

**Arizona Department of Commerce**  
**MOTION PICTURE PRODUCTION TAX INCENTIVES PROGRAM**

**Program Guidelines<sup>1</sup>**

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**Section 1. Overview**

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The Motion Picture Production Tax Incentives Program (A.R.S. §41-1517) was established by the Arizona legislature in 2005 to promote the motion picture industry in the state. The program is effective December 31, 2005 through December 31, 2010 and provides the following tax incentives to qualified motion picture production companies:

- Transaction privilege tax (TPT) exemption on:
  - ✓ machinery, equipment and other tangible personal property
  - ✓ the lease or rental of lodging space
  - ✓ sales of catered food, drink and condiments
  - ✓ construction contracts for buildings or other structures
- Use tax exemption on machinery, equipment and other tangible personal property
- Income tax credits equal to 10%, 15% or 20% of the company's investment in qualifying production costs

A company seeking tax incentives under this program must obtain a twelve-month pre-approval (letter of qualification) from the Arizona Department of Commerce (Commerce). If the company's initial application is eligible, Commerce will issue pre-approval and will transmit a copy of the pre-approval to the Arizona Department of Revenue (Revenue). If Revenue establishes the company's eligibility under its statutes, Revenue will issue a certificate for transaction privilege tax and use tax exemptions and a Certificate of Good Standing. Once the company has the exemption certificate, TPT and use tax exemptions can be taken. When all productions proposed in the initial application are finished, the company must submit a Completion Report to Commerce. Commerce may issue post-approval to a company after verification that eligibility requirements have been met by the company during the production of the qualified motion picture(s). Once post-approval is received, a company may claim tax credits and retain TPT and use tax exemptions. For productions extending more than twelve-months, the company must obtain re-qualification from Commerce. Failure to submit a Completion Report will result in revocation of eligibility and tax incentives.

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**Section 2. Eligibility Requirements for Motion Picture Production Companies**

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A motion picture production company is eligible for incentives upon completion of all productions in its initial application and compliance with requirements in A.R.S. §41-1517 if it:

- Is primarily engaged in the business of producing motion pictures
- Has a physical office and bank account in Arizona
- Starts all of the productions in the initial application in Arizona in the first twelve-month pre-approval period
- Has a script, budget and proposed director, list of cast and crew for every production in the initial application
- Invests at least \$250,000 in qualifying production costs during each twelve-month pre-approval period
- Employs the statutorily required percentage of Arizona residents during each twelve-month pre-approval period
- Acknowledges each production, except for commercial advertisements, was filmed in Arizona,
- Is not obscene, does not depict sexual activity or sexually exploit a minor as provided under A.R.S. §§41-1517(E); 12-811; 13-3501; 13-3551; 13-3552; 13-3553
- Submits a viewable copy of the complete production to Commerce
- Receives pre-approval and post-approval for an initial application from Commerce

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<sup>1</sup> These Guidelines are provided to assist applicants. In case of conflict between what is presented here and the Arizona Revised Statutes, the statutes and the Arizona Administrative Code shall prevail. See A.R.S §§ 41-1517, 42-5009, 43-1075 and 43-1163.

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### Section 3. Definition of Program Terms

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For purposes of applying for and maintaining eligibility for the Motion Picture Production Tax Incentive Program, the following terms are either defined in A.R.S. §41-1517 or by Commerce. If a term is not defined, the most commonly accepted meaning will apply. For purposes of this program:

1. "Aggregated group" means two or more productions submitted in an initial application and treated as one production for purposes of calculating the investment threshold, employment requirements, tax credit limits, completion of production and content restrictions. Ineligibility for, or denial and recapture of, tax incentives applies to all the productions included in the initial application. Productions do not have to be of like nature to be combined as an aggregated group.
2. "Business day" means a day other than Saturday, Sunday, a legal holiday or the day the State of Arizona observes a legal holiday.
3. "Company" means the same as "motion picture production company."
4. "Completion" means the production meets all eligibility requirements under A.R.S. §41-1517 including: content restrictions, employment levels, inclusion of an Arizona acknowledgement and a viewable copy of the production has been submitted to Commerce for review.
5. "Costs incurred in Arizona" means an expense paid by the qualified company or its delegate to a retailer, lessor or contractor who has a physical office located within the boundaries of the state of Arizona.
6. "Date of receipt" means the day the initial application is **delivered to and accepted by** Commerce via United States Postal Service, private delivery service or hand delivery. Postmarks will be disregarded when determining the date of receipt. Any other form of delivery for an initial application, including emailed or faxed copies will not be accepted by Commerce and will be returned.
7. "Delegate" means a person or entity to whom the qualified company has assigned authority to incur expenses for the qualified company.
8. "Full-time employee" means an individual who works an average of at least four hours a day (during his/her employment periods) on productions identified in the initial application throughout the pre-approval period and for whom a qualified company or its authorized payroll service company is required to remit federal or state withholding tax. For each pre-approval period the company must verify whether an individual meets the conditions to be a "full-time employee."
9. "Initial application" means a Commerce form "Initial Application for Motion Picture Production Tax Incentives" and all required attachments to apply for the motion picture production tax incentives. An initial application may be based on a single production or an aggregated group of productions.
10. "Investment threshold" means qualifying production costs totaling at least \$250,000 during each pre-approval period.
11. "Motion picture" means a single medium or multimedia program, including a commercial advertising message, that:
  - a. Is created by production activities conducted in whole or in part in Arizona.
  - b. Can be viewed or reproduced.
  - c. Is intended for commercial distribution or licensing in the delivery medium used.
12. "Motion picture production company" means any person primarily engaged in the business of producing motion pictures and that has a physical business office and bank account in this state.
13. "Primarily engaged" means more than 50 percent of all business activity, measured by revenues or expenses, is in the business of producing motion pictures.
14. "Priority placement number" means the order in which the calendar year cap is allocated to qualified companies. The order is established by either:
  - a. The date of receipt of a single application by Commerce, or
  - b. The number determined by lottery for each day multiple initial applications are received.
15. "Production" means the same as "motion picture."
16. "Qualifying production costs" means costs incurred in Arizona after the date of pre-approval and prior to expiration of pre-approval and include:
  - a. Salaries and other compensation for talent, management and labor paid to residents of Arizona.
  - b. A story and scenario to be used for a motion picture.

- c. Set construction and operations, wardrobe, props, accessories and related services in Arizona. Construction costs are limited to those paid to contractors licensed in Arizona under A.R.S. §32-10.
  - d. Photography, sound synchronization, lighting and related costs.
  - e. Editing and related services.
  - f. Rental of facilities and equipment.
  - g. Catered food, drink and condiment.
  - h. Other direct in-state costs of producing the motion picture, pursuant to rules adopted by Commerce and Revenue that follow generally accepted accounting standards for the motion picture industry.
  - i. Payments for penalties and fines do not qualify as production costs.
17. "Script" means the storyline, dialog, scenes and directions written for a motion picture.
  18. "Start" means the date when qualifying production costs were incurred within the current twelve-month pre-approval period for each of the productions listed in the initial application.
  19. "Substantially complete" means all questions in the initial application are fully addressed by the company and all documents required by Commerce are attached or can be supplied within 5 working days after receipt of notification by Commerce of any deficiencies.
  20. "Synopsis" means a condensed written outline or summary of the motion picture.
  21. "Tax incentives" means the tax exemptions from transaction privilege and use taxes listed in A.R.S. §42-5009(H) and tax credits against Arizona tax liability provided under A.R.S. §§43-1075 or 43-1163.
  22. "Time of lease or rental" as used in Section 4 of this Guideline, means the period during which the lease or rental of the tangible personal property or lodging space for a consideration occurs. Due to the periodic nature of lease and rental transactions a motion picture production company must possess a letter of pre-approval from Commerce and a current Revenue issued exemption certificate throughout the lease or rental period in order to qualify to the TPT exemption.
  23. "Time of sale or purchase" as used in Section 4 of this Guideline, means the date on which the transfer of title or possession, or both, of the tangible personal property, for a consideration occurs.

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#### **Section 4. Program Tax Incentives**

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The Motion Picture Production Tax Incentives program provides the following six Arizona tax incentives to companies approved by Commerce:

1. **Transaction privilege tax exemption on machinery, equipment and other tangible personal property.** Under A.R.S. §§42-5061(B)(23) and 42-5071(B)(2)(b), eligible tangible personal property sold or leased to a qualified motion picture production company and used directly in motion picture production is exempt from TPT. *To qualify for the exemption, the qualified company must present a current Revenue issued exemption certificate to the retailer or lessor at the time of sale or lease.*
2. **Transaction privilege tax exemption on leases or rentals of lodging space.** Under A.R.S. §42-5070(C)(2), eligible leases or rentals of lodging space to a qualified motion picture production company is exempt from TPT. *To qualify for the exemption, the qualified company must present a current Revenue issued exemption certificate to the operator of the transient lodging facility at the time of lease or rental.*
3. **Transaction privilege tax exemption on catered food, drink and condiments.** Under A.R.S. §42-5074(B)(10), eligible sales of catered food, drink and condiments to a qualified motion picture production company are exempt from TPT. *To qualify for the exemption, the qualified company must present a current Revenue issued exemption certificate to the catering business at the time of the purchase.*
4. **Transaction privilege tax exemption on construction contracts.** Under A.R.S. §42-5075(B)(20) eligible contracts for the construction of any building, or other structure, associated with motion picture production in Arizona are exempt from TPT. *To qualify for the exemption, a qualified company must present a current Revenue issued exemption certificate to the prime contractor at the time the contract is entered into.*
5. **Use tax exemption on machinery, equipment and other tangible personal property.** Under A.R.S. §42-5159(B)(23), the storage, use or consumption in Arizona of eligible tangible personal property that is used directly in the motion picture production by a qualified motion picture production company is exempt from use tax. *To qualify for the exemption, at the time of purchase the qualified company must present to the retailer a current Revenue issued exemption certificate.*

6. **Income tax credits.** Under A.R.S. §§43-1075 and 43-1163, for years beginning from and after December 31, 2005 a non-refundable tax credit is allowed for a qualified motion picture production company. These tax credits can be used to offset Arizona tax liability. The tax credit is equal to 10%, 15% or 20% of the qualifying production costs incurred by a qualified company that are directly attributable to the production of a motion picture in Arizona.

The tax credits for a qualified motion picture production company are equal to:

<u>Credit Amount</u>	<u>Production Costs</u>
10%	\$250,000 - \$1,000,000
15%	\$1,000,001 - \$3,000,000
20%	More than \$3,000,000

The tax credit must be claimed by a qualified company on an original Arizona tax return along with Form 334 for the tax year in which post-approval was received. Co-owners of a company (including partners in a partnership, LLC members and shareholders of an S corporation) may each claim a share of the tax credits allowed. The allocation of tax credits among owners is not required to follow ownership interest. The total credits allowed all such owners may not exceed the amount that would have been allowed for a sole owner of the company. (A.R.S. §§43-1075(E) and 43-1163(E))

After the qualified company claims the tax credits on its original Arizona tax return it may use, carry forward, transfer or sell all or part of the tax credits to one or more persons, who may in turn use, carry forward, transfer or sell the tax credits an unlimited number of times. Transfer or sale of tax credits must meet the requirements of A.R.S. §§43-1075(G) and 43-1163(G). The sale or transfer of tax credits does not extend the five-year carry forward period. If qualification is terminated or revoked, all or part of the tax credits received under this program are subject to recapture under A.R.S. §§43-1075(G) and 43-1163(G). The transferee (purchaser) of the tax credit has recourse only against the transferor (seller), not the State of Arizona. Both the transferor and transferee must submit written notice of transfer to Revenue within 30 days after the transfer or sale of tax credits. To download Revenue's forms, visit <http://www.azdor.gov/>

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## Section 5. Tax Incentives Limitations

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- A. By law, Commerce cannot pre-approve more than \$5 million in tax credits for an initial application. Further, Commerce cannot pre-approve a total amount of tax credits that exceeds:

<u>Calendar Year</u>	<u>Maximum Tax Credit Amount</u>
2006	\$30 million
2007	\$40 million
2008	\$50 million
2009	\$60 million
2010 and after	\$70 million

- B. By law, Commerce cannot pre-approve tax incentives to a production that is obscene, depicts sexual activity or sexually exploits a minor as provided under A.R.S. §§41-1517(E); 12-811; 13-3501; 13-3551; 13-3552; 13-3553.
- C. All productions in an aggregated group must start during the twelve-month pre-approval period.
- D. Additional productions may not be added to or deleted from the aggregated group after the date of receipt of the initial application.
- E. If a company files a completion report for an initial application, Commerce shall not pre-approve any additional tax credits for any of the productions in an initial application for which pre-approval was issued.
- F. There is no limitation on the amount of TPT and use tax exemptions available to a qualified company or motion picture. Nor is there a limit on the total amount of TPT and use tax exemptions available in any calendar year under this program.

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## Section 6. Calendar Year Cap Management

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- A. Commerce shall pre-approve tax credits according to A.R.S. §41-1517(D). The date of pre-approval dictates the cap year from which the allocation is made. The total amount of credits pre-approved for a single production or an aggregated group of productions shall be applied against the calendar year cap in which pre-approval occurred. If a calendar year cap is exhausted, Commerce shall not allocate tax credits against any future year's cap until the first business day of that calendar year.

- B. When initial application is made, if sufficient cap is not available the company may either:
1. Accept any remaining allocation amount, or
  2. Withdraw the initial application and apply in the next year when sufficient cap may be available
- C. If a company files a completion report for an initial application, Commerce shall not pre-approve any additional tax credits for any of the productions in an initial application for which pre-approval was issued.
- D. A company may voluntarily relinquish the entire pre-approved tax credit amount by submitting the Commerce form "Voluntary Relinquishment of Tax Credits." A company can not relinquish part of its pre-approved tax credit amount. Tax credits that were voluntarily relinquished may be re-allocated to a qualified company with the next priority placement number if the relinquishment occurs in the same calendar year in which the initial pre-approval was issued. Tax credits relinquished after the calendar year in which pre-approval was issued are not subject to re-allocation.

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## **Section 7. Process for Accepting Initial Applications**

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The acceptance process described in this section will determine the priority placement number assigned to initial applications. The priority placement number determines the order in which Commerce allocates that calendar year's cap. Commerce shall accept initial applications for a calendar year's cap on or after the first business day of every calendar year. Any initial application for a calendar year's cap received prior to the first business day of the calendar year will be returned. Commerce will date stamp initial applications on the date of receipt and assign a priority placement number as follows. If a single application is received on any day, it will be assigned a priority placement number on the next business day following the date of receipt. If more than one initial application is received on any day, each initial application will be entered into a lottery for that day. The lottery will be held on the next business day following the date of receipt of the initial application.

Any initial application for a calendar year's cap that is not substantially complete will be returned without further processing and the priority placement number will be voided. If an initial application is returned by Commerce a company may file a revised initial application for the same production(s) and receive a new priority placement number.

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## **Section 8. Processing Initial Applications for Pre-Approval**

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- A. A company may apply to Commerce for a twelve-month pre-approval (letter of qualification) for motion picture production tax incentives on or after the first business day of a calendar year. For 2006, the first business day is Tuesday, January 3<sup>rd</sup>.

An initial application may be based on either a single production or an aggregated group of productions. Note: a television episode is treated as a single production and may be combined with other episodes to form an aggregated group; the same is true for commercial advertising messages and still photography work. Productions do not have to be of like nature to be combined as an aggregated group. A company choosing to aggregate productions in its initial application agrees that all productions included in the aggregated group will be treated as a single production for determining the following:

- \$250,000 threshold investment,
- Percentage of tax credit allocation,
- \$5 million tax credit maximum,
- Completion of production,
- Arizona employment level requirements,
- If it is obscene, depicts sexual activity and sexually exploits a minor as provided under A.R.S. §41-1517(E), and
- Denial or recapture of incentives due to ineligibility of one or more productions listed in the initial application.

Application can be made by submitting the Commerce form: "Initial Application for Motion Picture Production Tax Incentives". A company may have more than one initial application at any given time. Note: pre-approval does not guarantee receipt of tax incentives under this program because pre-approval is issued before Commerce determines final eligibility.

The Initial Application shall include:

1. Name and contact information for the company
2. Name and contact information of an individual who will maintain records of expenditures in Arizona
3. The Arizona production office address and phone number
4. For each production in the initial application, including those in an aggregated group:
  - a. A script and synopsis

- b. Name of the proposed director
  - c. Name of the proposed producer
  - d. Prelim list of cast and crew
  - e. Projected earliest pre-production date and last production date in Arizona
  - f. The estimated total budget of each production
  - g. The estimated total Arizona expenditures of each production
  - h. The estimated total percentage of the production taking place in Arizona
  - i. The estimated level of employment of Arizona residents in cast and crew
5. The company must submit to Commerce a signed affidavit in which the company agrees, but is not limited, to the following:
- a. To furnish records of expenditures in Arizona to Commerce or Revenue on request
  - b. Use any items purchased with a certification of exemption directly in or associated with motion picture production
  - c. That the information contained in the initial application is true and correct under penalty of perjury
- B. Concurrent with submittal of an initial application to Commerce, a company may request a certificate of good standing from Revenue by submitting form "Tax Clearance Application." Submitting the "Tax Clearance Application" at this time will expedite Revenue's approval.
- C. During review of the initial application, Commerce may request additional information, conduct a site visit or discuss the initial application with the company. The company will have five working days to supply any additional information requested by Commerce. If the information is not timely submitted to Commerce the initial application will be returned to the company and the priority placement number assigned to the initial application will be voided.
- D. Pre-approval will be granted or denied within 30 days after the date of receipt of a complete initial application.
- E. If Commerce denies pre-approval, the company may appeal the decision in accordance with A.R.S. Title 41 Chapter 6 Article 10.
- F. If the company is eligible for tax incentives, Commerce shall issue pre-approval (letter of qualification) and transmit a copy to Revenue for action. Pre-approval is issued to a qualified company for each initial application and is effective for a twelve-month period. A pre-approval includes an estimated dollar amount and percentage of calendar year cap allocation of tax credits, the effective date and the expiration date of the pre-approval, the priority placement number and the production name(s).
- G. If Revenue establishes the company's eligibility under its statutes, Revenue will issue a certificate for TPT and use tax exemptions and copy Commerce. Once the company has the exemption certificate, TPT and use tax exemptions can be claimed by providing a copy of the Revenue issued exemption certificate to a vendor at the time of the transaction as discussed in Section 4 of this Guideline.

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## **Section 9. Next Steps: During Production**

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### **A. Qualifying Expenses**

Any expense incurred prior to a pre-approval or subsequent to expiration of a pre-approval will not be considered a qualifying expense, nor will it be counted toward the \$250,000 investment threshold. Only qualifying costs incurred in Arizona that are directly attributable to a production as shown in the initial application can be counted toward the investment threshold. The \$250,000 investment threshold must be met for each pre-approval, which is based on an initial application. Therefore, a company with two or more initial applications must make a separate \$250,000 investment for each pre-approval.

A qualified company must maintain records of expenditures on a single production or aggregated group of productions in order to certify costs to Commerce or Revenue upon completion of production. Expenditures shall be reported to Commerce using "Expense Report Forms 1 & 2."

### **B. Employment Levels and Residency**

The calendar year of a pre-approval or re-qualification letter dictates the employment percentages that must be met for the twelve-month period. A qualified company must employ residents of Arizona in its production activities as follows:

- In 2006, at least twenty-five per cent of full-time employees working in the state must be Arizona residents.
- In 2007, at least thirty-five per cent of full-time employees working in the state must be Arizona residents.
- In 2008 through 2010, at least fifty per cent of full-time employees working in the state must be Arizona residents.

To establish residency for a full-time employee, a qualified company must on the date of hire obtain a "Residency Affidavit" for each Arizona resident involved in production activities in the state. The Residency Affidavit is valid for all pre-approval periods but can only be used for a single initial application. The company must retain the Residency Affidavits to document the Arizona employment levels in the event of audit by Revenue.

To report employment data to Commerce, a company shall use "Calculation of Arizona Residency Forms 1 & 2." Arizona residency must be expressed as a percentage. To calculate the percentage: divide the total number of hours worked by full-time Arizona residents by the total number of hours worked by full-time employees on the production during each pre-approval period while in Arizona.

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## **Section 10. Processing Completion Reports for Post-Approval**

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- A. To maintain eligibility, within 30 days of completion of all productions in the initial application, the company must submit a "Completion Report" to Commerce. A production does not need to be released or distributed to be considered complete and to generate tax credits or exemptions.

The Completion Report shall include:

1. Expense Report Forms 1 & 2 for each production in the initial application
  2. Calculation of Arizona Residency Forms 1 & 2 for each pre-approval period
  3. A complete and viewable copy of each production in the initial application
- B. To generate a tax credit and retain TPT and use tax exemptions a company must document compliance with the provisions of A.R.S. §41-1517 and the requirements established in the Program Guidelines. Commerce will verify the company met all eligibility criteria in each pre-approval period.
- C. Upon verification of eligibility, Commerce shall issue post-approval. The post-approval will include the production name(s), a specific dollar amount and the percentage of tax credits the qualified company may claim. Commerce will review total production costs and recalculate the final amount of tax credits. The post-approved amount may be less than the pre-approved amount (if costs were less than estimated), but never higher. The qualified company must claim tax credits on its original Arizona tax return for the year in which post-approval was received. Only after claiming the tax credit with Revenue can the qualified company use, carry forward, transfer or sell the tax credits.

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## **Section 11. Re-Qualification Process**

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- A. If one or more of the productions is not completed in the twelve-month pre-approval period and work in Arizona will continue, the company must be re-qualified. A company may apply for another pre-approval by submitting a "Request for Re-Qualification" to Commerce at least 30 days prior to the expiration of a pre-approval period. Re-qualification applies to a single initial application.
- B. If one or more of the productions is not completed in the twelve-month pre-approval period and work will continue outside of the state of Arizona, the company must submit written notification to Commerce of that fact.
- C. For either a single production or aggregated group of productions, during re-qualification periods the company must make an investment of \$250,000 in qualifying production costs on a production that was listed in the initial application but not yet completed. If the company does not meet the investment threshold or otherwise maintain eligibility in re-qualification periods, the company will not receive post-approval and, therefore, will be unable to claim any tax credits on all productions in the initial application. Further, TPT and use tax exemptions will be denied and recaptured for all periods.
- D. The Request for Re-Qualification shall include but is not limited to:
- a. Updated information on the location, ownership and operations of the company
  - b. Affirmation that eligibility requirements continue to be met
- E. Re-Qualification will be granted or denied within 30 days after the date of receipt of a complete Request for Re-Qualification. If a Request for Re-Qualification is deficient the company will be notified by Commerce and have 5 working days to correct the deficiencies.
- F. If Commerce denies re-qualification, the company may appeal the decision in accordance with A.R.S. Title 41 Chapter 6 Article 10.
- G. If the company is eligible for re-qualification, Commerce shall issue another twelve-month pre-approval (letter of qualification) and transmit a copy to Revenue for action.
- H. If Revenue establishes the company's eligibility under its statutes, Revenue will issue another certificate for TPT and use tax exemptions.

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## Section 12. Revocation of Qualification and Recapture of Incentives

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- A. A.R.S. §41-1517(L)(2) provides that a company must be primarily engaged in the business of producing motion pictures during all of the pre-approval periods. If a qualified company doesn't meet the requirements as reported in the Completion Report, the company's qualification will be revoked. Commerce will notify Revenue to initiate revocation and recapture of incentives already received during all of the pre-approval periods.
- B. Under A.R.S. §§42-5009, 43-1075 and 43-1163, Revenue may terminate a company's eligibility if it obtains information indicating failure of the company to qualify for incentives and compliance with program requirements. Revenue may require the taxpayer to file appropriate amended tax returns reflecting the recapture of the tax incentives.
- If qualification is terminated or revoked, all or part of the tax credits received under this program are subject to recapture under A.R.S. §§43-1075(G) and 43-1163(G). The transferee (purchaser) of the tax credit has recourse only against the transferor (seller), not the State of Arizona.
  - If qualification is terminated or revoked, all or part of the TPT and use tax exemptions received under this program are subject to recapture under A.R.S. §42-5009(H).
  - If a production in the aggregated group becomes ineligible the entire aggregated group is ineligible. Therefore, cancellation or recapture of incentives applies to all productions in the aggregated group.

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Questions regarding Motion Picture Production Tax Incentives  
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