



**TO:** Film Project Applicants of Benefits Granted under the Puerto Rico Film Industry Economic Incentives Act

**RE:** Film Project Application Protocols and Validation of Puerto Rico Production Expenses<sup>1</sup> (Agreed Upon Procedures)

**I. Eligibility**

A. A Person may obtain a Grant with respect to a Film Project, subject to various conditions. A Film Project means:

1. Feature length films;
2. Short films;
3. Documentaries;
4. Series in episodes, miniseries and television programs of a similar nature, including pilots;
5. Music videos;
6. National and international commercials;
7. Video games;
8. Recorded live performances;
9. Original soundtrack and dubbing recordings for any of the above; or
10. Television programs, including but not limited to reality shows, talk-shows, news programs, game-shows as well as entertainment, comedy children's and variety programming.

B. A Film Project does not include any of the following:

1. a production that includes pornographic material;

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<sup>1</sup> All terms not defined herein will have the meaning given to them in the Act.

2. a production that primarily consists of religious or political advertising;
3. a radio program;
4. a production that primarily markets a product or service other than a national or international commercial;
5. a production with the primary purpose of fund-raising;
6. a production that primarily is for employee training or in-house corporate advertising or other similar production; or
7. any other project as determined by the Film Commissioner through circular letter.

C. Some of the conditions for eligibility are:

1. The production and/or post-production of the Film Project must be carried out in whole or in part in Puerto Rico;
2. In the case of a Film Project other than (1), (2) and (3) mentioned above under Part (A.), it must be intended for airing, commercial distribution or exhibition to the general public outside of Puerto Rico by any means and media. Such airing, distribution or exhibition outside of Puerto Rico may not be considered incidental or minimal; and
3. Puerto Rico Production Expenses must be at least \$100,000, except for short films, for which Puerto Rico Production Expenses must be at least \$50,000.

D. The Film Commissioner will request as part of the application process any documentation that he deems necessary to assure the previous conditions are met. In the case of national and international commercials evidence of actual airing, commercial distribution or exhibition to the general public outside of Puerto Rico may be requested. Eligible Film Projects distributed by “viral media” will be evaluated on a case by case basis.

## **II. Grant**

- A. Eligible parties interested in receiving the income tax benefits and tax credits (the “Applicants”) granted under the Puerto Rico Film Industry Economic Incentives Act (the “Act”) in connection with a Film Project must complete and file an application with the Executive Director of the Motion Picture Arts, Sciences and Industry Development Corporation

(the “Film Commissioner”) using Form PRFPG-1. Such application must be filed before the end of Principal Photography to be eligible for consideration. In the case of standalone post-production, videogames or soundtrack and dubbing recording such application must be filed before post-production or production, respectively.

- B. Form PRFPG-1 is available at [www.puertoricofilm.com](http://www.puertoricofilm.com);
- C. Eligible expenses will only be considered for purposes of calculating the corresponding tax credit after the date the application is duly filed. Notwithstanding this general rule, the Applicant may contact the Film Commissioner in advance to express intent to file the application and request tax credits under the Act (the “Pre-application Conference”). In such case, pre-production, production and/or post-production expenses may count from the date of such Pre-application Conference (the “Pre-application Conference Date”) for purposes of calculating the corresponding tax credits. The Film Commissioner will issue a letter confirming the Pre-application Conference Date. Development expenses will be evaluated by the Film Commissioner on a case by case basis to determine their eligibility.
- D. The Film Commissioner shall review the application within 5 days after filing, and request any additional documentation or information necessary for evaluating the application;
- E. Applications endorsed by the Film Commissioner will be submitted to the Puerto Rico Treasury Department for general review and certification of tax credits availability;
- F. The Puerto Rico Treasury Department may request additional documentation or information necessary for evaluating the application;
- G. The Puerto Rico Treasury Department shall review applications endorsed by the Film Commissioner within 15 working days. This term is interrupted if additional information is requested by this agency. Whenever the 15 working day period is so interrupted and the information requested is furnished by the applicant, the Puerto Rico Treasury Department shall only have the remaining days of the 15 working day period to complete its review;
- H. The applicant will be required to pay a filing fee totaling 1% of the budgeted expenses that qualify for the tax credits, up to a maximum amount of \$250,000 (the “Filing Fee”). Fifty percent (50%) of such fees, computed based on an estimate of the Puerto Rico Production Expenses filed with the application, will be required to be paid at the time of the issuance of the Grant. The remaining balance will be

payable upon completion of the Film Project and certification of the qualifying expenditures, as described below;

- I. The applicant must hire an independent certified public accountant (the “Auditor”) to complete an agreed upon procedures audit, as described in section III below (the “Agreed-Upon Procedures Report”), to validate the amount of Puerto Rico Production Expenses. The name and information of the Auditor must be submitted to the Film Commissioner for evaluation and approval. The Film Commissioner may consider previous performance of the Auditor with respect to other Film Projects and type of compensation arrangement as part of the evaluation of the Auditor. Such approval will be provided in the notification described in paragraph (J.) below;
- J. After an endorsed application finalizes the Puerto Rico Treasury Department review and approval process described in paragraph (G.) above, the Film Commissioner will notify the applicant, requesting the payment of 50% of the Filing Fee specified in paragraph (H.) above. Such Notice will include a draft copy of the Grant to be issued to applicant (now hereinafter referred to as the “Grantee”). The Grant will describe the amount of tax credits reserved in connection to the Film Project. The actual amount of tax credits to be granted will be confirmed upon completion of the Film Project pursuant to the certification of the Puerto Rico Production Expenses by the Auditor through the Agreed-Upon Procedures Report, subject to the payment of the remaining balance of the Filing Fees;
- K. In order for the Grant to be effective, the Grantee will have a period of 15 working days from the date of the issuance of the Grant to accept in writing, by means of a sworn statement, the Grant as issued and to pay the 50% of the Filing Fees. Failure to accept the Grant and/or pay the 50% of the Filing Fees will be deemed as a withdrawal of the application. The Applicant may re-submit the application and the new application will be subject to tax credit availability at the date of its filing;
- L. Once a Grant is issued and effective as set forth in paragraph (K.), the Grantee will have a 30-day period to start Principal Photography (or post-production or production, in the case of standalone post-production and videogames or soundtrack and dubbing recordings, respectively) to be considered in compliance with the Grant. Failure to start principal photography, production or post-production as required will be deemed as non-compliance of the Grant with respect to the tax credits and tax credits reserved may be forfeited, as well as the Filing Fees paid. The Applicant may re-submit the application with respect to the tax credits and request that the Filing Fees paid be credited with

respect to the new application of tax credits. The new application of tax credits will be subject to tax credit availability at the date of its filing;

- M. Once the Film Project is completed and the Grantee furnishes the Auditor the necessary information for the Agreed-Upon Procedures Report, the Auditor shall have a term of 30 days to complete the Agreed-Upon Procedures Report which may be extended by the Film Commissioner for 30 additional days for reasonable cause. Failure to submit the Agreed-Upon Procedures Report on the required date will be deemed as non-compliance of the Grant with respect to the tax credits and tax credits reserved may be forfeited, as well as the Filing Fees paid. The Applicant may re-submit the application with respect to the tax credits and request that the Filing Fees paid be credited with respect to the new application of tax credits. The new application of tax credits will be subject to tax credit availability at the date of its filing;
- N. The Agreed-Upon Procedures Report will be submitted to the Film Commissioner and the Puerto Rico Secretary of the Treasury for their review and certification of tax credit availability based on the Agreed-Upon Procedures Report;
- O. Within 30 days of receipt of the Agreed-Upon Procedures Report by the Puerto Rico Secretary of the Treasury, the Puerto Rico Secretary of the Treasury must certify the tax credit to the Film Commissioner. This 30-day period may be interrupted if the Puerto Rico Secretary of the Treasury requests additional information to the Auditor. Whenever the 30-day period is so interrupted and the information requested is furnished by the Grantee or the Auditor, the Puerto Rico Secretary of the Treasury shall only have the remaining days of the 30-day period to complete the certification process; and
- P. Once the Film Commission receives the tax credit certification described above, it will confirm within 1 day to the Grantee that the tax credit is available for use or transfer, subject to the payment of the remaining balance of the Filing Fees. In order for the tax credits to be available, the Grantee will have a period of 15 working days from the date of the confirmation to pay the remaining balance of the Filing Fees. Failure to pay the remaining balance of the Filing Fees will be deemed as non-compliance of the Grant with respect to the tax credits and tax credits reserved may be forfeited, as well as the Filing Fees paid. The Applicant may re-submit the application with respect to the tax credits and request that the Filing Fees paid be credited with respect to the new application of tax credits. The new application of tax credits will be subject to tax credit availability at the date of its filing. The terms and conditions of Transfer of tax credits shall be governed by Internal Revenue Circular 11-03.

### **III. Tax Credit Advance**

Tax credits issued under the Act may be advanced in the following situations:

- A. Upon receipt of a Grant, the Grantee may advance 50% of the tax credit reserved under the Grant by placing a Bond acceptable to the Puerto Rico Secretary of the Treasury, which names the Puerto Rico Secretary of the Treasury as beneficiary, for the face value of 50% of the tax credits. The Bond shall remain in place until the Puerto Rico Secretary of the Treasury certifies the tax credit to the Film Commissioner pursuant to Part II, Paragraph (O.) above. The Puerto Rico Secretary of the Treasury shall issue to the Grantee a letter (with copy to the Film Commissioner) certifying that the bond is acceptable and the amount of the advance credits available for sale and use; or
- B. If the Auditor certifies to the Puerto Rico Secretary of the Treasury that 40% or more of the budgeted Puerto Rico Production Expenses has been disbursed, following the Agreed Upon Procedures guidelines described in Part IV below, the Grantee may advance 50% of the tax credit authorized under the Grant upon receipt of a letter from the Puerto Rico Treasury Department that (with copy to the Film Commissioner) certifies the amount of the advance credits available for sale and use.

The remaining balance of the tax credits that were not advanced will be subject to the procedure described in Section II above. Tax credits generated by payments made to Nonresident Talent shall not be eligible for the advance in this Section III.

### **IV. Agreed-Upon Procedures**

- A. Once the Grantee has provided the Auditor all the necessary information, the Auditor will have a 30-day period to present the Agreed-Upon Procedures Report to the Film Commissioner and the Puerto Rico Secretary of the Treasury for their review. The term of 30 days to complete the Agreed-Upon Procedures Report may be extended by the Film Commissioner for 30 additional days for reasonable cause. Failure to submit the Agreed-Upon Procedures Report on the required date will be deemed as non-compliance of the Grant with respect to the tax credits and tax credits reserved may be forfeited, as well as the Filing Fees paid. The Applicant may re-submit the application with respect to the tax credits and request that the Filing Fees paid be credited with respect to the new application of tax credits. The new application of tax credits will be subject to tax credit availability at the date of its filing.
- B. The Auditor must be a Certified Public Accountant licensed in the Commonwealth of Puerto Rico, who is not related to the Grantee and /or

producer of the Film Project and under no other type of contract or arrangement with the Grantee and /or producer of the Film Project.

- C. The Agreed-Upon Procedures Report of the Puerto Rico Production Expenses must be conducted in accordance with Statements on Standards for Attestation Engagements applicable to Agreed-Upon Procedures and the Auditor must have sufficient knowledge of accounting principles and practices generally recognized in the film and television industry.
- D. The Auditor must prepare and present as part of the Agreed-Upon Procedures Report: (i) a schedule of eligible costs incurred by calendar year, and (ii) provide notes to the report, including the notes described below. The schedule of eligible costs must set forth a breakdown with the full name of the payees by the proper budgetary item, as set forth in paragraph (G.) (ii) below, or describing the concept of the payment if such cost does not correspond to any of the items set forth in paragraph (G.) (ii) below.
- E. Puerto Rico Production Expenses will count towards the Tax Credits subject to: (i) in the case of production and post-production expenses, those incurred after the Pre-application Conference with the Film Commissioner or her designated representatives, and (ii) in the case of development and pre-production expenses, those that can be validated as being related to the Film Project covered by the Grant.
- F. The Agreed-Upon Procedures Report must be addressed to the Grantee. The Auditor's name, address, and telephone number must be evident on the report. The Agreed-Upon Procedures Report must be dated as at the completion of the audit fieldwork. The Film Project Title must be disclosed. The period during which the costs were incurred must be disclosed.
- G. The following procedures set forth minimum standards for acceptability of the Agreed-Upon Procedures to be performed. The Auditor is to make the certification considering the following guidelines and on the basis of having performed, at a minimum, these procedures:
  - i. The Auditor must verify all costs, expenses and disbursements incurred to determine that: (i) it has been duly invoiced to the Grantee or its designee, (ii) has been paid by the Grantee or its designee, (iii) it is related to the production costs, and (iv) it is considered an eligible cost. The process should include examination of invoices, source documents, contracts and cancelled checks. Also, the Auditor shall verify that: (1) all deposits associated to the 20% withholding on payments to the Non-resident Talent have been performed by comparing the deposit coupon of

tax withheld at source Form 480.31 (field labeled as “other”) and informative returns 480.6C<sup>2</sup> with the Non-resident Talent expense claimed by the Grantee, and (2) that all Puerto Rico Production Expenses claimed correspond to the economic reality of the transactions, that the benefit to Puerto Rico is more than a mere pass-thru activity and that it represents a true purchase and sale by a Puerto Rico vendor.

- ii. These costs must be charged to the proper budgetary item. Costs covered by making a lump-sum payment must be broken down by category, amount and vendor (if principal vendor contracts with other vendors for purposes of providing the article or service, all vendors in the supply chain must be identified). Production costs that will qualify for the motion picture tax credit shall not exceed standard market rates. Examples of production costs that will qualify for the motion picture tax credit include, but are not limited to the following:
  1. wages, fringe benefits, per diems or fees for talent, management or labor to a Person who is a Puerto Rico Resident or a Nonresident Talent;
  2. interest, charges and fees paid to financial institutions doing business in Puerto Rico; and/or
  3. any of the following provided by a vendor that is a Puerto Rico Resident:
    - a. the story and script to be used for a Film Project;
    - b. set construction and operations, wardrobe, accessories and related services;
    - c. photography, sound synchronization, lighting and related services;
    - d. editing and related services;
    - e. rental of facilities and equipment with a brief explanation of use and purposes;
    - f. leasing of vehicles, including the chartering of aircraft or watercraft provided such aircraft or watercraft are registered and homeported in Puerto Rico and such leasing is limited for travel within Puerto Rico, its airspace and territorial waters;
    - g. food or lodging (i.e. solely expense for room night);
    - h. commercial airfare if purchased through a Puerto Rico-based travel agency or travel company for travel

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<sup>2</sup> In the event that the informative returns on Form 480.6C are not available for the taxable year under review, the Auditor may perform the analysis set forth in paragraph (G.) (i) (I) by comparing the deposit coupon of tax withheld at source Form 480.31 against a copy of the payment instrument made to the corresponding Non-resident Talent.

- to and from Puerto Rico or within Puerto Rico that is directly attributable to the Film Project;
- i. insurance coverage and bonding if purchased through a Puerto Rico-based insurance agent or broker; and
  - j. production fees or similar budgetary items but only up to 10% of the Puerto Rico Production Expenses.
- iii. For expenditures that are considered eligible only in part, the Auditor must verify the allocation of cost formula to assure that its appropriately reflecting the expenditure related to the Puerto Rico production.
  - iv. The cost report must be in US dollars. Only expenditures which were incurred for the production can be recorded as production costs. Refunds and credit notes received for discounts, rebates, invoicing errors, and purchase returns must be credited to the production costs; similarly, proceeds from the sale of props and other production assets must be deducted from the costs presented in the cost report. In cases where props and other productions assets are kept in inventory for future productions, they must also be deducted, at fair market value, from the costs presented in the cost report. Completion bond expenditures must reflect any "no-claims rebate" received (the amount reported must be net after rebate). Amortization of series costs must be allocated to specific cost categories.
  - v. The Film Commissioner may authorize the use of a sampling method for purposes of performing the audit. In that case, the selection of the costs and eligible amounts incurred to be tested must be made using only an acceptable **statistical** sampling method (i.e. dollar-unit sampling, CMA, PPS, etc.) and **not** a non-statistical method (i.e., scopes, judgmental, etc.).
  - vi. The Film Commissioner may request to the Auditor any information that she deems necessary for purposes of validating the information presented by the Auditor as part of the Agreed Upon Procedure.
  - vii. The notes to the Agreed-Upon Procedures Report must include the following disclosures and schedules:
    1. The amounts spent in each calendar year for both the overall expenditures and the Puerto Rico employee payroll.

2. All non-Puerto Rico costs and must include the budget item and the amount of the transaction (if there are no non-Puerto Rico costs, the cost report must include a note to that effect).
3. All related party transactions (as defined by the accounting standards), and include the following: (i) The name of the related party, (ii) the nature of the relationship between the related party and the motion picture production company, (iii) the nature of the transaction, and (iv) the amount of the transaction. If there are no related party transactions, the cost report must include a note to that effect.
4. The amount of accounts payable, accrued charges and deferrals must be presented separately as of the ending date of the Agreed-Upon Procedures Report. If there are no accounts payable, accrued charges or deferrals, the Agreed-Upon Procedures Report must include a note to that effect.
5. All sources of funds that were used to finance the production must be disclosed, including any non-monetary transactions that were included in the cost of the production. Non-monetary transactions must be disclosed at fair market value.
6. The nature of the services provided and the consideration given in exchange for the services must be disclosed. If there were no non-cash transactions, the cost report must include a note to that effect.
7. An assertion that any disbursements for repairs and construction resulting from the damages caused by a natural even such as hurricanes, floods or earthquakes, are excluded from the costs reported as eligible.
8. An assertion that estimated costs of the time invested by the producer or any partner of the Grantee are excluded from costs reported eligible.
9. An assertion that cost allocations were made in accordance to the allocation method determined by the Company.