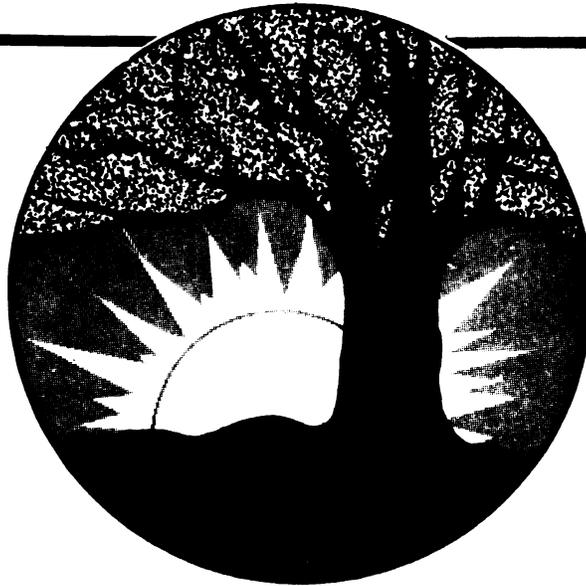


PERFORMANCE AUDIT

Tennessee Film, Entertainment and Music Commission
January 2013



Justin P. Wilson
Comptroller of the Treasury



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Comptroller of the Treasury
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January 24, 2013

The Honorable Ron Ramsey
Speaker of the Senate
The Honorable Beth Harwell
Speaker of the House of Representatives
The Honorable Mike Bell, Chair
Senate Committee on Government Operations
The Honorable Judd Matheny, Chair
House Committee on Government Operations
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the performance audit of the Tennessee Film, Entertainment and Music Commission. This audit was conducted pursuant to the requirements of Section 4-29-111, *Tennessee Code Annotated*, the Tennessee Governmental Entity Review Law.

This report is intended to aid the Joint Government Operations Committee in its review to determine whether the Tennessee Film, Entertainment and Music Commission should be continued, restructured, or terminated.

Sincerely,

A handwritten signature in cursive script that reads "Deborah V. Loveless".

Deborah V. Loveless, CPA
Director

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12-029

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Performance Audit
Tennessee Film, Entertainment and Music Commission
January 2013

AUDIT OBJECTIVES

The objectives of the audit were to evaluate the effectiveness of the Tennessee Film, Entertainment and Music Commission film incentive program; to evaluate the incentive award process; to document the future agenda of the agency and any changes to be proposed by the new administration; to observe the working of the commission in terms of statutory rules; and to review performance measures.

FINDINGS

The Department of Economic and Community Development and the Department of Revenue have disregarded their statutory responsibility and exercised poor management and administrative oversight of the state's headquarters film incentive program

The Visual Content Act of 2006 gives the Department of Economic and Community Development the authority to administer film and television incentives. The department is partnered with the Film Commission to attract film producers to the state and increase film/television production among state film producers by offering a 17% reimbursement incentive for eligible expenses. The Department of Revenue developed an additional incentive program

that the Film Commission offered as part of its incentive package. The film incentive program through the Department of Revenue is to return up to 15% of a production company's approved in-state Spend provided the company has established, or partnered with an investor who has, a Tennessee headquarters facility. We observed misrepresentation of headquarters information; the disregard of obvious pass-through arrangements between out-of-state companies and in-state investors not in keeping with the spirit of the law; failure to identify inconsistent data between the Film Commission application forms and Department of Revenue letter rulings; and a general lack of due diligence in verifying the legitimacy of headquarters facilities in

accordance with the spirit of the law. Also, we found little or no support that the headquarters incentive has led to new permanent film producing facilities or new permanent and professional Tennessee jobs in the film industry (page 12).

The Tennessee Spend, which is eligible expenses used to calculate the 17% and 15% incentive payments, is likely to be significantly overstated for reasons including poor internal controls, insufficient policy, and lack of management accountability among the departments involved with its determination

Our audit revealed significant problems with the commission's incentive determination audit process for qualifying eligible expenses for the Tennessee Spend that was established by the previous Tennessee Film, Entertainment and Music Commission and Economic and Community Development administrations. We identified production company expenditures that should not have qualified for Tennessee Spend. Furthermore, auditors observed a serious misalignment of expectations between the Film Commission/Department of Economic and Community Development and the

Department of Revenue for the Film Commission Tennessee Spend results (page 22).

The former Tennessee Film, Entertainment and Music Commission executive director, after signing statements of understanding for the Department of Economic and Community Development's Conflicts of Interest Policy and Governor Bredesen's Executive Order #3, did not adequately disclose a personal connection to a law firm that appears to have been involved with at least three productions that received incentives

The audit revealed information suggesting the former executive director's husband worked for, or was in appearance, professionally involved with, a law firm involved with at least three film projects that received a Film Commission incentive. Auditors could not confirm that this information was properly disclosed prior to the decision to approve these films for the incentive. This represents a serious concern about the proper disclosure of conflicts of interest by Film Commission staff (page 29).

OBSERVATION AND COMMENT

The audit report also discusses measures of program effectiveness and the past reporting of Return on Investment (page 31).

ISSUE FOR LEGISLATIVE CONSIDERATION

The General Assembly may wish to consider reviewing state laws and policies in order to clarify and align them with program goals for current and future film production incentive programs.

Performance Audit

Tennessee Film, Entertainment and Music Commission

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Performance Audit Tennessee Film, Entertainment and Music Commission

INTRODUCTION

PURPOSE AND AUTHORITY FOR THE AUDIT

This performance audit of the Tennessee Film, Entertainment and Music Commission was conducted pursuant to the Tennessee Governmental Entity Review Law, *Tennessee Code Annotated*, Title 4, Chapter 29. Under Section 4-29-234, the Tennessee Film, Entertainment and Music Commission is scheduled to terminate June 30, 2013. The Comptroller of the Treasury is authorized under Section 4-29-111 to conduct a limited program review audit of the agency and to report to the Joint Government Operations Committee of the General Assembly. The audit is intended to aid the committee in determining whether the Tennessee Film, Entertainment and Music Commission should be continued, restructured, or terminated.

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to evaluate the effectiveness of the commission's film incentive program;
2. to evaluate the incentive award process;
3. to document the future agenda of the agency and any changes to be proposed by the new administration;
4. to observe the working of the commission in terms of statutory rules; and
5. to review the commission's performance measures.

SCOPE AND METHODOLOGY OF THE AUDIT

The activities of the Tennessee Film, Entertainment and Music Commission were reviewed for the period June 2006 to December 2011; fieldwork was performed from December 2011 to July 2012. 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. Methods used included

1. review of applicable legislation, policies, and procedures;
2. examination of the Film Commission and Department of Revenue files, film expense logs, biannual status reports, film expenses, receipts and payroll vouchers, and Economic and Community Development Grants and Loans Committee minutes;
3. review of prior performance audit reports, public hearing question and answer inventories, financial and compliance audit reports, and audit reports from other states; and
4. interviews with Film Commission staff, Department of Economic and Community Development staff, the Commission Chair, and Department of Revenue staff.

The Visual Content Act of 2006 (Section 4-3-4903, *Tennessee Code Annotated*) authorizes the Department of Economic and Community Development to promulgate rules and regulations as necessary to administer the “Tennessee Film/Television Incentive Fund.” Auditors gathered information from the commission and the department related to the Film/Television Fund. In 2006, the General Assembly amended the Franchise Tax Law (Section 67-4-2109[j], *Tennessee Code Annotated*) to allow the Department of Revenue to provide an additional incentive by issuing a “credit in an amount equal to fifteen percent (15%) of any qualified expenses” to any qualified production company that has established a headquarters facility as defined in § 67-6-224.” The auditors reviewed and gathered information related to this tax credit from the Department of Revenue.

HISTORY AND STATUTORY RESPONSIBILITIES

Section 4-3-5003, *Tennessee Code Annotated*, creates the Tennessee Film, Entertainment and Music Commission, which is statutorily responsible for

1. attracting and bringing to this state the production activities of film, television, record and other producers of entertainment properties;
2. developing increased production activities by those producers of entertainment properties already located in this state; and
3. coordinating the needs of the producers of entertainment properties with the needs of the citizens of this state and of the various departments of state and local governments.

The commission is created within the office of the Governor and is administered by an executive director, who is appointed by the Governor. Under Section 4-3-5003(a)(3), *Tennessee Code Annotated*, the commission is administratively attached to the Department of Economic and Community Development. The executive director may

1. request information from any branch, department, division, or other agency of the state that will enable the executive director to serve the commission
2. enter into agreements with any local government to use any production facilities of such local government for production activities
3. coordinate the use of production facilities within the control of any branch, department, or other state agency for production activities and grant permission for use of such facilities after the receipt of authorization from appropriate official(s)
4. issue permits to producers of entertainment properties in accordance with rules and regulations promulgated by the commission; and
5. employ necessary personnel to perform the duties of the commission.

According to Section 4-3-5004, *Tennessee Code Annotated*, the commission should be composed of nine Tennesseans who are experienced in and knowledgeable of the film, television, or music industries. The members are appointed by the Governor to assist and counsel the Governor on the film, television, and music industries. The law requires that one member be appointed from each of the film, television, and music segments of the industry and that membership reflect “the racial make-up of the state.” Commission members serve four-year terms and are to meet quarterly at minimum, but may meet as often as is necessary to accomplish their duties. Members receive no compensation for their services but can receive reimbursement for expenses incurred in attending meetings.

In addition, at least one member should be from each grand division. Members are to serve until a successor is appointed. If a vacancy occurs, it is to be filled by the Governor for the remainder of the unexpired term. The Governor designates one member to serve as chair for a one-year term, but the member may be appointed to serve an additional one-year term. No member is to serve for more than two consecutive terms. As of November 2012, all positions were filled, and membership appeared to meet statutory requirements. (See Appendix 1 for additional information on the commission members.)

The Governor can also appoint a film, entertainment, and music advisory council to advise the commission. Members are appointed for two-year terms, and the duties of the council are established by the commission. As of December 2012, there was only one member of the advisory council.

Based on state law creating the Film Commission and the Visual Content Act and interviews with staff of the Departments of Economic and Community Development and Revenue, the intent of the incentive programs is to encourage film companies to produce films within the state and to develop the in-state film industry, creating permanent film-making jobs and filling them with Tennessee residents.

ORGANIZATION

Administration

Commission administrative staff includes three positions: an executive director, a Director of Music and Business Development, and a project manager.

Film Incentive Program

The commission's major program is the 17% film incentive authorized by the Visual Content Act of 2006 (Section 4-3-4903, *Tennessee Code Annotated*). The incentive program, funded by the Film and Television Fund, is the primary inducement the agency uses to encourage in-state growth in the film and television industry. It provides to eligible production companies a 17% return on any qualified expenses (necessary production expenses for products or services of Tennessee residents or businesses, referred to as Tennessee Spend) that is necessary to produce a film or television program. The incentive is available to in-state and out-of-state production companies with the exception that out-of-state companies must establish a Tennessee Spend of \$500,000 dollars compared to only \$150,000 for in-state companies.

In 2006, the General Assembly appropriated \$10 million to the Film and Television Fund. This was followed by another \$10 million in 2007. In 2011, an additional \$2.5 million was appropriated.

Department of Revenue Incentive Program

A second incentive is provided to production companies through legislation enacted in the Franchise Tax Law. This incentive was first enacted by Public Acts, 2006, Chapter 1019, Section 8, as a 15% tax refund from franchise and excise tax collected by the Department of Revenue for any production company that establishes headquarters in Tennessee. Section 67-4-2109(j), *Tennessee Code Annotated*, as amended in 2012, reads,

(2) A credit in an amount equal to fifteen percent (15%) of any qualified expenses shall be allowed against the combined franchise and excise tax liability of any qualified production company that has established a headquarters facility as defined in § 67-6-224. If the qualified production company does not have a headquarters facility as defined in § 67-6-224, then any qualified investor shall be allowed a credit equal to the amount of credit to which the qualified production company would have been entitled had it established a headquarters facility as defined in § 67-6-224, multiplied by the qualified investor's percentage ownership interest in the qualified production company.

(5) Once the qualified production company has been notified of the approved credit, either the qualified production company or the qualified investment company, as appropriate, may submit a claim for the credit. To the extent that any amount allowed as a credit under this subsection (j) exceeds the current and outstanding combined franchise and excise tax liability of the claimant, the

amount of such excess shall be deemed an overpayment and shall be refunded to the claimant. For qualified expenses incurred and paid during any tax year, the commissioner is authorized to issue a refund as described in this subdivision (j)(5) prior to the expiration of such tax year if the amount of the approved credit exceeds the claimant's current and outstanding franchise and excise tax liability on the date of such refund. Any refund under this subsection (j) shall be subject to the procedures of § 67-1-1802; provided, however, notwithstanding any procedure of § 67-1-1802 to the contrary, that a claim for refund shall be filed with the commissioner within three (3) years from December 31 of the year in which the qualified expenses were incurred. In no case shall a refund for the same qualified expenses be allowed twice.

A production company can qualify for the 15% incentive by establishing a physical headquarters facility in the state or by partnering with a local investor headquartered in the state. The "Headquarters facility" should be more than an address without substance. The definition of "Headquarters Facility" stated in Section 67-6-224(b)(3), *Tennessee Code Annotated*, and referenced in 67-4-2109(j)(1)(B) is

a facility in this state that houses the international, national, or regional headquarters of a taxpayer, where headquarters staff employees are located and employed, and where the primary headquarters related functions and services are performed.

In addition to the headquarters requirement, state law also states that eligible companies will demonstrate a qualified Tennessee Spend of \$1 million dollars or more (Section 67-4-2109[j][1][C], *Tennessee Code Annotated*). The Department of Revenue primarily manages the 15% headquarters incentive; however, the Department of Economic and Community Development is also responsible for the determination of the qualified Tennessee Spend from which the 15% incentive is calculated.

According to Section 67-4-2109 [j][1], *Tennessee Code Annotated*,

(A) "Qualified expenses" means those expenses incurred in this state that are necessary for the production of a movie or episodic television program in this state; provided, however, that the expenses shall not qualify under this subdivision (j)(1)(A) unless both the commissioner of revenue and the commissioner of economic and community development determine, in their sole discretion, that the production and the allowance of the credit are in the best interests of this state. For purposes of this subdivision (j)(1)(A), "best interests of this state" means a determination by the commissioner of revenue and the commissioner of economic and community development that the production is a result of the credit provided in this subsection (j) and that the production is not found to be obscene as defined in § 39-17-901.

The Department of Economic and Community Development and the Film, Entertainment and Music Commission are the budgetary and statutorily identified agencies responsible for attracting the film industry to the state and managing the incentive funds to do so. Both the film incentive of 17% and the Department of Revenue’s headquarters incentive of 15% are advertised by the Film Commission to production companies as a packaged deal, providing a company the opportunity to recoup up to 32% of its Tennessee Spend. Because of this, it is our view that the Film Commission, the Department of Economic and Community Development, and the Department of Revenue share responsibility for the proper management and oversight of both programs.

As of June 2012, the Film Commission reported that since 2008, it has paid out \$9,100,127.64 in incentives to 27 film projects. The Department of Revenue, as of October 2012, reported 30 production companies have been approved for \$9,135,748.88 in incentives.

**Table 1
Program Incentives Paid**

Incentive Program	Appropriated Funds	Incentives Paid
17 % Tennessee Film, Entertainment and Music Commission Incentive	\$22,500,000* (as of June 2012)	\$9,100,127.64 (as of June 2012)
15% Department of Revenue Headquarters Incentive	N/A	\$9,135,748.88 (as of October 2012)

* Amount does not include any interest earned.

Process and Background of the Incentive Plans

The 17% film incentive and the 15% headquarters incentive are regarded as two independent and separate programs. Film Commission staff direct production company staff to contact the Department of Revenue if they wish to apply for the headquarters incentive in addition to the film incentive.

Applying for the Incentives

To participate in the film incentive program, the Tennessee Film, Entertainment and Music Commission directs each production company to call first the commission to discuss any proposed projects early in the pre-production phase. Film Commission staff inform production company personnel of Tennessee’s film incentive eligibility requirements, possible available funds, and the application process. Film Commission staff inform producers of information provided on the commission’s website, which includes guideline information for the incentives programs and a link to the Tennessee Production Directory that provides a listing of a local, statewide, industry-related workforce available for hire on the production.

Production company representatives then register the production with the Film Commission by filling out Form A, “Registration for Certification of Conditional Eligibility.” (See Appendix 2.)

The Film Commission asks that Form A be submitted at least three months before the start of “principal photography” and that the project be fully funded. The Department of Economic and Community Development Grants and Loans Committee reviews the Form A application and makes the decision to approve or not approve the project. If the project is approved, the commission issues a “Certificate of Conditional Eligibility” to the production company.

Before beginning film production, the production company staff meets with the Film Commission staff and, in some cases, the Department of Revenue audit staff. The Film Commission recommends that the production company’s head accountant, line producer, production supervisor, and the production company’s primary contact be included in this meeting. During this meeting, Film Commission agency staff, and if present, Department of Revenue audit staff, will review further processes and requirements necessary for the production company to follow to continue to participate in the program. Film Commission staff discuss a general time line for the production company to follow, including principle shooting, the submission of further forms after completion of principle shooting, the process for submitting expense reports for evaluation, and how the eligible Tennessee Spend is determined.

Submitting the Incentive Request

During production, the production company should have each Tennessee resident employed complete a “Declaration of Residency” form (Form B; see Appendix 2) and attach a copy of a current Tennessee driver’s license, issued prior to the project certification.

Once the production is final, the Film Commission requires each production company to compile a comprehensive record of the Tennessee expenditures that may be eligible for the incentives. The production company submits the records, in an Excel spreadsheet or Access database, to the Film Commission for review. The production company fills out Form C, “Incentive Application” (see Appendix 2) and submits this form with the expenditures spreadsheet. The Film Commission asks the production company to include in the spreadsheet all expenditures incurred in Tennessee paid to Tennessee vendors and residents during pre-production, production, and post-production.

Reviewing the Incentive Request

The Film Commission briefly reviews the expense ledger to ensure its completeness and then forwards the materials to the Department of Revenue Audit Support Unit. The production company must submit the final ledger and supporting documents to the Film Commission within 15 months from the issue date of the “Certificate of Conditional Eligibility.”

The Revenue Audit Support Unit pulls a stratified random sample of expenses from the total ledger expense report. The sample is then passed to the Department of Revenue Tax

Refund Unit auditor. The auditor requests from the production company all support documentation that may be used to verify the sampled expenses. The production company mails the invoices, employment payroll records, proofs of residency, checks issued, vendor names and addresses, receipts, and any other verifying information to support the submitted expenses for the sample to the Revenue auditor. The auditor reviews these materials and calculates the total eligible Tennessee Spend sample amount, then sends the sample total to the Audit Support Unit for further processing. The Audit Support Unit uses a specially developed formula to extrapolate from the sample total a final total Tennessee Spend that is representative of the larger, complete expense report. The Audit Support Unit staff then create a report showing the results and the final calculated incentive amount. The Revenue report is sent to the Tax Refund Unit auditor, who then forwards it to the production company. The Audit Support Unit sends a separate report to the Film Commission for the 17% film incentive, and the commission then forwards the report to the production company.

Revenue Audit

One Tax Refund auditor is assigned the task of reviewing the production company expenses. This task is in addition to the auditor's normally assigned duties. The Department of Revenue auditor reviews film expenses for films that are applying for the 17% film incentive or, that are applying for both the 17% and 15% incentives. The same sample is used when auditing for both incentive programs, however, the guidelines are different. Revenue management only reviews expenses for the 15% headquarters incentive; once the auditor finishes the 17% Film Commission review, the results are sent to the Audit Support Unit which determines the incentive payment and then sends the payment amount to the Film Commission.

Eligible Expenditure Guidelines

The Film Commission's 17% incentive provides some specific guidelines concerning eligible and non-eligible expenses; however, Revenue's requirements are much broader and only specifically require the expenses be \$1,000,000 or more and from a Tennessee company or resident.

A summary of the Film Commission's guidelines for eligible and non-eligible expenditures is as follows.

Eligible expenditures are:

- Tennessee services, equipment, and personnel
- Wages, salaries, fees, per diem, and fringe benefits for Tennessee cast and crew; residents must have a permanent Tennessee Driver's License
- Housing in-state and travel when purchased from a Tennessee vendor or travel agency, only travel to and from Tennessee is eligible not including chartered or private flights
- Expenses that are directly associated with the production of the film in Tennessee.

Significant non-eligible expenditures are:

- Payments/payroll for out-of-state cast and crew
- Any advertising, marketing, distribution, financing, and insurance costs/fees
- Internet purchases, alcohol and tobacco, and cell phone reimbursements
- Producer or production company markup fees, contingency fees, development fees, profit sharing, gifts, prizes, or in-kind goods and services
- Expenses originating in Tennessee for portions of production taking place outside of the state (i.e., travel, equipment rental, crew/talent hires, or post production for portions of projects filming outside Tennessee)
- Payments made to “pass thru” or conduit companies; only payments made to a bona fide Tennessee company or Tennessee residents, publicly engaged in that specific area of business are eligible
- Payments between multiple companies “having the same or similar owners, or for companies approved to receive the incentive, payments that are made to that company’s owner, partner or principal, and especially with a Sole Partnership or Single Member LLC. All transactions must be ‘arms-length’.”
- Payments made directly to the government (city, county, state, federal)
- Expenditures for Section 501(c), non-profit organizations.

In contrast to the details used to qualify for the 17% film incentive, the Department of Revenue only defines qualified expenses for the 15% headquarters incentive as those incurred in the state that both the Commissioner of Revenue and the Commissioner of Economic and Community Development, “in their sole discretion,” determine are necessary for the production of a film or TV show and are in the best interest of Tennessee.

Approving the Incentive Request

The Audit Support Unit generates a separate report for the 15% headquarters incentive and the 17% film incentive. The final extrapolation report for the 17% film incentive is e-mailed to Film Commission agency staff along with notes of disallowed expenditures. The Revenue Audit staff expect the Film Commission staff to review the audit work and verify the results. Film Commission staff inform the production company of the audit results for the 17% film incentive. The Revenue auditor e-mails the 15% headquarters incentive results to the production company directly after a Department of Revenue management review.

The Department of Revenue Requires a “Letter Ruling” for the Headquarters Incentive

To qualify for the headquarters incentive program, each film production company is required to apply for and receive a “letter ruling” from the Department of Revenue’s Special

Counsel that documents the location of the qualified headquarters and outlines detailed information as to the circumstance and/or relations between the parties involved in establishing the headquarters status. The production company submits a written request to the Department of Revenue that indicates how it wishes to qualify for the incentive (by stating the company has a physical headquarters facility established in-state or by means of an investor relationship with a company that has a physical headquarters facility established in-state) and pays a \$200 fee. The Revenue Special Counsel reviews the requests, and then, if the information provided meets the requirements, issues a letter ruling signed by the counsel and the commissioner of Revenue acknowledging the headquarters status of the proposed facility.

The Special Counsel does not verify addresses as part of the qualifying process but rather solely relies on the information provided by the company in the request letter and the assertions of the company. According to the Special Counsel, the letter ruling is written so that if the information provided by the production company is not true, the letter ruling is void and the production company is not eligible for the incentive. The letter ruling specifically states:

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling and a retroactive revocation of the ruling must inure to his detriment.

According to the Special Counsel, the production company does not have to identify a specific project at the time it is requesting headquarters status. When the company is ready to begin a project, however, it submits a budget to Revenue to be reviewed by the Special Counsel and the commissioner. After reviewing the project budget, the commissioner will send a "Determination Letter" to the production company that acknowledges the letter ruling and states that the projected expenses are eligible to qualify subject to the Department of Revenue expense audit.

History of Recent Incentives

Auditors learned through interviews with agency staff that in 2007, the former executive director of the Film Commission, the former commissioner of Economic and Community Development, the former commissioner of Revenue, and various other executive staff collaborated in an effort to get the film incentive program underway. It is our understanding that

as part of this collaboration, the former executive director of the Film Commission entrusted the qualifying of film expenses for the Tennessee Spend to the Department of Revenue. The justification for this was because the Department of Revenue employs audit staff and the commission does not and because the Department of Revenue would be qualifying film expenses for the 15% headquarters incentive. The Film Commission also believed having the Department of Revenue audit the film expenses would be beneficial because the process would serve as a generally accepted good business practice, providing a separation of duties for the agency. The Department of Economic and Community Development has authority to promulgate rules necessary for the administration of the Film and TV Incentive Fund. Commission staff provided information suggesting that the former executive director of the Film Commission created the guidelines for qualifying the Tennessee Spend in consultation with Economic and Community Development executive management.

The Department of Revenue Special Counsel believed that during the development of the 15% headquarters incentive administered by the Department of Revenue, the former commissioners of Economic and Community Development and the Department of Revenue collaborated to create the legislation along with other tax incentive legislation to attract the film industry to Tennessee. We were told that the former commissioner of Revenue was focused on bringing industries to the state and, using tax incentives was a way to do it. We were also informed by the Department of Revenue Special Counsel that Revenue management is aware of the ability of in-state investors to pass along incentive payments to out-of-state production companies through the investor relationship exception written into the legislation. The counsel speculated that this legislation was written with input by the film industry. Film industry representatives explained to the commissioners that movie-makers often create Limited Liability Companies (LLCs) for the purpose of making a film, and the companies are dissolved once the production of the film is complete. The film industry still wanted to be able to get the incentive, so the investor option was written into the law.

FINDINGS AND RECOMMENDATIONS

1. The Department of Economic and Community Development and the Department of Revenue have disregarded their statutory responsibility and exercised poor management and administrative oversight of the state's headquarters film incentive program

Finding

The Visual Content Act of 2006 gives the Department of Economic and Community Development the authority to administer film and television incentives. The department is partnered with the Film Commission to attract film producers to the state and increase film and television production among state film producers. The Department of Revenue developed an additional incentive program that the Film Commission offered as part of its incentive package. The Department of Economic and Community Development shares responsibility for the administration of the Revenue program or any other program that may use state funds to attract film and television production. The headquarters film incentive program through the Department of Revenue is to return up to 15% of a production company's approved in-state Spend provided the company has established, or partnered with an investor who has established, a Tennessee headquarters facility. We reviewed a sample of 16 film projects, 15 of which received an incentive between 2008 and 2011. One project was denied the incentive payment. For four of these projects, we found that the Department of Revenue sent incentive payments (totaling \$4,578,062) directly to out-of-state companies approved as having in-state headquarters. We questioned the headquarters statuses of 12 companies, resulting in possibly \$7,536,498.39 in inappropriate refund of tax revenue. We observed misrepresentation of headquarters information; the disregard of obvious pass-through arrangements between out-of-state companies and in-state investors not in keeping with the spirit of the law; failure to identify inconsistent data between the Film Commission application forms and Department of Revenue letter rulings; and a general lack of due diligence in verifying the legitimacy of headquarters facilities in accordance with the spirit of the law. Also, we found little to no support that the headquarters incentive has led to new permanent film-producing facilities or new permanent and professional film-producing Tennessee jobs.

In discussing the Department of Revenue's approval of the headquarters incentive with the Special Counsel to the Commissioner of Revenue, the following general assumptions were mentioned as being relevant when determining headquarters statuses.

- If a company is applying for headquarters status as the production company, then it must be the production company, producing the film for which the credit is given.

- If a company is applying for headquarters status as an investor, the company should be independent from the out-of-state production company producing the film and the payment should go to the investor.
- The intent of the program is to entice film production companies to establish permanent headquarters within the state and to perform the bulk of their production work here employing Tennessee citizens.

Our audit found that these assumptions were not always observed.

Audit Observations and Determinations

To verify headquarters locations, the auditors reviewed e-mail correspondence and production expense files; used a variety of resources, including the Secretary of State's business filing system, to identify the primary locations of the production companies in question; and, in some instances, the auditors conducted site visits to verify the headquarters locations. We determined many of the locations to be questionable in meeting the program requirements for reasons such as:

- being unclear that the qualified production company was the actual producer of the film;
- having inconsistent addresses, including in-state and out-of-state addresses for the production company;
- having a questionable investor relationship with an out-of-state company;
- having a superficial location (i.e., not a facility where staff would perform movie production duties); and
- not having a permanent headquarters location at the time of the letter ruling (the production company said it would be moving to Tennessee).

In direct violation of the payment requirements for the headquarters incentive, Revenue made payments directly to out-of-state company addresses. Under Section 67-4-2109(j), *Tennessee Code Annotated*, incentives are to go to a Tennessee headquartered company or a Tennessee investor.

Table 2
Incentive Payments to Addresses Other than the Eligible Headquarters Address

Production	State Payment Sent To	In-State Qualifying Relationship	Amount
A	California	Headquarters	\$455,582*
B	California	Headquarters	\$2,083,300*
C	California	Investor	\$1,888,743*
D	California	Investor	\$150,438
Total:			\$4,578,062

* Represents multiple payments

Department of Revenue staff do not verify headquarters locations prior to issuing the letter ruling or paying the incentives; the department relies on the word of the production company. We found the following issues.

- Production company had not yet located to the state. In three instances, letter rulings were issued to production companies that did not yet have physical facilities in the state but were promising to do so. This is in direct violation of statute, which describes a qualified production company as having “established a headquarters facility as defined in Section 67-6-224” (Section 67-4-2109(j)(2), *Tennessee Code Annotated*).
- Location of headquarters facility in Tennessee questionable. Ten facility locations were questionable. Six of the participating production companies are no longer at the locations used to receive the headquarters incentives, and we could not verify they were ever in these locations. For four other companies, we could not determine whether the companies were still at their headquarters location or whether they had ever been there.
- Headquarters status questioned, but incentive still paid. The auditors observed through a review of e-mails between Film Commission and Revenue staff that in three cases, despite questions raised by the Revenue Special Counsel about the legitimacy of headquarters statuses, Revenue staff still made the incentive payments. For example, in one case, the Department of Revenue’s determination letter had been returned because the Tennessee headquarters address was no longer valid. The Department of Revenue Special Counsel spoke with the representative of the

production office and confirmed that the office had moved back to California after the completion of the production. Even so, the incentive payment was sent to California. In another situation, the Special Counsel questioned a headquarters location that appeared to be superficial (see next item). Payment was still made even though a clear resolution to the question was not apparent. In the third situation, the auditors found e-mails questioning the relationship between an out-of-state production company (not the qualified headquarters company) and a production. Payment for this production was made, not to the qualified headquarters company but to the questioned out-of-state company. This payment appears to be against policy.

- Superficial headquarters location. A production company rented temporary office space from a local company that specializes in temporary and virtual office housing. When the auditor visited the location to verify the production company headquarters, the receptionist confirmed that the company in question did lease office space from them; however, to her knowledge, the office is mainly used to collect and forward mail. According to the receptionist, no one from the production company was there at the time or had maintained a major presence here in Tennessee. According to the company's headquarters request letter, the location housed their national headquarters and is where the company's headquarters-staff employees are located performing the company's primary functions. These functions were reported to include financing, scheduling, and coordinating all aspects of film production, theatrical/DVD distribution, packaging, and marketing. Auditors did find e-mail correspondence that shows questions were raised by the Revenue Special Counsel; nevertheless, payment was still made.
- Actual producer was out of state. In another case, the incentive was sent directly to a separate California-based production company at the direction of the documented headquartered producer. Auditors determined later, through examination of the Film Commission's application Form C, through the Internet Movie Database (IMDb.COM), and the examination of the incentive payment address, that the out-of-state company produced the film. This same headquartered company was later denied status on another film project because Revenue determined it was not the actual producer of the film. The Special Counsel again granted headquarters status to this same company for another project that used a modified, but similar, name. The Special Counsel granted status despite the production company having the same address as the previously disqualified company.
- Tennessee investor company was owned by the out-of-state production company. A Tennessee investor company, approved to be a legitimate headquarters company qualified to receive the incentive based on its investment in a production, was in fact owned by the out-of-state company producing the film. Furthermore, shortly after the production of the film, the investor company was closed by the out-of-state production company and is no longer in business in Tennessee.

- Tennessee investor was a pass-through to the out-of-state company. In another case, the auditors observed a letter ruling showing the nature of the relationship between an out-of-state production company and an in-state investor. The out-of-state company and the in-state investor created an LLC in which the in-state investor owned 99% of the interest. Although the out-of-state company only invested 1%, it controlled all financial and creative decisions of the production and owned all rights, titles, interests, and distribution rights. The investor received no controlling interest in the production or rights of ownership; however, the investor served as the headquarters facility for purposes of receiving the 15% incentive. We further observed e-mail correspondence from the out-of-state production company to the Department of Revenue deputy commissioner, outlining its intention: the in-state company would pass along the incentive payment to the out-of-state company once receiving it. (See Exhibit A.)
- Company did not move to Tennessee. A production company stated on its headquarters request letter that it would be moving its production facilities to Tennessee and would be conducting additional production work in the state. Our review revealed that only the accountant of the production team had moved to Tennessee and that since completion of the Tennessee-produced film, the company has made 10 other films, all in other states. The production company still shows its headquarters to be out of state on its webpage.
- Residential homes and apartments approved as headquarters facilities. The auditors observed that the Department of Revenue allowed five residential homes and one apartment to qualify as production company headquarters; two of these production companies promised in their requests for a letter ruling that they would be moving their company to Tennessee but did not have a permanent location at the time. One of the residential homes qualified is not even owned by the producer according to property assessment records.
- Production companies later dissolved. A review of the Secretary of State's Business Listings reveals that 8 of the 15 approved production companies with headquarters are dissolved or have been dissolved since completion of their corresponding project. Three have principal addresses in California.
- Production company with multiple productions. Only one qualified headquartered production company was approved for more than one film project.

Differences in information given to the Film Commission and the Department of Revenue. The auditors observed a lack of information-sharing between the agencies that could have been useful for verifying headquarters information. When applying for program participation, film companies submit pre-production and later post-production application forms to the Film Commission in which they indicate whether or not the company is planning on participating in one or both incentive programs. The forms ask

Exhibit A

The names and addresses have been redacted to protect confidential information. Boxes have been inserted by the Comptroller Auditor to provide clarifying information.

██████████

From: ██████████ [Revenue Deputy Commissioner]

Sent: Thursday, July 22, 2010 11:20 AM

To: ██████████ [Executive, Business Affairs, Out of State Production Company]

Cc: ██████████

Subject: Re: ██████████ -Tennessee tax incentives

Mr. ██████████,

I have reviewed your email and the statements made are correct, except for the fact that 99% of the incentive will go to the headquarters company not the production company. In this scenario, the headquarter's company is know as the "qualified investor."

Also, as we discussed, please keep in mind that the incentive is generated in the form of a credit rather than a refund. As such, the credit must first be applied to any franchise, excise tax liability that the entity i.e. the headquarters facility claiming the credit has, if any. Then the remaining credit may then be refunded to the qualified investor that has an approved headquarters facility.

Finally, please make sure that you submit a complete budget for the production to me as soon as possible and get a qualified expense determination letter which will be signed by the Commissioner. Many times this step in not done on the front end and sometimes delays the credit/refund approval.

I trust this is what you needed in terms of a response. We certainly hope that you will decide to shoot ██████████ in Tennessee. If have additional questions, please do not hesitate to contact me.

██████████
 Deputy Commissioner
 Tennessee Department of Revenue
 Phone: (615) ██████████
 Fax: (615) ██████████
 Email: ██████████@tn.gov

>>> ██████████ <██████████> 7/21/2010 7:10 PM >>> [From: Business Affairs, Out of State Production Company]

Dear ██████████: [To: Revenue Deputy Commissioner]

It was a please to speak with you earlier today. Further to our conversation, we are drafting a request for a letter ruling from the Tennessee Department of Revenue, which we will forward to you shortly.

In the meantime, we would like confirmation that the scenario described below would qualify for Tennessee tax incentives as described:

- 1) ██████████, a wholly-owned subsidiary of ██████████, will form a subsidiary company ██████████, which will then enter into an agreement with a Tennessee Headquarter Company and form a single purpose production company ("Tennessee Production Company") for the purposes of producing the pilot/series currently entitled "██████████" in Tennessee. [An out-of-state production company]
- 2) The Tennessee Production Company will be owned 99% by the

Tennessee Headquarter Company and 1% owned by the [redacted] Subsidiary Company. <

[Owned by an out-of-state production company]

3) The Tennessee Production Company will apply for and receive the 15% Tennessee Department of Revenue ("DOR") incentive.

4) The Tennessee Production Company will be signatory to all the related and necessary labor guilds.

5) The [redacted] Subsidiary Company will control all financial and creative decisions related to the production of the pilot and series.

6) Although the 15% DOR Headquarters Incentive would be paid to the Tennessee Production Company, the agreement between the [redacted] Subsidiary Company and the Tennessee Headquarter Company would provide for the Tennessee Production Company to pass all of these funds on to the [redacted] Subsidiary Company. We understand that the Tennessee Production Company would qualify for only 99% of the rebate as a result of the ownership structure of the Tennessee Production Company.

[The out-of-state production company]

7) [redacted] will own all right, title and interest--including copyright-in and to the pilot and series. [redacted] will control all distribution rights to the pilot and series.

[The out-of-state production company]

8) [redacted] will apply for the separate 17% out of state, nonresidential production company incentive under its own FEIN and receive it separately in addition to the DOR incentive received from Tennessee Production Company.

9) Any out-of-state personnel deemed qualified for the 17% rebate also will be considered qualified for the 15% DOR incentive.

Sincerely,

[redacted signature]

[Executive, Business Affairs, Out of State Production Company]

[redacted] Business Affairs | [redacted] | [redacted]
[redacted], Los Angeles, California [redacted] |
310-[redacted] | [redacted] |
<mailto:310-[redacted] | [redacted] >

the applying film company to disclose the producer of the film, name and address, and the name and address of the production company headquarters. The auditors found eight instances in which this information differed from the information provided to Revenue for the headquarters letter ruling. This information could have raised questions about the legitimacy of some headquarters claims. The auditors were told by the Revenue Special Counsel that such information was not reviewed, that film companies are taken at their word.

The Department of Revenue views its incentive program as separate and independent from the Film Commission's program. Revenue assumes the Film Commission has its own information gathering processes to verify eligible expenses for the Film Commission incentive. The two agencies do not have a formal agreement that provides a protocol to share gathered, verifying information.

Conclusion

The headquarters incentive law is poorly written and allows production companies to circumvent the intent of the law. The provision that allows out-of-state production companies to partner with any in-state investor lacks detail to ensure that the incentive money is benefiting a bona fide Tennessee company and not merely being a means for the incentive to pass through to an out-of-state company. The Revenue Special Counsel mentioned in an interview that the law does not say what the local investor is to do with the incentive once it is received from Revenue, and many times, the local investor, through partnership or additional side contract, simply passes the incentive to the out-of-state producer after receiving the incentive. The Special Counsel believed the reason the investor clause was added was because during the drafting of the law, film representatives complained that a lot of times a production company is established to produce a movie and a Limited Liability Company (LLC) is created for the production of the film. The LLC will only produce that one film and then is dissolved after the production. The industry representatives still wanted the headquarters credit without having to maintain a permanent headquarters location so an alternative method was put into the law. If a production company does not have a headquarters here in Tennessee, it can still get the credit through an investor relationship.

Another problem with qualifying a production company for the incentive is that not all production companies are the actual filmmaking entities. A production company may be established by a single person and may be only one of many producers working for a larger film-making company. For example, according to the crew list of four of the production companies we reviewed, the headquartered producer was only one of four producers. The others listed included two executive producers and a producer/director. One of the listed executive producers is tied to another film we reviewed that has a questionable headquarters ruling. Production companies in today's film-making process are not necessarily permanent by design, and more often than not, the production company is a created LLC, or similar venture, created by a larger film-producing entity, specifically set up to manage a single film project. These LLCs are often funded by larger studios, which are the actual makers and owners of the film and are the entities most interested in the incentive programs, but which are headquartered in states other than

Tennessee. The provision in the headquarters film incentive allows film companies to access the incentive without having to invest in a Tennessee headquarters.

In addition, we could not identify a specific reason why the Film Commission and the Department of Revenue have two different policies for qualifying the Tennessee Spend in their respective incentive programs. The Department of Revenue's broader definition appears to be for the purpose of allowing items to qualify that would not qualify under the Film Commission/Economic and Community Development guidelines. We found in recorded meeting minutes of a conversation between the former deputy commissioner of Revenue and movie industry representatives that "we (Revenue) can be more flexible" and that "all of our information is confidential."

The Department of Revenue's film production headquarters incentive—unlike the broader headquarters incentive for other types of companies in Section 67-6-224, *Tennessee Code Annotated*, from which the definition of a qualifying headquarters facility is referenced—does not require any department to ensure a production company that claims to have established a permanent production facility in Tennessee is, in fact, a permanent filmmaking facility dedicated to making films in the state. The incentive does not require a company to establish permanent staff positions, or even to establish a commitment to operate in Tennessee for a period of time after receiving the incentive. Many of the approved production companies may only have one employee and, in one observed case, may only be renting an apartment or home. Once the film project is complete, the LLC may or may not be dissolved; however, the larger out-of-state entertainment company receives the incentive.

The Assistant Commissioner for Strategy in the Department of Economic and Community Development informed us of the intent to eliminate Revenue's headquarters incentive and limit the incentives to the Film Incentive Fund. By doing this, Economic and Community Development believes it will be able to improve the state's return on investment, promote transparency that is not possible under the current Revenue legislation, and improve processing efficiency of the film incentives program overall. The assistant commissioner also stated that the Department of Economic and Community Development will undertake direct supervision of the Film Commission. This would allow the commission to work closely with Economic and Community Development's Business Development staff in future entertainment industry recruitment efforts. The General Assembly passed legislation in 2012 that establishes a new 25% incentive for the total expenses incurred by a production company for a project. The legislation also eliminates the 15% headquarters film incentive for projects started after July 1, 2012. Films approved prior to July 1, 2012, are still eligible for the 15% and 17% incentives.

Recommendation

The 15% headquarters incentive program is poorly written with few controls. Further investigation may be warranted to determine more definitively if funds were improperly awarded and whether or not such funds should be recovered. The Film Commission, the Department of Economic and Community Development, and the Department of Revenue need to evaluate questionable headquarters incentives to determine whether or not funds should be recovered.

Also, we encourage the Film Commission, the Department of Economic and Community Development, and the Department of Revenue to review incentive payments not included in our sample to determine if there are additional inappropriate payments.

In carrying out the new 25% incentive program, the Film Commission should establish guidelines and controls for qualifying for the incentive and approving incentive payments. As the program continues, the commission should review the guidelines for adequacy.

Management's Comments

Joint response by the Film, Entertainment and Music Commission and the Department of Economic and Community Development:

We concur. The department's 2011 top-to-bottom review included a detailed examination of the Tennessee Film, Entertainment and Music Commission and this review concluded that the most flawed aspect of the state's film incentive program was the 15% headquarters film refundable tax credit. In addition to the concerns described in this sunset audit, the Department identified the following significant deficiencies with this tax credit:

- *Complexity* – Filmmakers interviewed by the department almost unanimously reported that the state's program was confusing and cumbersome because applicants were forced to deal with two different sources of incentives rather than a "one-stop shop." Out of the 39 states with film incentive programs, Tennessee was one of two with a two-pronged program that offered incentives in the form of both grants and refundable tax credits.
- *Lack of Transparency* – Refundable credits, such as the film tax credit, are an undesirable incentive vehicle because spending under these credits is protected by taxpayer confidentiality laws. The department prefers incentive programs that permit the full disclosure of all awards.
- *Return on Investment* – The 32% rebate on Tennessee expenses available to production companies due to the film tax credit equated to more than \$100,000 per new full-time equivalent position, which is almost thirty times the average return on investment on a per job basis the department provides under its Fastrack program.
- *Other Weaknesses* – Refundable tax credits are poor public policy because they are not subject to the budget process due to the fact that payments under these credits are not sourced from funds appropriated by the General Assembly. Other weaknesses in the film tax credit were that it had no agreed upon procedures, spending cap or expiration date.

As a result of the deficiencies highlighted above, the department worked with the Department of Revenue and the General Assembly to repeal the 15% headquarters film

refundable tax credit during the 2012 legislative session. The repeal of this credit and related reforms to the statutes that govern the film incentive program (i) greatly simplified the program by making the department the only state agency involved in delivering film incentives; (ii) introduced transparency and accountability to the incentive process by eliminating the film tax credit as an incentive tool; and (iii) improved the state's return on investment on film incentives by setting the maximum award at 25% of Tennessee expenses. These reforms took effect on July 1, 2012.

Department of Revenue:

We concur. The audit by the Office of the Comptroller has correctly identified weaknesses in the incentive statutes and their administration. The Department agrees that the headquarters incentive lacked sufficient detail, rules, and safeguards to prevent production companies from circumventing the intent and spirit of the law. The law did not require companies to stay a certain length of time or employ a particular number of people, did not include a "clawback" provision that would allow the state to recapture any credits taken by companies that failed to maintain a permanent headquarters in Tennessee following the completion of a project, and did not restrict companies from forming a subsidiary LLC headquartered in Tennessee for the production of a particular project. Because of these deficiencies, the Department of Revenue worked with the Department of Economic and Community Development and the General Assembly to repeal the 15% headquarters film refundable tax credit during the 2012 legislative session.

-
- 2. The Tennessee Spend, which is used to calculate the 17% and 15% incentive payments, is likely to be significantly overstated for reasons including poor internal controls, insufficient policy, and lack of management accountability among the departments involved with its determination**

Finding

Our audit revealed significant problems with the commission's incentive determination audit process for qualifying eligible Tennessee Spend that was established by the previous Tennessee Film, Entertainment and Music Commission and Economic and Community Development administrations. The auditors reviewed the expense audit samples for nine film projects beginning July 2007 through fiscal year 2011. Of the nine projects, seven were participants of both incentive programs and two were only involved with the Film Commission's 17% program. The seven projects receiving both incentives were chosen because they received the greater proportion of the incentives as of January 2012. One 17%-only project was selected because it was a company that matched a company in a previously selected project, and the other was selected at random. The review included 11,418 sampled expense records equal to \$20.6 million in film expenses. Of these expenses, the Department of Revenue audit approved 9,436 items equal to approximately \$19 million (93% of total submitted film expenses) in eligible expenses for the Revenue 15% headquarters incentive and 10,189 items equal to approximately

\$18.9 million (92% of total submitted film expenses) in eligible expenses for the 17% Film Commission incentive.

We identified approximately \$12,621,386 that we believe should not have qualified for the Film Commission 17% incentive Tennessee Spend and approximately \$12,509,876 that we believe should not have qualified for the Revenue 15% headquarters incentive Tennessee Spend (see table 3).

These items include expenses that we question after reviewing policy and the support documentation as to their eligibility to qualify as Tennessee Spend; missing documents including items on the expense reports for which we could not find corresponding support documentation; and approved labor and vendor expense items for which we could not find driver’s license documentation. Furthermore, auditors observed a serious misalignment of expectations between the Film Commission/Department of Economic and Community Development and the Department of Revenue for the Film Commission Tennessee Spend results.

Table 3
Summary of Questioned Items and Amounts Reviewed During the Audit

	Approved for 17% Incentive	Approved for 15% Incentive
	Amount	Amount
Total Questioned Expenses	\$4,339,443	\$4,124,958
Total Missing Documents	\$6,294,838	\$6,371,677
Total Missing Driver’s License	\$1,987,105	\$2,013,241
Total Overall Unqualified	\$12,621,386	\$12,509,876

We identified expenditure items that appeared to be questionable in terms of meeting policy guidelines (i.e., questionable expenses). Of these items, we estimate the Revenue film audit staff approved 1,383 expenditures equal to approximately \$4,981,980 for the Film Commission’s 17% incentives spend and 1,338 expenditures equal to approximately \$4,975,231 for Revenue’s 15% incentives spend (see Table 4). The audit revealed problems with verifying state residency for employees and vendors; the allowance of related-party transactions; the use of conduit companies to have out-of-state expenses qualify as in-state; an inability to trace support documentation to expenses; the allowance of items deemed to be non-eligible by policy; the over-allowance of commission-approved out-of-state payroll exceptions; the allowance of out-of-state vendor payroll handling fees; and the allowance of the full retail price of a truck for a film that had a 31-day production time.

During our review, we observed a lack of support for expenditure items (i.e., missing documents). The Revenue film audit staff approved approximately \$6,294,838 for the 17% Incentive spend and approximately \$6,371,677 for the 15% Incentive spend.

The audit also identified payroll expenditures that did not have copies of required driver’s licenses. As with vendors that provide personal services, payroll expenditures for labor,

extras, main actors, and executives also must meet the Tennessee resident criteria. A clear and legible photocopy of a resident’s driver’s license must be on file for his or her pay to qualify as Tennessee Spend. The Revenue film audit staff approved approximately \$1,987,105 for the 17% incentive’s spend and approximately \$2,013,241 for the 15% incentive’s spend that we could not verify were for state resident employees through identifiable documentation of required driver’s licenses.

[Auditor’s Note: Because we believe it is in the best interest of the state that questionable expenses should not qualify for an incentive, we applied the requirements of the 17% Film Commission incentive to each incentive program. To support this decision, we refer to Section 67-4-2109(j)(1)(A), *Tennessee Code Annotated*, which specifically states expenses are to meet the approval of both the Commissioner of Economic and Community Development and the Commissioner of Revenue and be in the best interest of the state. If we discovered in our review that a particular expense would not be in the best interest of the state to qualify, based on either policy, we marked it as being questionable as one that should not have been allowed. In addition, we acknowledge that state statute only specifically identifies the Film Commission and Economic and Community Development as being responsible for the administration of film incentives; therefore, we believe the rules and policies they establish for qualifying Tennessee Spend take precedent.]

Table 4
Questioned Expenses Processed as Eligible Tennessee Spend

	Approved for 17% Incentive		Approved for 15% Incentive	
	Items	Amount	Items	Amount
A – Items Without Proof of Tennessee Residency	462	\$2,326,838	462	\$2,328,779
B – Related-Party Transactions – Not at “Arm’s Length”	132	\$1,263,605	132	\$1,264,865
C – Pass-Through/Conduit Companies (1)	91	\$920,001	91	\$920,001
D – Non-Traceable Items	465	\$192,589	465	\$193,341

	Approved for 17% Incentive		Approved for 15% Incentive	
	Items	Amount	Items	Amount
E – Significant Non-Eligible Items	75	\$147,803	70	\$120,951
F – Over-Allowance For Out-Of-State Exceptions	2	\$38,189	3	\$54,639
G – Handling Fees	155	\$43,546	114	\$43,245
H – Truck	1	\$49,411	1	49,411
Total	1,383	\$4,981,980	1,338	\$4,975,231

(1) We observed 38 more instances (an additional \$189,594) of these conduit companies on various production expense reports; however, we could not verify these due to missing support documentation.

(2) Some questioned expenses are counted in more than one category because the expense was questioned for more than one reason.

A – Items Without Proof of Tennessee Residency: According to incentive requirements, “Tennessee residents MUST meet Tennessee resident criteria (must have a permanent Tennessee Driver’s License issued prior to the date the project is certified).” This includes individual vendors who perform personal services or labor. We noted payments made to vendors who provided personal services or labor without documented residency information. We also observed payments made for non-Tennessee companies and employees with out-of-state driver’s licenses to qualify as eligible expenses.

B – Related-Party Transactions – Not at “Arm’s Length”: Film Commission policy prohibits payments exchanged between multiple companies having the same or similar owners; policy also prohibits payments that are made to that company owner, partner, or principal, and especially with a Sole Partnership or Single Member LLC. All transactions must be at “arm’s length.” However, we observed expenditures between companies with the same or similar owners that should have been researched further and possibly disallowed.

C – Pass-Through/Conduit Companies: According to the Film Commission policies, “only payments made to a bona fide Tennessee company or Tennessee residents, publicly engaged in that specific area of business, are eligible.” Furthermore, the Department of Revenue, in defining a conduit company in its incentive policy, states that a company is a sham company that has little or no substance, expertise, or business purpose other than to receive fees from the production company and contract with out-of-state companies in a scheme that attempts to enable the qualified production company to secure the services of the out-of-state company and still qualify. Auditors observed various examples of production company purchases from a local company which purchased production-related items from an out-of-state company in order to

have the out-of-state purchases qualify as in-state spend. The local companies appear to be of little or no substance and serve as a means to qualify expenses that if made directly, would be out-of-state and unqualifiable. In one instance, we discovered a local Tennessee company that rented office space to an out-of-state company on a temporary basis so the out-of-state business could work with a production company during a production to have the expenses qualify as in-state.

D – Non-traceable Items: Item amounts could not be matched from the log to the invoices or to payroll vouchers supplied by the production company. For example, an expense listed in the log could not be found on the provided invoice for the item. These items also include payroll expenses that could not be matched to a corresponding payroll invoice. Because they did not match the provided invoices, these items could not be verified or traced. Auditors found no other explanations for the approval of these expenses.

E – Significant Non-eligible Items: Various items should not have been allowed including fees, fines, expenditures made to nonprofit organizations, alcohol purchases, cell phone reimbursements, and refundable deposits. Also, the documentation for some items was illegible, there were duplicate payments, and one camera rental appeared to far exceed the original amount.

F – OverAllowance for Out-of-State Exceptions: These expenses are for out-of-state payrolls that, through department-approved exceptions, were allowed to qualify as eligible in-state spend. We found that Department of Revenue audit staff did not test to see if the exception amounts were exceeded. Our audit revealed three instances in which approved exception amounts were surpassed and allowed to qualify as eligible spend.

G – Handling Fees: These items are fees charged by payroll companies to process payroll. We found handling fees charged by out-of-state payroll companies were approved as eligible spend.

H – Truck: The Department of Revenue film audit staff qualified the full retail purchase price of a truck totaling \$49,411 for both incentive programs. While policy does not prohibit this transaction, we question the qualifying of this expenditure. Supporting documentation shows the vehicle was purchased in Tennessee and used in the production; however, it is being retained by the production company. If the truck is kept and used as a company vehicle, the full amount should not qualify for an incentive. This has been an issue with other state film programs. The useful life of the item is significantly longer than the 31-day filming of the movie. The production company kept the truck saying the company planned to use it in a follow-up production, but there is no guarantee this will be the case.

As part of the audit process, we compared the Tennessee Spend approved by the Department of Revenue to the Spend amount we found support for (i.e., met program requirements and had proper documentation) to have some perspective on the differences. The table below shows the different spend amounts per production.

Table 5
Summary of Verified Tennessee Spend Sample Amounts

Production Submission Number¹	DOR Film Audit 15%	Comptroller Audit 15%	Difference	DOR Film Audit 17%	Comptroller Audit 17%	Difference
A	\$1,255,914	\$399,383	\$856,532	\$1,255,914	\$399,383	\$856,532
B.1 ²	\$1,104,031	--	\$1,104,031	\$1,087,031	--	\$1,087,031
B.2 ²	\$882,100	--	\$882,100	\$878,559	--	\$878,559
B.3 ⁴	\$598,310	\$584,414	\$13,896	--	--	
C.1	\$2,348,088	\$993,624	\$1,354,463	\$2,346,828	\$993,624	\$1,353,203 ⁵
C.2	\$367,236	\$35,216	\$332,020	\$367,236	\$35,216	\$332,020 ⁵
C.3 ²	\$236,884	\$81	\$236,803	\$236,478	\$81	\$236,397 ⁵
C.4	\$1,732,258	\$534,882	\$1,197,376	\$1,727,258	\$529,882	\$1,197,376 ⁵
C.5 ²	\$3,890,416	--	\$3,890,416	\$3,855,768	--	\$3,855,768
C.6 ⁷	\$312,425	--	\$312,425	\$290,777	--	\$290,777
D	\$2,887,114	\$1,781,623	\$1,105,491	\$2,886,863	\$1,780,061	\$1,106,802
E	\$1,670,998	\$1,187,689	\$534,285 ⁶	\$1,638,236	\$1,155,679	\$520,320 ⁶
F.1	\$132,359	\$116,532	\$15,827	\$132,227	\$116,400	\$15,827
F.2	\$695,416	\$644,359	\$51,483 ⁶	\$674,934	\$623,877	\$51,483 ⁶
G.1	\$1,611,235	\$1,014,765	\$599,708 ⁶	\$1,538,412	\$976,047	\$562,365
G.2	\$65,781	\$42,760	\$23,021	\$64,922	\$41,903	\$23,019
H ³	--	--	--	\$266,078	\$12,877	\$253,202
I ³	--	--	--	\$414,654	\$413,948	\$706
		Total	\$12,509,876			\$12,621,386

¹ The letter is the production while the number shows when a production company had more than one report.

² Documentation such as invoices and receipts is missing to support these submissions.

³ These productions participated only in the 17% Film Commission incentive.

⁴ These expenses qualified only for the 15% headquarters incentive.

⁵ These expenses did not result in a 17% Film Commission incentive; the applicant did not follow film commission guidelines when applying for the incentive.

⁶ The difference will not compute from the values provided in the table; DOR allowed payroll expenses to exceed agreed-to limits. This overpayment was added as a questioned cost in Table 3 but was not shown as a questioned cost in the DOR Expense Log reviews. To balance the two tables, the amount overpaid in payroll exceptions was added to the difference to properly reflect the audit's Questioned Costs.

⁷ Items on C.6 were also found on C.5; this had duplicate items.

Concerns With Program Management and Accountability

As previously mentioned, during the development of the Film Commission incentive program, we understand that Department of Revenue management agreed to audit the film expenses for the Film Commission's 17% program. This is because Revenue has the resources to perform the work and because Revenue was already reviewing the film expenses to qualify the Tennessee Spend for the headquarters incentive. However, neither the Film Commission, Economic and Community Development, nor the Department of Revenue provided us evidence of a written agreement. Without an agreement, there is no reviewable documentation detailing the agreed-to roles, responsibilities, and expectations. This has resulted in differing points of view on who is accountable for the determined spend and two different policies defining eligible and non-eligible spend.

According to current Film Commission staff, Revenue management agreed to audit and be accountable for qualifying Tennessee Spend for both incentive programs. The executive director stated that the Film Commission does not have the staff qualified to audit expenses and that it relies on Revenue's expertise. The Department of Revenue supervisory and management staff have repeatedly reported throughout the audit that they believe they are only responsible for qualifying film expenses related to the Revenue 15% headquarters incentive. Although they are performing the audit for the 17% incentive, they have reported to us that the 17% film expenses are not their responsibility and that "the Film Commission should answer for their incentive costs." Again, auditors were not provided with any written agreement assigning responsibilities.

We view this lack of accountability as actions that are not in the best interest of the state and as a significant concern that undermines the integrity of the qualified Spend.

We acknowledge that the current Economic and Community Development executive administrative staff have identified this concern and have reported that the department is in the process of redeveloping the incentives program. According to Economic and Community Development, the department is considering moving the audit function performed by Revenue to an outside, independent service provider or adding a position to the Film Commission staff in order to hire an auditor experienced with film production accounting.

Recommendation

For any future incentive program, or the continuance of this program, the Film, Entertainment and Music Commission and/or the General Assembly should consider reviewing state laws and policies in order to clarify and align them with program goals. We also recommend that any future auditing of qualifying spend include consistent, well-defined policy and involve proper due diligence to ensure the Tennessee Spend is legitimate.

Management's Comments

Joint response by the Film, Entertainment and Music Commission and the Department of Economic and Community Development:

We concur. In connection with the repeal of the film tax credit described in the Management's Comment section above, the responsibility for auditing productions shifted from the Department of Revenue to third party CPAs hired by production companies. This new audit structure, which reflects best practice in film incentive programs around the country, decreases the risk of errors such as those described in this sunset audit. The film incentive program has been temporarily suspended and the department is currently working with a third party CPA firm with extensive experience in both the entertainment industry and state film incentive programs to establish agreed upon procedures that the CPAs hired by production companies will follow for future projects.

In addition, in early 2012, when the department learned that preliminary findings from this sunset audit revealed that expenses may have been overstated, the three pending awards that had not yet been paid out to companies under the 17% portion of the incentive program administered by the department were frozen and a third party CPA firm was retained to perform a second audit on each of these projects. This firm will also perform audits on all twelve projects seeking the 17% audit that were awaiting an audit by the Department of Revenue when the preliminary findings from the sunset audit came to light. These third party audits are currently underway. The department thanks the Office of the Comptroller for sharing information about potential problems with the prior audit process with the department early in the sunset audit process.

Department of Revenue:

We concur. The Film Commission and the Department of Revenue did not have any formal agreement regarding the roles, responsibilities, and expectations of each agency. The lack of a formal agreement combined with the lack of clarity in the statute has resulted in inconsistent treatment of certain expenses. The issues identified in finding 1 and in this finding were significant factors in the Department's agreement to support legislative changes in 2012. The Department of Revenue is no longer involved in reviewing expenses for purposes of the Film Commission's 17% program, and the 15% headquarters film refundable tax credit has been repealed for any projects after July 1, 2012.

-
- 3. The former Tennessee Film, Entertainment and Music executive director, after signing statements of understanding for the Department of Economic and Community Development's Conflicts of Interest Policy and Governor Bredesen's Executive Order #3, did not adequately disclose a personal connection to a law firm that appears to have been involved with at least three productions that received incentives**

Finding

The audit revealed information suggesting the former executive director's husband worked for, or was in appearance professionally involved with, a law firm involved with at least three film projects that received a Film Commission incentive. Auditors could not confirm that this information was properly disclosed prior to the decision to approve these films for the incentive. This represents a serious concern about the proper disclosure of conflicts of interest by Film Commission staff.

Executive Order No. 3 signed by Governor Bredesen concerns ethics, conflicts of interest, and acceptance of gifts on the part of Executive Branch employees and provides guidance necessary for the maintenance of honesty, integrity, and impartial conduct by employees to ensure the proper performance of government business and the maintenance of confidence by citizens in their government. The order states that the avoidance of misconduct and conflicts of interest on the part of employees of the State of Tennessee is indispensable. Each employee is responsible and should avoid any action, whether or not prohibited by statute, policy, or regulation, which might create the appearance of or result in conflicts of interest. The order specifies that it applies to each executive level employee, including Economic and Community Development and therefore the administratively attached Film Commission.

Auditors reviewed past meeting minutes of the Grants and Loans Committee beginning April 16, 2007, to May 23, 2011, and conflict-of-interest statements signed by Film Commission staff. The auditors did not find that the former executive director provided proper disclosure of a potentially significant conflict, even though the department's *Ethics, Conflicts of Interest, and Acceptance of Gifts Policy And Executive Order #3 Employee's Acknowledgement Statements* were signed. Auditors found communication between the former executive director and her spouse that clearly demonstrates the spouse working for a law firm involved with at least three productions that received incentive payments. Dates indicate that the productions were approved and payments were made during the time of the former executive director's tenure at the Film Commission. The communication suggests the connection was advertised as a selling point to at least one or more producers. Furthermore, the projects were approved and the incentives partly paid before being approved by the Grants and Loans Committee. According to current staff, at the time these productions were considered by the Film Commission, fiscal year 2007-2008, the commission was new and few policies and procedures were in place. The productions were eventually approved by the Grants and Loan Committee on November 21, 2008; however, two of the three productions received incentive payments prior to this review (\$347,399.43 and \$455,581.68).

Based on a review of Grants and Loans Committee minutes from 2007 through 2011, no members were found to recuse themselves or acknowledge any conflicts of interests. Auditors did not see evidence in the minutes that such discussions were taking place during committee meetings.

Recommendation

Commission staff and Grants and Loans Committee members, or any individuals involved with the incentives program, should identify and disclose any potential conflicts, especially when in a position to manage, present, or approve program projects. Further investigation into the relationship and possible benefit of the former executive director and the parties involved should be considered. We recommend that the commission and Department of Economic and Community Development policy should encourage the consideration and acknowledgement of any potential or true conflicts of interest when approving grants, loans, or other forms of projects. Members should not only acknowledge but recuse themselves from voting in situations where a conflict exists.

Management's Comment

Joint response by the Film, Entertainment and Music Commission and the Department of Economic and Community Development:

We concur. The department takes conflicts of interest, both real and perceived, very seriously and in 2011 we instituted a revised Ethics and Conflicts of Interest Policy that requires commission members, even though they act in an advisory capacity and do not participate in incentive decisions, to report potential conflicts of interest on an annual basis at a minimum.

OBSERVATION AND COMMENT

The topic discussed below did not warrant a finding but is included in this report because of its effect on the operations of the Film, Entertainment and Music Commission and on the citizens of Tennessee.

Commission Lacks Adequate Program Effectiveness Measures

Auditors reviewed the Film, Entertainment and Music Commission's methods for determining the effectiveness of the film incentive program. Section 4-3-4903(h), *Tennessee Code Annotated*, provides that the executive director of the commission report, biannually, to the Commissioner of Finance and Administration on the status of the grant program. The report should include

- the award amount for each grant since the previous report,
- the name of the production company receiving the benefit,

- the total amount of outstanding grants, and
- the total unobligated amount in the Film/TV Fund.

In addition, a copy of each report is to be provided to the Speaker of the House of Representatives and the Speaker of the Senate; the chairs of the Finance, Ways and Means Committees; the State Treasurer and the Comptroller of the Treasury; and the Office of Legislative Budget Analysis.

We reviewed five reports the committee submitted from January 2010 through June 2012 and determined the commission is submitting reports as required. We observed in a number of early reports in the sample that a Return On Investment (ROI) index was being provided in addition to the required information—January 2010, July 2010, and July 2011. For example, the July 2011 report provided an ROI of \$4.87. (See table below.) The index suggests that the state earns a return of \$4.87 for every incentive dollar spent.

Table 6
ROI Example

Completed Productions	Total Tennessee Spend	Total Incentive Committed (17%)	ROI
30*	\$60,931,884.80	\$10,380,351.70	\$4.87

* This number includes 19 productions that have received the incentive and 11 completed productions that were waiting to receive the Film Commission incentive.

According to the Department of Economic and Community Development, this index is calculated by subtracting the committed incentives from the Tennessee Spend and dividing by the committed incentives.

$$(\text{Tennessee Spend} - \text{Total State Incentives}) / (\text{Total State Incentives}) = \text{ROI}$$

Following this example, the completed productions listed in the chart above created a Tennessee Spend of \$60,931,884.80 and received \$10,380,351.70 in Film Commission incentives, generating an ROI of \$4.87. Such a high rate of benefit is in contrast to a 2011 Economic and Community Development cost-per-job analysis. According to the analysis, the incentive program costs the state an estimated \$118,116 per full-time-equivalent job created between 2007 and 2009.

We see a number of problems with this index such as being overly simplistic and not representative enough for understanding meaningful effects of the incentives program. The following are some of the specific concerns:

1. The index does not use the true Tennessee Spend because it does not correct for non-qualifying spend that was allowed to count as eligible (see finding 2). At the very least, exceptions granted by the commission to allow film producers to count out-of-state payroll as in-state spend is not accounted for.
2. The index does not include the additional \$9.1 million in state incentives awarded by the Department of Revenue. We believe it necessary to include the total state expense in order to accurately gauge any valid ROI.
3. The index is not a representation of the return in state funds per state funds expended, but rather is a measure of general economic effect, not necessarily a return. To determine the state's return per dollar spent, a calculation should include an estimate of the dollars the state recoups from the Tennessee Spend per state dollars spent. To do this we modified the previous ROI formula by applying the State Sales Tax rate of 7% to include an estimate of tax revenue the Tennessee Spend will generate for the state.

The adjusted formula is as follows:

$$\begin{array}{rccccccc}
 \text{(Tennessee Spend)} & - & \text{(Total State Incentives)} & \times & \text{(State Sales Tax Rate)} & / & \text{(Total State Incentives)} \\
 \\
 (\$60,931,885) & - & (\$19,516,101) & \times & (7\%) & / & (\$19,516,101) \\
 & & (\$10,380,352 \text{ Film Incentives} + \\
 & & \$9,135,749 \text{ Revenue Incentives}) & & & &
 \end{array}$$

Using this formula we estimate the actual ROI in state funds to be \$0.14 cents per state dollar spent. This estimate of return appears to be reasonable because it is within a reported range of state incentive program revenue gains (\$0.07 to \$0.28 per dollar of awarded subsidy) according to the Center on Budget and Policy Priorities.

4. The index does not describe information as to how the state is benefiting from the production spending (i.e., the number and amount spent on Tennessee full-time jobs, the number and amount Tennessee residents received, the number and amount non-Tennessee residents received but that were included as in-state spend, or perhaps a breakdown of Tennessee business sectors and services affected.)

If the agency and commission wish to provide some additional indexes that show the effect of the program, they should choose to provide information that shows a more complete picture. A general economic index is important; however, other contextual variables are just as important for assessing or providing perspective for a program's benefit. We note that even though the economic index may appear favorable, it should be viewed in context that the average production time of the film projects we reviewed was found to be approximately 47 days. So any market benefit to a local area is for a short period of time.

Economic and Community Development management informed us that they intend to develop new performance measures that are more aligned with the goals of the program. As

reported in the 2011 Presentation, management created a cost per job formula to gauge how much incentive money is expended per Full Time Employee hired. ECD management believes the new 25% incentives package will reduce the state's cost per job from \$120,000 to \$90,000.

As is listed in the 2012 Agency Strategic Plans Volume 2, a new performance standard and measure has been developed.

Performance Standard

1. Create job opportunities for experience and exposure to Tennessee film and television professionals, in order to foster a viable film and television production industry in the state of Tennessee.

Performance Measure

1. Full time equivalent jobs created as a result of film and television productions that receive incentives under the program.

Actual (FY2011-2012)	Estimate (FY 2012-2013)	Target (FY 2013-2014)
172	50	30

RECOMMENDATIONS

LEGISLATIVE

This performance audit identified areas in which the General Assembly may wish to consider statutory changes to improve the efficiency and effectiveness of the Film Commission and film incentive operations.

1. For future incentive programs, or the continuance of this program, the General Assembly may wish to consider reviewing state laws and policies in order to clarify and align them with program goals.

ADMINISTRATIVE

The Tennessee Film, Entertainment and Music Commission, the Department of Economic and Community Development, and the Department of Revenue should address the following areas to improve the efficiency and effectiveness of their operations.

1. The 15% headquarters incentive program poorly written with few controls. Further investigation may be warranted to determine more definitively if funds were improperly awarded and whether or not such funds should be recovered. The Film Commission, the Department of Economic and Community Development, and the Department of Revenue need to evaluate questionable headquarters incentives to determine whether or not funds should be recovered. Also, we encourage the Film Commission, the Department of Economic and Community Development, and the Department of Revenue to review incentive payments not included in our sample to determine if there are additional inappropriate payments.
2. For future incentive programs, or the continuance of this program, the Film, Entertainment and Music Commission should consider reviewing state laws and policies in order to clarify and align them with program goals.

We also recommend that any future auditing of qualifying spend include consistent, well defined policy and involve proper due diligence to ensure the Tennessee Spend is legitimate.

3. Commission staff and Grants and Loans Committee members, or any individuals involved with the incentives program, should identify and disclose any potential conflicts, especially when in a position to manage, present or approve program projects. Further investigation into the relationship and possible benefit of the former

executive director and the parties involved should be considered. We recommend that the commission and Department of Economic and Community Development policy should encourage the consideration and acknowledgement of any potential or true conflicts of interest when approving grants, loans, or other forms of projects. Members should not only acknowledge, but recuse themselves from voting in situations where a conflict exists.

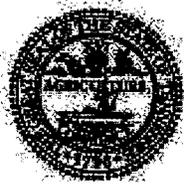
APPENDIX 1

Commission Member Ethnicity and Gender November 2012

MEMBER	TERM	MALE/ FEMALE	RACE	GRAND DIVISION
Mike Curb	07/01/11 - 06/30/13	M	Caucasian	Middle
Craig Brewer	09/06/11 - 06/30/15	M	Caucasian	West
Carey Nelson Burch	07/01/09 - 06/30/13	F	Caucasian	Middle
Rod Essig	07/01/09 - 06/30/13	M	Caucasian	Middle
Jay Frank	07/01/11 - 06/30/15	M	Caucasian	Middle
Susan Packard	07/01/11 - 06/30/15	F	Caucasian	East
David Porter	07/01/11 - 06/30/15	M	African American	West
Rivers Rutherford	07/01/09 - 06/30/13	M	Caucasian	Middle
Bruce Shine	07/01/09 - 06/30/13	M	Caucasian	East

APPENDIX 2

Tennessee Film, Entertainment and Music Commission Forms A, B, and C



**FORM A
REGISTRATION FOR CERTIFICATION OF CONDITIONAL ELIGIBILITY**

Tennessee Film, Entertainment & Music Commission
312 Rosa L. Parks Avenue, 10th Floor, Nashville, TN 37243
(615) 741-3456 Fax: (615) 741-5554 tn.film@tn.gov

Only submit this form when the project is fully funded/greenlit.

PRODUCTION INFORMATION

Production Title	Type of Production (i.e. Feature film, commercial, etc.)	Name of Production Company
Executive Producer(s)	Producer(s)	Director

PRODUCTION COMPANY HEADQUARTERS INFORMATION (payment will be issued to this company)

Company Name	Contact Name	Contact Title
Contact E-mail Address	Contact Phone	Contact Fax
Company Address	Company City, State, Zip	Company Phone
Company Website	State where Incorporated or Registered	Federal Tax ID Number (FEIN)
Indicate if the production company is certified as minority-owned, women-owned, or service-disabled veteran owned: (as defined in T.C.A. §12-3-801 through 808 and Public Chapter 1140 effective July 1, 2010)		

TENNESSEE PRODUCTION COMPANY INFORMATION (if different)

Company Name	Contact Name	Contact Title
Contact E-mail Address	Contact Phone	Contact Fax
Company Address	Company City, State, Zip	Company Phone
Company Website	State where Incorporated or Registered	Federal Tax ID Number (FEIN)
Indicate if the production company is certified as minority-owned, women-owned, or service-disabled veteran owned: (as defined in T.C.A. §12-3-801 through 808 and Public Chapter 1140 effective July 1, 2010)		

TYPE OF INCENTIVE THE PRODUCTION INTENDS TO APPLY FOR (select one of the following)

- 17%** - Out-of-state, nonresident production company, and qualified production costs expended in Tennessee in a 12 month period will equal or exceed \$500,000 per production/per episode.

OR

- 17%** - Production company is located in Tennessee, and qualified production costs expended in Tennessee in a 12 month period will equal or exceed \$150,000 per production/per episode.

DEPARTMENT OF REVENUE HEADQUARTERS INCENTIVE (Projects will also need to register with the TNDOR)

- Production company is headquartered in Tennessee and will incur at least \$1,000,000 in qualified expenses producing a theatrical film or television show in Tennessee. Applicant will register with the Department of Revenue and will apply for both incentives.

OR

- Qualified investor is headquartered in Tennessee and invested in a production company that shall incur at least \$1,000,000 in qualified expenses producing a theatrical film or television show in Tennessee. Applicant will register with the Department of Revenue and will apply for both incentives.

ESTIMATED PRODUCTION FINANCIAL INFORMATION

Preliminary Budget <i>(entire project)</i>		Total TN Expenditures <i>(paid to TN residents and vendors)</i>
TN Wages Amount <i>(paid to TN residents)</i>	TN Vendor Spend Amount <i>(paid to TN vendors)</i>	TN Music Amount <i>(licensing, recording, etc.)</i>
TN Pre-Production spend	TN Production spend	TN Post-Production spend
Total Number of Episodes <i>(if applicable)</i>		Number of Episodes to be shot in TN <i>(if applicable)</i>

ESTIMATED TENNESSEE CAST AND CREW

Total Number of Crew	Number of TN Crew	% Total Crew
Total Number of Cast	Number of TN Cast	% Total Cast

TENNESSEE PRODUCTION SCHEDULE

Pre-Production			
Production			
Post-Production			

ATTACH THE FOLLOWING DOCUMENTS WITH YOUR APPLICATION:

- Detailed preliminary budget
- Written description of your project, **script** and synopsis *(script can be e-mailed to tn.film@tn.gov)*
- List of all cities the project is considering for filming, both inside and outside of Tennessee
- List of all creative elements currently known (i.e. principal cast, director, line producer, location manager, etc.)
- Copy of your insurance policy for production, including agent, insurance company(s) and policy amounts
- Detailed, current plans for distribution, including name(s) of distributor(s) to the extent known
- Detailed information as to what assurances the State of Tennessee will have that financing to complete the production is available, such as completion bond, financial guarantees, etc. The State reserves the right to request additional information.
- If project is a "work for hire" please attach a copy of the agreement showing that the applying company is authorized to receive the incentive.

I hereby certify that the information provided in this application is true and correct, and I am aware that any applicant that obtains incentives from the State of Tennessee by filing a knowingly false or fraudulent claim shall be liable to the State of Tennessee for reimbursement of all monies received. Reimbursement of such monies shall be in addition to payment of a fine and/or other penalties imposed pursuant to Title 39 of the Tennessee Code. I understand that submission of an application does not in any way guarantee receipt of the incentive or that incentive funds will be available.

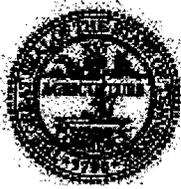
Signature

Date

Printed Name

Title

**SEND COMPLETED APPLICATION TO:
Tennessee Film, Entertainment & Music Commission
312 Rosa L. Parks Avenue, 10th Floor
Nashville, TN 37243**



**FORM B
TENNESSEE DECLARATION OF RESIDENCY**

Tennessee Film, Entertainment & Music Commission
312 Rosa L. Parks Avenue, 10th Floor, Nashville, TN 37243
(615) 741-3456 Fax: (615) 741-5554 tn.film@tn.gov

The purpose of this form is to verify information for the Tennessee residents hired as part of the cast/crew. To be considered an eligible expenditure, all production companies must have each Tennessee resident employed by the production complete this form AND attach a copy of proof of residency.

PERSONAL INFORMATION

Name	Position on Project (i.e. Grip, Driver, Extra, etc.)	Title of Project
(For minors only) Parent or Guardian's Name	SS#	TN Drivers License # <i>(minors should list parent or guardian's license #)</i>

CONTACT INFORMATION

E-mail Address	Phone	Fax
Address	City, State, Zip	Phone

ADDITIONAL INFORMATION

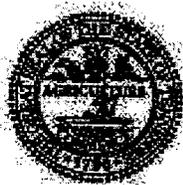
Are you presently a resident of Tennessee?	<input type="checkbox"/> YES <input type="checkbox"/> NO
Do you anticipate changing your residency status during the time that you are expected to work on the project?	<input type="checkbox"/> YES <input type="checkbox"/> NO

Tennessee residents employed with this project must provide proof of residency in the form of a current, permanent Tennessee driver's license. No other form of ID will be accepted. The driver's license must have been issued prior to the date the project was certified for participation in the incentive. A minor would need to present their parent or guardian's proof of residency.

I declare under penalty of perjury that the above information is true, correct and complete.

Signature Date

(FOR MINORS ONLY) Parent or Guardian's Signature Date



**FORM C
INCENTIVE APPLICATION**

Tennessee Film, Entertainment & Music Commission
312 Rosa L. Parks Avenue, 10th Floor, Nashville, TN 37243
(615) 741-3456 Fax: (615) 741-5554 tn.film@tn.gov

PRODUCTION INFORMATION

Production Title	Type of Production (i.e. Feature film, commercial, etc.)	Name of Production Company
Executive Producer(s)	Producer(s)	Director

PRODUCTION COMPANY HEADQUARTERS INFORMATION (payment will be issued to this company)

Company Name	Contact Name	Contact Title
Contact E-mail Address	Contact Phone	Contact Fax
Company Address	Company City, State, Zip	Company Phone
Company Website	State where Incorporated or Registered	Federal Tax ID Number (FEIN)
Type of Entity (e.g. "C" or "S" Corporation, LLC, Partnership, Trust, etc.) Please attach a copy of last annual report filed		
Indicate if the production company is certified as minority-owned, women-owned, or service-disabled veteran owned: (as defined in T.C.A. §12-3-801 through 808 and Public Chapter 1140 effective July 1, 2010)		

TENNESSEE PRODUCTION COMPANY INFORMATION (if different)

Company Name	Contact Name	Contact Title
Contact E-mail Address	Contact Phone	Contact Fax
Company Address	Company City, State, Zip	Company Phone
Company Website	State where Incorporated or Registered	Federal Tax ID Number (FEIN)
Indicate if the production company is certified as minority-owned, women-owned, or service-disabled veteran owned: (as defined in T.C.A. §12-3-801 through 808 and Public Chapter 1140 effective July 1, 2010)		

TYPE OF INCENTIVE THE PRODUCTION WAS CERTIFIED FOR (select one of the following)

- 17%** - Out-of-state, nonresident production company, and qualified production costs expended in Tennessee in a 12 month period equaled or exceeded \$500,000 per production/per episode.

OR

- 17%** - Production company is headquartered in Tennessee, and qualified production costs expended in Tennessee in a 12 month period will equaled or exceeded \$150,000 per production/per episode.

DEPARTMENT OF REVENUE HEADQUARTERS INCENTIVE (HQ has registered with the TNDOR)

- Production company is headquartered in Tennessee and has incurred at least \$1,000,000 in qualified expenses producing a theatrical film or television show in Tennessee. Applicant registered with the Department of Revenue and is applying for both incentives.

OR

- Qualified investor is headquartered in Tennessee and invested in a production company that has incurred at least \$1,000,000 in qualified expenses producing a theatrical film or television show in Tennessee. Applicant has registered with the Department of Revenue and is applying for both incentives.

PRODUCTION FINANCIAL INFORMATION

Total Budget (entire project)		Total TN Expenditures (paid to TN residents & vendors)	
Total TN Payroll (paid to TN residents)	Total TN Vendor Spend (paid to TN vendors)	Total TN Music Amount (paid to TN residents)	
Pre-Production Expenditures	Production Expenditures	Post-Production Expenditures	
Number of Episodes Filmed in TN (Television Series Only)			

TENNESSEE CAST AND CREW

Total Crew	TN Crew	% TN Crew
Total Cast	TN Cast	% TN Cast
Average TN crew size (per day) for prep		Average TN crew size (per day) for shoot

TENNESSEE PRODUCTION SCHEDULE (Attach additional pages if necessary)

PHASE	START DATE	END DATE	NUMBER OF DAYS
Pre-Production			
Production			
Post-Production			

ADDITIONAL INFORMATION

Date of Last Qualified Expenditure Incurred in TN	Anticipated Release / Premiere Date
/ / The Production Will Premier in TN <input type="checkbox"/> YES <input type="checkbox"/> NO	/ / Production has satisfied all financial obligations <input type="checkbox"/> YES <input type="checkbox"/> NO
Newspaper notice was posted at least once a week for 3 consecutive weeks in a local newspaper for each city filming took place <input type="checkbox"/> YES <input type="checkbox"/> NO	

ATTACH THE FOLLOWING DOCUMENTS WITH YOUR APPLICATION

- Copy of your insurance policy for production, including agent, insurance company(s) and policy amounts
- Detailed, current plans for distribution, including name(s) of distributor(s) to the extent known
- Final Budget
- General ledger
- Total Payroll report (excluding/obscuring individual social security numbers)
- Certificate of Legal Existence from the Secretary of State
- Crew call sheets
- List of All Locations Used, both inside and outside of Tennessee – include address and contact information
- Declaration of Residency Forms - attach proof of residency and alphabetize by last name
- Final Crew list – include address and contact information
- Final Vendor list – include address and contact information
- Copy of Newspaper Notices or Invoice
- At least one copy of the production (Due upon completion)
- At least five production still photos in an electronic format with rights cleared for promotional use (Due upon completion)
- At least one poster for promotion of the project (Feature films only. Due upon completion)

Under penalty of perjury, I hereby certify that the information provided in this application is true and correct, and I am aware that any applicant that obtains incentives from the State of Tennessee by filing a knowingly false or fraudulent claim shall be liable to the State of Tennessee for reimbursement of all monies received. Reimbursement of such monies shall be in addition to payment of a fine and/or other penalties imposed pursuant to Title 39 of the Tennessee Code. I understand that submission of an application does not in any way guarantee receipt of the incentive or that incentive funds will be available.

Signature

Date

Printed Name

Title

SEND COMPLETED APPLICATION TO:
Tennessee Film, Entertainment & Music Commission
312 Rosa L. Parks Avenue, 10th Floor
Nashville, TN 37243