

Frequently Asked Questions about Tax Credits for Qualifying Expenses of a Production Company

Unless specifically noted, all references to the "Department" mean the North Carolina Department of Revenue.

1. What is the audit process? What can the production company expect?

After receiving the completed Form NC-415, Tax Credit for Qualifying Expenses of a Production Company, the Department will contact the taxpayer to set up an audit appointment to review the taxpayer's information. An appointment letter is sent to the taxpayer confirming the date of the audit along with an Information Document Request (IDR) outlining the information needed to conduct the audit upon arrival.

2. Approximately when will the audit begin in relation to submitting the Form NC-415?

The Department will set up an audit appointment within three to four weeks after receiving the request for refund (Form NC-415). The audit will begin based on an agreed upon time by the taxpayer and the Department.

3. What are typical questions during the audit?

Typical questions and document requests include but are not limited to the following:

1. **Power of Attorney (Form NC Gen. 58, Power of Attorney and Declaration of Representative)**
2. **A detailed explanation of the corporation's business activity in North Carolina, which includes all locations and business functions of each location.**
3. **Copies of W-2s and 1099s for all activities in North Carolina.**
4. **Detailed list of all people employed in NC with respect to the production including social security numbers for each employee. This includes all individuals who received a W-2 or 1099.**
5. **Detailed list of all qualifying expenses for goods leased or purchased in North Carolina, services leased or provided in North Carolina, production-related insurance purchased in North Carolina from an unrelated entity and qualifying expenses spent for compensation and wages paid in North Carolina. Total wages and compensation for the entire production of the film are also requested. Taxpayer must provide a copy of all receipts.**
6. **Copy of the North Carolina and federal income tax returns for the periods covering the expenses.**
7. **Detailed description of the film and copy of the production (rough-cut or finished copy "DVD").**

All the above information is requested in an electronic format (excel) in order to expedite the audit.

4. What is the duration of a typical audit?

The duration of the audit depends on the volume of the documents to review (usually four or five days at the taxpayer's office). The Department will send the preliminary audit papers to the taxpayer to review within a couple of weeks of the office visit. (This is assuming all documentation is provided timely.)

5. Knowing that production companies contract with payroll service companies, is the payroll service company required to withhold taxes on loan-out corporations? Or is it the responsibility of the loan-out corporation to take care of its own taxes?

Withholding law requires the payroll company to withhold taxes on compensation paid to an out-of-state loan-out corporation unless the out-of-state loan-out corporation registers to do business in North Carolina. However, to be eligible for the film credit, tax must be withheld on the payment to the loan-out for the compensation to be considered a qualified expense. The production company or the payroll company can do the withholding. (Also see #8)

6. Money paid to payroll companies includes wages and fringes. Wages on which North Carolina income tax has been withheld count as qualifying expenses. What about fringes paid by the production company? (fringes include FUI, SUI, FICA, SS, health insurance, retirement, union membership fees)

Fringes do not count as qualified expenses because tax has not been withheld and remitted on the fringes.

7. Is the production company's ability to claim payments to loan-out corporations as qualifying expenses tied to the filing of the loan-out's tax forms? Or are the loan-out's taxes an issue between the State and the loan-out?

Taxes must be withheld on the payments to a loan-out for a production company to claim them as qualifying expenses. The production company's eligibility to claim the compensation in calculating the film credit is not contingent on the loan-out corporation filing a North Carolina Income tax return. (Also see #8)

8. Please explain the law changes from Session Law 2006-162 (House Bill 1963).

Prior to this law change, compensation and wages were qualifying expenses for purposes of the film production credit only if the production company remitted withholding. Pursuant to Article 4A, companies were required to withhold tax of 4% from payments in excess of \$1500 to any nonresident entity unless that entity had obtained a North Carolina Certificate of Authority from the Secretary of State. If a "loan out company" had obtained a North Carolina Certificate of Authority, the production company did not withhold tax from the payment. As a result, the production company could not claim this as a qualifying expense. To remedy this situation, Session Law 2006-162 (House Bill 1963) was enacted so compensation and wages are qualifying expenses for purposes of the film production credit if withholding payments are remitted, whether withheld on the payments by the production company to the loan-out company or withheld from the payments by the loan-out company to the actor.

9. Please explain the law changes from Session Law 2008-107 (House Bill 2436).

Effective for tax years beginning on or after January 1, 2008, the cost of insurance coverage purchased in this State by the production company for production-related activities would be considered a qualifying expense. The insurance must be purchased from an unrelated entity to qualify. In addition, for productions that have production credits, the taxpayer must acknowledge in the production credits both the North Carolina Film Office and the regional film office responsible for the geographic area in which the filming for the production occurred.

10. Please explain the law changes from Session Law 2009-529 (Senate Bill 943).

Effective for tax years beginning on or after January 1, 2010, a taxpayer may elect to take a credit against taxes equal to twenty-five percent (25%) of the production company's qualifying expenses less the difference between the amount of tax paid on purchases subject to the tax imposed on mill machinery under G.S. 105-187.51 and the amount of sales or use tax that would have been due had the purchases been subject to the sales or use tax at the combined general rate. The taxpayer can elect to either claim the 15% credit without the sales or use tax reduction or the 25% with the sales or use tax reduction. The election is binding and is made at the time the return is filed to claim the credit.

11. A fee of \$1.5 million is paid to a loan-out corporation (in this case, the loan-out corporation is owned by someone working as a producer and an actor). Of that amount, \$1.2 million is for "acquiring the script" and "producing", something that takes place in CA years prior to shooting the film). The balance of the fee, \$300,000 is for acting in the film in NC during the course of production. Does the payment of \$1.5 million to the loan-out corporation qualify the loan-out as "a highly compensated individual" and therefore exclude the \$300,000 payment from being considered as part of the qualifying expenses for the tax credit? Remember, only \$300,000 was earned in NC for services rendered during the filming in NC. The other \$1.2 million was earned previously in CA for services rendered in CA.

For tax years beginning prior to January 1, 2008, the payment of \$1.5 million to the loan-out qualifies the loan-out as "a highly compensated individual" and therefore excludes the \$300,000 payment from being considered as part of the qualifying expenses for the tax credit. For tax years beginning on or after January 1, 2008, only the amount of compensation in excess of one million dollars paid to a highly compensated individual does not qualify. Since the amount earned in North Carolina is less than one million, the entire amount qualifies.

12. To what kind of "companies" must payments be made to classify payments as "qualifying expenses"? (1) NC corporations, (2) Companies that pay corporate taxes in NC, (3) Companies that have a physical presence in NC. (Examples: Vehicle Rental Company based in Georgia that rents vehicles in NC. If this company charges NC sales tax on rentals, does it qualify? What if this company opens a "satellite office" in NC?)

Payments for goods must be made to persons with a physical location in North Carolina. In the example, charging sales tax is not enough. The production company must rent the vehicle from a North Carolina store. Payments to persons for a service can be paid to an out-of-state person if the production company substantiates that the service was performed in North Carolina.

13. Do payments to a NC Production Services Company qualify? (Example: A production company needs a widget. Widgets are not available in NC. A NC Production Services Company is contracted to locate and purchase the widget in another state and then sell the widget at a mark-up to the production company.)

The payment to the NC Production Services Company qualifies.

14. Similar to question #12, can a production company form its own NC Production Services Company and utilize it to source and purchase goods that can not be found in NC? This avoids doing business with another entity and avoids a mark-up.

No. This equates to a phony transaction by a business formed with no purpose but to circumvent the tax laws. Conversely, if the affiliated production services company performs a service, charges fair compensation for the service, files a tax return and pays the income tax due, then the expense would qualify for the credit.

15. An out-of-state production company wishes to make a movie for \$2.5 million dollars. It contracts with a NC production company "to make the movie". The out-of-state company pays the NC Company \$2.5 million for the movie. Since the full \$2.5 million was spent with a NC company, can the out-of-state company file for an incentive using the full \$2.5 million payment as a qualifying expense?

No. The North Carolina company makes the movie. Therefore, the North Carolina company qualifies for the credit.

16. Do payments to shipping companies count as qualifying expenses? (FedEx, DHL, UPS?) These companies obviously have facilities and employees in NC.

Yes, to the extent that the service is obtained from a North Carolina location. If goods are delivered into North Carolina from an out-of-state location, the shipping charge does not qualify.

17. An out-of-state caterer is brought to North Carolina to serve meals at a production site for twelve weeks. The caterer's employees are placed on the production company's payroll. The production company rents the caterer's mobile kitchen. The caterer then charges a per person /per meal price which covers the cost of supplies (food, dry goods, fuel, ice, etc.) and includes profit. The caterer then spends money locally to purchase these supplies. Do the meal prices paid to the out-of-state caterer count as qualifying expenses? Does the truck rental paid to the out-of-state caterer count as qualifying expenses?

The meal price paid to the out-of-state caterer for service performed in North Carolina qualifies if the production company substantiates that the services were performed in North Carolina. The truck rental from the out-of-state caterer does not qualify.

18. Is "NC Sales Tax" a qualified expense?

No. It is not considered a good or service eligible for the tax credit.

19. A production company films for six weeks in NC and then moves to SC and continues filming an additional four weeks. The "filming equipment" (lights, cable, generators, cameras, grip equip, etc.) is being rented from a company based in NC. Can the production company receive a credit in NC for the equipment rental fees paid while working in SC?

No. The credit is allowed only for the equipment rental fees paid while working in NC.

20. Related to #19 above, a production company is filming completely in SC. However, it has rented all of its "filming equipment" (lights, cable, generators, cameras, grip equip, etc.) from NC since there are no vendors in SC. Will NC give a credit against expenses in NC from an out-of-state production?

No. The credit is allowed only for an in-state production.

21. Do items purchased on the internet (clothing – LL Bean, Gap, American Eagle, etc.) count as qualifying expenses?

Yes, to the extent the production company can substantiate that the items were acquired from a North Carolina location.

22. Some production companies are part of larger companies that have their own in-house travel departments that purchase airline tickets with their corporate discounts. If travel is booked on US Airways (for example, which has a huge North Carolina presence) by a larger company's travel department located out of state for a film shooting in North Carolina, do those costs count as qualifying expenses?

No. The travel has to be acquired from a North Carolina vendor to be considered a qualified expense.

23. If a company produces multiple productions in North Carolina in one year, does it file one corporate tax return and a separate form NC 415 for each production?

Yes.

24. Do the amounts spent in North Carolina by a production company during the phases referred to within the film industry as "pre-production" and "post-production" count as qualified expenses? "Pre-production" encompasses expenses incurred in connection with a production before actual filming begins. "Post-production" encompasses expenses incurred in connection with a production after actual filming is concluded but does not include expenses related to distribution and marketing.

Yes.