcD’s Response: GDEcD agreed with our assessment but indicated that “[t]here still however remains a disagreement between GDEcD and DOAA as to which projects are ineligible.”</i></p>

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Original Findings/Recommendations	Current Status
<p>Distinct risks exist for productions with significant out-of-state filming and those that are not completed.</p> <p>Our report noted that a high level of out-of-state filming was associated with a higher risk of out-of-state expenditures being used for the credit. We found that many other states with a film incentive require a minimum percentage or number of filming days in-state. Additionally, incomplete projects represent a higher risk of fraud. These risks were compounded by the low probability of being selected for audit.</p> <p>We recommended that GDEcD establish a minimum percentage of production that must occur in-state and verify production by requiring the final product or sufficient documentation to show production occurred.</p>	<p>Partially Addressed – House Bill 1037’s audit provision helps reduce the risk from out-of-state filming and incomplete projects. Additionally, GDEcD updated its rules and processes to help address the risk related to incomplete projects.</p> <p>The audits required by House Bill 1037 will help identify and disallow out-of-state or unsupported expenditures. However, GDEcD has not established a minimum percentage of in-state production, and certain expenditures may not be detected by auditors. For example, post-production costs for out-of-state footage are ineligible but may go undetected if intermingled with similar costs for in-state footage.</p> <p>GDEcD has updated its rules to require evidence of project funding prior to certifying the project for the credit, which should reduce the likelihood of incomplete or fraudulent projects. GDEcD procedures also indicate that the company must supply documentation that principal photography occurred in Georgia.</p> <p><i>GDEcD’s Response: GDEcD agreed with our assessment but disagreed with the recommendation to require a minimum percentage of production in-state. GDEcD indicated this “would exceed the authority delegated to it by the Georgia General Assembly considering the film tax credit...does not require a minimum amount of in-state shooting.”</i></p>
<p>GDEcD does not ensure that all projects receiving the uplift complete all requirements for eligibility.</p> <p>The uplift provides an additional 10% credit for a qualified promotion, which typically involves placing a Georgia logo in the completed, distributed project (e.g., in the credits) and a link to Georgia’s film office on the project’s website. Companies can also use an alternative marketing opportunity approved by GDEcD. Our audit identified projects that received the uplift although they had not fulfilled all statutory requirements.</p> <p>We recommended that GDEcD verify that all projects receiving the uplift fulfill all statutory requirements.</p>	<p>Fully Addressed - House Bill 1037 requires that a project meet the uplift requirements before the additional 10% credit is issued.</p> <p>GDEcD and DOR have implemented the uplift changes required by House Bill 1037 to address identified issues. GDEcD now certifies only the 20% base credit when the project initially applies for certification. Once the project is completed and distributed, the company applies for the uplift and provides GDEcD with evidence that it has met all requirements. GDEcD then issues the uplift certification letter to the company and notifies DOR that the uplift has been verified. Prior to GDEcD’s uplift certification, DOR will not grant the uplift credit.</p> <p>Additionally, to address staffing limitations that contributed to this issue, GDEcD hired another staff person dedicated to administration of the credit.</p>

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Original Findings/Recommendations	Current Status
<p>The promotional value of the credit uplift is unknown, but certain issues reduce any value the state receives.</p> <p>Our report noted that GDEcD was unable to determine the promotional value of the logo placement or alternative marketing opportunities, which are used to earn the uplift credit. However, we identified three scenarios that reduced any value received. These were undistributed projects receiving the uplift, the logo being skipped in streaming content, and a large uplift value for inexpensive merchandise. The first and last scenarios were related to alternative marketing, which allowed projects to receive the uplift without the logo placement and project distribution.</p> <p>We recommended that the General Assembly consider changes to the uplift provisions in statute, such as eliminating the uplift for undistributed projects and/or eliminating the use of alternative marketing opportunities to obtain the uplift.</p>	<p>Partially Addressed – The General Assembly passed House Bill 1037, which eliminated the uplift for undistributed projects, one of the options discussed in our recommendation. GDEcD also took steps to address the logo being skipped in streaming content.</p> <p>Two of the three scenarios discussed in the report have been addressed. House Bill 1037 prohibited undistributed projects from receiving the uplift. Additionally, GDEcD rules now require that projects using streaming services to fulfill the distribution requirement must automatically show the logo without requiring the viewer to opt in to view the credits. (When the credits are skipped, the logo’s placement in the credits typically prevents it from being seen by viewers.)</p> <p>Neither the General Assembly nor GDEcD has made changes to the alternative marketing opportunities, which can allow companies to receive very large credits for relatively inexpensive items.</p>
<p>13 Findings</p>	<p>8 Fully Addressed</p> <p>4 Partially Addressed</p> <p>0 Not Addressed</p> <p>1 No Recommendations</p>

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