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## Department of Revenue

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### Directive 07-1: Questions Concerning the Film Credit; Qualifying Expenses, Transferee Liability and Withholding Procedures

#### Introduction:

This Directive responds to several questions that have arisen under St. 2005, c. 158, as *amended* by St. 2005, c. 167 (the "Act"), which provides various incentives to the motion picture industry. In particular, this Directive explains:

- what expenses will constitute qualifying expenses for purposes of the Act's two credits, the payroll expense credit and the production expense credit;
- potential transferee liability for purchasers of the film credits; and
- procedures for withholding on employee salaries, as required in connection with the credits.

For a more detailed explanation of the film credits and their requirements, please refer to Technical Information Release (TIR) 06-01, *An Act Providing Incentives to the Motion Picture Industry*.

#### Discussion of Law:

For taxable years beginning on or after January 1, 2006 and before January 1, 2013, a motion picture production company may be entitled to a payroll expense credit equal to 20 per cent of its total qualifying aggregate payroll and may also be entitled to a production expense credit equal to 25 per cent of its qualifying Massachusetts production expenses. M.G.L. c. 62, § 6(l) and c. 63, § 38T. Both the payroll expense credit and production expense credit allow a film credit to be obtained for certain qualifying payments made to employees. Qualifying payments that are equal to or greater than \$1,000,000 may be used to calculate the production expense credit, including the portion of such salary that is less than \$1,000,000 (provided that such entire salary is excluded from the payroll credit, for which it does not qualify). See TIR 06-01. However, in each case the credit is allowed only as to payments that constitute Massachusetts source income. *Id.* Further, in each case, the person making the payment must be registered for Massachusetts withholding and must withhold on the employee payments. *Id.*

Not all ordinary and necessary business expenses incurred in connection with the production of a motion picture qualify for the Massachusetts production expense credit. To qualify, among other things, the production expense must be "directly incurred in the production of the motion picture" and must also be "clearly and demonstrably incurred in the commonwealth." M.G.L. c. 62, § 6(l)(1) and c. 63, § 38T(a).

Examples provided by the statute of qualifying production expenses include:

The costs of set construction and operation, editing and related services, photography, sound synchronization, lighting, wardrobe, make-up and accessories; film processing, transfer, sound mixing, special and visual effects; music; location fees and the cost of purchase or rental of facilities and equipment...

*Id.* In addition, the statute specifically excludes as qualifying expenses "...costs incurred in the marketing or advertising of the motion picture, any costs related to the transfer of tax credits or any amounts paid to persons or businesses as a result of their participation in profits from the exploitation of the production." *Id.*

As indicated by the above-referenced provisions, the film credits are intended to generate payments to in-state persons or firms or to otherwise foster in-state economic activity. See also M.G.L. c. 63, § 38T (the production expense credit also requires that at least 50% of the total production expenses or "total principal photography days" incurred in connection with the motion picture take place in

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Massachusetts<sup>[1]</sup>).

**Issue 1:**

Do insurance expenses, loan fees, completion bond expenses and interest expenses incurred in connection with the production of a film qualify for the production expense credit? Does the answer depend on whether the insurance company or lender is outside Massachusetts?

**Directive 1:**

Insurance expenses, loan fees, completion bond expenses and interest expenses do not qualify for the production expense credit, regardless of the location of the lender, insurance company or completion bond company. These expenses are not expenses that are “*directly* incurred in the production of a motion picture” as required by the Act.

**Issue 2:**

Do living expenses and travel expenses such as airline tickets for motion picture employees flying in and out of Massachusetts, incurred during the preproduction, production or postproduction of a motion picture in Massachusetts, qualify for the production expense credit?

**Directive 2:**

Lodging, food and other living expenses qualify for the production expense credit when the expense is clearly and demonstrably incurred in Massachusetts and when the expense is incurred by or on behalf of persons that are directly engaged in the preproduction, production and postproduction of a motion picture. Travel expenses qualify for the production expense credit, if otherwise qualifying, when the travel originates and concludes within Massachusetts. Conversely, air travel from another state into Massachusetts or to another state from Massachusetts does not qualify for the production expense credit because the expense is not “clearly and demonstrably incurred in the commonwealth.”

**Issue 3:**

Does equipment or other tangible personal property rented or purchased outside of Massachusetts and clearly and demonstrably used in Massachusetts directly in the production of a motion picture qualify for the production expense credit?

**Directive 3:**

Yes, to the extent the proportionate cost of the equipment or other tangible personal property is incurred in Massachusetts. See M.G.L. c. 62, § 62(l)(1) and c. 63, § 38T(a) (referencing the cost of rental equipment as a qualifying production expense). For example, if an equipment rental cost \$1,500 and 60% of the rental use was clearly and demonstrably incurred in Massachusetts directly in the production of a motion picture, the qualifying portion of the rental cost for purposes of the production expense credit would equal \$900.

**Issue 4:**

If the Department disqualifies some or all of a motion picture production company's film credit, can a transferee be held liable for, or subject to, an assessment pertaining to the disqualified portion of the credit?

**Directive 4:**

In general, a transferee will not be held liable for the disqualified portion of a film credit. In the event of disqualification, the Department would typically seek recourse against the motion picture production company and not the transferee.

However, the Department will disallow credits in any case where a motion picture production company (or other entity) originally obtained the credit through the means of fraud. For example, production credits claimed in the instance where no production activity took place would be disallowed to the applicant and any transferee.

In addition, while generally a transferee is not liable for the disqualified portion of a film credit, a transferee may be assessed for claiming credits to which it is not entitled under applicable law. For example, a transferee would be assessed additional tax if upon audit the Department determined that the transferee had used a credit beyond its allowable five year carryover period or had claimed an amount in excess of the unused amount transferred.

**Issue 5:**

May a motion picture production company contract with a payroll service company to perform the Massachusetts withholding required to receive a film credit in connection with an employee payment? (The basic transactions provided by a payroll service company include gathering information on

employees such as their taxpayer identification numbers, hours worked and pay rates and utilizing such information to (1) issue employee paychecks and (2) comply with federal, state and local tax filing requirements).

**Directive 5:**

For purposes of the film credits, the Department will treat a payroll service company as the employer of the individuals who are properly treated as employees of such payroll service company for federal income tax purposes, provided that the motion picture production company contracts with the payroll service company to carry out withholding responsibilities and that the company properly registers for withholding in Massachusetts. The payroll service company should withhold on wages paid to their employees according to standard employer withholding procedures.<sup>[2]</sup> In addition, the payroll service company must file a quarterly wage report (Form WR-1) with the Department, as required by the federal government.<sup>[3]</sup>

**Issue 6:**

May a motion picture company obtain a film credit for payments made to a loan-out corporation when a payroll service company does the withholding and, if so, what is the proper withholding procedure? (A loan-out corporation is sometimes used as the entity through which persons provide services in connection with a motion picture. The corporation effectively "loans" its personnel to the motion picture production company).

**Directive 6:**

Payments to a loan-out corporation, rather than to an individual employee, may qualify for the film credits, even in cases in which the withholding is performed by a payroll service company. However, in such cases, the payroll service company must register to withhold and perform withholding through the Department's performer withholding system.<sup>[4]</sup> If the loan-out corporation is properly treated as the employer for federal income tax purposes and is not receiving payments from the payroll service company, then the loan-out corporation must register and withhold according to standard employer withholding procedures.<sup>[5]</sup>

**Issue 7:**

In any case in which some part of the employee's salary is not subject to state income tax withholding, e.g., there are allowable deductions or exclusions, is the payroll or the production expense credit based on the gross salary payment to the individual or is it based on the amount that is subject to withholding?

**Directive 7:**

In general, the payroll and production expense credit is based on the gross salary or wage payment to the individual, assuming that the gross salary or wage payment otherwise qualifies for the credit. For example, if an otherwise qualifying payment of \$100,000 is made to an individual, and the amount subject to withholding is \$80,000, the motion picture production company may claim a payroll credit of \$20,000 (20% x \$100,000) on such payment.

**Issue 8:**

Do employer-paid payroll expenses that are not included in the gross salary payment to the employee (e.g., SUTA/FUTA, FICA, workers compensation, health insurance, pension contributions) qualify for the payroll and production expense credits?

**Directive 8:**

Employer-paid payroll expenses are not qualifying wages or payments made *to the employee*, and therefore do not qualify for the payroll expense credit. However, employer-paid payroll expenses are qualifying production expenses that are directly incurred in the production of a motion picture *to the extent*<sup>[6]</sup>

they are related to qualifying payroll expense payments to the employee, so long as the movie production company otherwise qualifies for the production expense credit. M.G.L. c. 62, § 6(l)(1) and c. 63, § 38T(a).

**Issue 9:**

Do archival material costs, fees for stock footage, or costs for licensing footage from another production entity or from an archival source constitute qualifying production expenses?

**Directive 9:**

No, such expenses are not qualifying production expenses. The underlying production activity necessary to create such archival material or stock footage occurred in a previous production, not in

the motion picture production for which the material or footage is sought.

**Issue 10:**

May a movie production company apply mid-production for a partial film credit and then submit an additional final film credit application for the remaining qualifying expenses? Similarly, may a movie production company file a film credit application with estimated expenses and then subsequently amend the application with final expenses?

**Directive 10:**

A movie production company may submit only one film credit application per movie production. Qualifying expenses submitted to the Department on the film credit application must be final and paid, and not just accrued or anticipated at the time of the application. If the movie production company chooses to file a film credit application mid-production it will not be allowed to file additional qualifying expenses either by amending the initial application or submitting a subsequent application.

**Issue 11:**

If a film credit application is received by the Department during a tax year of the applicant movie production company that precedes its tax year during which the film credit certificate is issued, which tax year is the initial tax year for purposes of applying the film credit?

**Directive 11:**

The initial tax year for applying the film credit is the taxpayer's tax year during which the Department received the film credit application. For example, if the Department receives a completed film credit application on December 15, 2006 and the Department issues a film credit certificate on January 29, 2007, the film credit certificate could be applied to the taxpayer's 2006 tax year.

**Issue 12:**

May a film credit transferee apply a purchased film credit to the transferee's tax liability for its tax year during which the initial film credit certificate was applied for (see Directive 11, *supra*), even if such tax year pre-dates the tax year that the transferee submitted its film credit transfer application to the Department?

**Directive 12:**

Yes, but the transferee may only apply the credit to its tax year immediately preceding its tax year in which the transfer of the credit takes place and only if its tax return for the previous tax year has not yet been filed (including a valid extension period, if any). For example, assume that the Department receives a film credit application on December 22, 2006. Subsequent to its receipt of a film credit certificate from the Department, the movie production company files a film credit transfer application that is received by the Department on March 26, 2007. The Department issues a film credit certificate to the transferee on April 16, 2007. The transferee is an individual who seeks to apply the credit to her 2006 personal income tax return. The transferee may apply the film credit to her 2006 taxes so long as her tax return has not yet been filed and she has a valid extension in place. Note that a transferee is not entitled to apply a film credit to its tax return until a film certificate is issued from the Department.[\[7\]](#)

**Issue 13:**

A movie production company may qualify for the production expense credit if its "... Massachusetts production expenses exceed 50 per cent of the total production expenses for a motion picture ...." M.G.L. c. 62, § 6(l)(3) and c. 63, § 38T(c). For purposes of this calculation, are the company's payroll expenses included in the "Massachusetts production expense" numerator and the "total production expense" denominator?

**Directive 13:**

Yes, the company's qualifying payroll expenses are included in the "Massachusetts production expense" numerator and the company's total payroll expenses for the production (qualifying and nonqualifying) are included in the "total production expense" denominator. Production expenses are defined under the statute to include "... wages and salaries paid to individuals employed in the production of the motion picture...." M.G.L. c. 62, § 6(l)(1) and c. 63, § 38T(a). In general, qualifying wages and salaries less than \$1 million paid to an individual are included for purposes of the payroll credit and qualifying wages and salaries equal to or more than \$1 million paid to an individual are included for purposes of the production expense credit. M.G.L. c. 62, § 6(l)(2), (3) and c. 63, § 38T(b), (c). However, all wages and salaries (regardless of amount) are included in the definition of production expenses for purposes of the 50% production expense ratio referenced above.

**Issue 14:**

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Are per diem payments made to employees an allowable production expense?

**Directive 14:**

Yes, to the extent the per diem is made to reimburse otherwise qualifying food, lodging and transportation expenses.

/s/ Alan LeBovidge

Alan LeBovidge

Commissioner of Revenue

AL:MTF:jmw

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[1] "Principal photography days" refers to the days when the motion picture is actually filmed. See M.G.L. c. 62, § 6(l) and c. 63, § 38T.

[2] Note that electronic filing may be required. See Technical Information Releases 05-22 and 04-30 for more information on electronic filing requirements. Also, penalties may be imposed on the payroll service company for failure to withhold correctly. For more information on the Department's withholding rules, please refer to the Department's Guide to Withholding of Taxes on Wages and the regulation that governs the withholding rules, 830 CMR 62B.2.1, *Withholding of Taxes on Wages and Other Payments*, both of which are available at [www.mass.gov/dor](http://www.mass.gov/dor).

[3] The federal government requires each state to implement a wage reporting system, which is used to ensure the fairness of a variety of programs, including unemployment insurance, veterans services, public welfare and child support enforcement. For more information on the Department's wage reporting rules, please refer to the Department's Form WR-1 booklet, which is available at [www.mass.gov/dor](http://www.mass.gov/dor).

[4] Note that the performer system requires a different registration than that required for employer withholding. Also, withholding under the performer withholding system is accomplished on the Department's website, and funds must be transmitted via ACH Debit. The amount subject to performer withholding may be reduced if the employee/performer submits a request in advance to the Department's performer withholding unit to allow the withholding to be reduced due to that person's projected expenses, provided that the Department accepts the expense projection. In the latter cases, the film credit is based on the gross salary or wage payment, and not the reduced amount on which there is Massachusetts withholding.

[5] See *infra*, Directive 5 for further guidance regarding standard employer withholding procedures and requirements.

[6] If the underlying qualified payroll expense payment to the employee is prorated, then such proration is also required for the employer-paid payroll expenses related to the qualified payroll expense payment.

[7] Therefore, transferors and transferees should allow sufficient time for the Department to process a film credit transfer application. Processing times may vary depending on the volume of applications received by the Department. It is suggested that transferors and transferees anticipate a minimum of 30 processing days between the Department's receipt of the film credit transfer application and the issuance of a film credit certificate.