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INDEPENDENT REGULATORY REVIEW COMMISSION

333 MARKET STREET, 14TH FLOOR, HARRISBURG, PA 17101

December 8, 2010

Honorable Austin J. Burke, Secretary
Department of Community and Economic Development
Commonwealth Keystone Building
4th Floor
Harrisburg, PA 17120

Re: Regulation #4-92 (IRRC #2876)
Department of Community and Economic Development
Film Tax Credit

Dear Secretary Burke: *Aust:*

Enclosed are the Commission's comments for consideration when you prepare the final version of this regulation. These comments are not a formal approval or disapproval of the regulation. However, they specify the regulatory review criteria that have not been met.

The comments will be available on our website at www.irrc.state.pa.us. We will send a copy to the new Standing Committees when they are designated.

If you would like to discuss them, please contact me.

Sincerely,

Kim Kaufman
Executive Director

sfh

Enclosure

cc: Robert A. Mulle, Esq., Office of Attorney General
Andrew Clark, Esq., Office of General Counsel

Comments of the Independent Regulatory Review Commission



Department of Community and Economic Development Regulation #4-92 (IRRC #2876)

Film Tax Credit

December 8, 2010

We submit for your consideration the following comments on the proposed rulemaking published in the October 9, 2010 *Pennsylvania Bulletin*. Our comments are based on criteria in Section 5.2 of the Regulatory Review Act (RRA) (71 P.S. § 745.5b). Section 5.1(a) of the RRA (71 P.S. § 745.5a(a)) directs the Department of Community and Economic Development (Department) to respond to all comments received from us or any other source.

1. Determining whether the regulation is in the public interest.

This proposed regulation details the requirements to obtain a film tax credit award. This regulation is mandated by Act 55 of 2007 (as amended by Act 48 of 2009) of the Tax Reform Code of 1971, also known as the PA Film Production Tax Credit Law (Law).

Section 5.2 of the RRA (71 P.S. § 745.5b) directs the Independent Regulatory Review Commission (IRRC) to determine whether a regulation is in the public interest. When making this determination, IRRC considers criteria such as economic or fiscal impact and reasonableness. To make that determination, IRRC must analyze the text of the Preamble and proposed regulation and the reasons for the new or amended language. IRRC also considers the information a promulgating agency is required to provide under § 745.5(a) in the Regulatory Analysis Form (RAF).

The explanation of the regulation in the Preamble and the information contained in the RAF are not sufficient to allow IRRC to determine if the regulation is in the public interest. In the Preamble and RAF submitted with the final-form rulemaking, the Department should provide more detailed information required under § 745.5(a) of the RRA, including a description of the language proposed for each section of the regulation and why the provisions are required.

2. Economic or fiscal impact of the regulation.

This regulation deals almost entirely with accounting procedures and financial compliance. However, the RAF states that: “the costs and/or savings to the regulated community resulting from this regulation cannot be calculated with any precision.” (RAF #17).

As noted above in our comments pertaining to "determining whether the regulation is in the public interest," there is insufficient information in the RAF and Preamble to enable us to determine what fiscal impact, if any, the rulemaking will have on the regulated community. In the final-form regulation, the Department needs to provide a more detailed cost-benefit and fiscal impact analysis of the regulation.

In addition, how many film production companies are currently participating in the film tax credit program? How will the implementation of this regulation affect them? As part of their fiscal impact analysis, the Department should provide this information.

3. Section 36.2. Application. – Implementation procedures; Clarity.

This section sets forth the required information submitted to the Department with an application for film tax credit. We raise four issues.

First, Subsection (a)(3) requires a comparison of “total production expenses and qualified Pennsylvania production expenses.” The Law defines “production expense” but does not use the term “qualified Pennsylvania production expense.” Did the Department intend to use the term “qualified film production expense,” which the Law defines? To improve clarity, we recommend that the final-form regulation use the appropriate statutory term.

Second, Subsection (a)(4) requires a statement indicating whether financing has been or “will be secured prior to the planned start date of principal photography.” Can the statement provide that financing will be secured at any time before the planned start date, including the day before? The final-form regulation should include a deadline for when financing **must** be secured. Similar concerns apply to Section 36.4(4).

Third, Subsection (a)(4) also states that a taxpayer shall provide “appropriate documentation and notify the Pennsylvania Film Office of any change in financing prior to completion of the project.” What does the Department consider “appropriate documentation?” In addition, what is proper notice (e.g., by telephone, in writing)? The final-form regulation should specify what qualifies as “appropriate documentation” and what type of notice is acceptable.

Finally, Subsection (a)(5) refers to an interview with the Department and a potential applicant for a film tax credit. Is such an interview conducted for every tax credit application? The final-form regulation should clarify whether this interview is required as part of the application process.

4. Section 36.3. Special circumstances. – Clarity.

This section describes the process for applicants for film tax credits with special circumstances. It is unclear whether applicants under Section 36.3 must also comply with Section 36.2. The final-form regulation should clarify this issue and, where appropriate, include in Section 36.3 a cross-reference to Section 36.2.

5. Section 36.4. Review. – Clarity.

This section contains the phrase, “the law, regulations, and guidelines.” What are the applicable laws and regulations? To facilitate compliance and improve clarity, this phrase should be replaced with a cross-reference to the specific laws and regulations that apply. Additionally, why is there a reference to guidelines? Guidelines, unlike regulations, cannot be mandatory for third parties. Further, under Section 8710-D of the Law, the guidelines currently in place are to be in effect until regulations are promulgated. We recommend that the reference to “guidelines” be deleted. Similar language is also contained in Subsections 36.6 (d)(1)(ii), (iii), and (d)(2)(iv).

In Paragraph (6), what qualifies as “job training opportunities?” The final-form regulation should include a definition for this term.

6. Section 36.5. Contract. – Consistency with the statute; Implementation procedures; Clarity.

This section details the contractual obligations of a taxpayer who has been approved for a film tax credit award. We raise three issues.

First, Section 8703-D(c) of the Law details information required in the contract, however, this language is not included in the regulation. In addition, Section 8703-D (d) states that once the contract is executed, the film tax credit will be awarded and a certificate issued, yet this section of the regulation does not contain any information on what happens after a contract has been executed. To improve clarity, we recommend that the final-form regulation include cross-references to both of these sections of the Law.

Second, Paragraphs (1)-(3) of this section require the taxpayer to “provide evidence” in the contract of various circumstances. The final-form regulation should clarify what is acceptable “evidence.”

Finally, what is the difference between an “economic impact report” in Paragraph (4)(i) and a “monthly report” in Paragraph (4)(ii)? The final-form regulation should define these terms.

7. Section 36.6. Financial compliance. – Statutory authority; Reasonableness; Implementation procedures; Clarity.

Subsection (a) Description.

What are “agreed upon procedures?” The term is vague and the final-form regulation should include a definition.

Subsection (c) Audit.

Subsection (c)(2)(vi) requires an audit to include a “compliance report including all findings.” However, a parenthetical immediately follows this provision which states: “(that is, instances of noncompliance or deficiencies in the internal control structure).” Does the Department intend for the audit to include *all findings* or just instances of noncompliance or deficiencies? The final-form regulation should clarify this inconsistency in the language in this subsection.

Subsection (d)(1) Scope.

Subsection (d)(1) states that if a taxpayer chooses to submit a report on agreed upon procedures, then the CPA must first submit a draft engagement letter. Subsection (d)(1) also lists six procedures which must be included in the letter. What is the Department’s statutory authority to regulate the actions of a CPA?

EisnerAmper (Accountants & Advisors) also expressed concern with the draft engagement letter and its contents, indicating that professional standards prohibit CPAs from conducting certain procedures required by this subsection, including using professional judgment in determining the scope and sample size for the engagement. Since Subsection (d)(2) requires agreed upon procedures to be conducted in accordance with national accounting standards, the Department should explain how the provisions under Subsection (d)(1) are aligned with the professional accounting standards. If a CPA fails to comply with this subsection due to its already-existing professional responsibilities, does the Department plan to issue a penalty over a member of an already-regulated profession? The final-form regulation should clarify these issues.

Subsection (d)(2) Components.

In Subsection (d)(2), it appears that a word is missing. We recommend that the final-form regulation add the word “letter” after “the agreed upon procedures engagement.”

In Subsection (d)(2)(iv), what are “the other materials provided by the Department?” The final-form regulation should clarify what these “materials” are.

Subsection (f) Submission of materials.

Subsection (f) references a request for an extension to submit materials to the Department. Is there a timeline for Department review of an extension request? To improve clarity, we recommend that the final-form regulation include the timeline within which the Department will approve or deny an extension.

8. Section 36.7. Issuance of tax credits. – Consistency with the statute.

This section states that “provided that the information submitted meets the financial reporting requirements of the regulations, a tax credit certificate will be issued within 45 days of receipt.” However, Section 8703-D (d) of the Law states that a certificate shall be issued upon execution of the contract. The final-form regulation should explain this inconsistency between the Law and the proposed regulation.

9. Section 36.8. Use and transfer of tax credits. – Statutory authority; Consistency with the statute; Reasonableness; Need; Implementation procedures; Clarity.

This section details the procedures for the use and transfer of tax credits. It also includes provisions for carrying forward and assigning the unused portion of the tax credit. We have five issues.

First, the Law states that both the Department and the Department of Revenue should “jointly promulgate regulations” for the approval of applications relating to “carryover, carryback and assignment of credit.” 72 P.S. §8705-D(e)(2). Therefore, what is the Department’s statutory authority for unilaterally promulgating this rulemaking without the Department of Revenue?

Second, Subsection (a) states that the credit cannot be applied against the liability until the return for the year has been filed. Tax Credits, LLC suggests that this is burdensome for the taxpayer and subjects the sale of the credit to an unnecessary delay. This commentator recommends that the production company be current on its filings and have no outstanding liability prior to selling its credit. Has the Department considered this option?

Third, Subsection (e) refers to “statutory requirements.” In the final-form regulation, this phrase should be replaced with a cross-reference to the specific laws that apply.

Fourth, Subsection (e) also states that “the effective taxable year for the transferred tax credits will be the date of approval of the application for transfer by the Department, the tax report filing date or the date the seller becomes compliant, whichever is latest.” However, the Law states that the purchaser or assignee “shall immediately claim the credit in the taxable year in which the purchase or assignment is made.” § 8705-D(f). We request that the

Department explain how the language in Subsection(e) is consistent with Section 8705-D(f) of the Law.

Finally, the provisions contained in Subsection (g) are redundant as they already appear in prior sections of the proposed regulation. We recommend that this subsection be deleted from the final-form regulation.



Facsimile Cover Sheet



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To: Jill Busch
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Date: 12/08/10
Pages: 7

Comments: We are submitting the Independent Regulatory Review Commission's comments on the Department of Community and Economic Development's regulation #4-92 (IRRC #2876). Upon receipt, please sign below and return to me immediately at our fax number 783-2664. We have sent the original through interdepartmental mail. You should expect delivery in a few days. Thank you.

Accepted by: Jill B. Busch Date: 12/8/2010