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Georgia Department of Revenue Increasing Random Audits of Entertainment Tax Credits

Georgia is unique amongst the states with large entertainment incentive programs in that there is no audit required to claim and sell Georgia entertainment tax credits. Nonetheless, many production companies choose to have their qualified production expenditures voluntarily audited by a third party CPA firm or by the Georgia Department of Revenue (the "Department") as a prerequisite to selling their entertainment tax credits.

Historically, there have not been many "involuntary" audits of production companies (meaning random selection for income tax audits like any other taxpayer). However, the Department appears to be ramping up involuntary audits of production companies, focusing on qualified production expenditures and resultant entertainment tax credits. These audits are mostly being performed by the same group that performs the voluntary audits. The Department does not appear to be treating these as audits requiring the taxpayer to reimburse the Department for the costs of the audit.

The group that performs the voluntary audits has historically been reasonable in interpreting Georgia's statutes and regulations governing the incentive program. However, the Department appears to be tightening in certain expense categories, most notably "excessive" travel and "extravagant" expenses.

It is important to remember that both involuntary and voluntary audits are ultimately state tax controversies which may be protested and appealed by the taxpayer, although the rules for protesting an involuntary audit may differ from the rules for challenging a voluntary audit (addressed below). Further, such audits are governed by Georgia's Administrative Procedures Act, which sets out certain limitations on how the Department should make and administer regulations. O.C.G.A. § 48-2-12(c). Chief among these limitations are the following:

The Department may not enforce unwritten rules via positions taken on audit. If a position taken by the Department on audit is generally applicable and is not set out in or clearly supported by a written regulation, the position may not be enforced; The Department may not create a secret body of rules known only to its auditors through unwritten positions taken on audit.

All rules and regulations promulgated by the Department must be clearly supported by statutory authority and must be a reasonable interpretation of the statute they purport to administer; The Department may not make or add to existing laws.

See, Dep't of Human Resources v. Anderson, 218 Ga. App. 528 (1995); Ga. Real Estate Commission v. Accelerated Courses in Real Estate, 234 Ga. 30 (1975); Oxford Construction Co., Inc. v. Commissioner, No. 2004CV168JS (Lee County Superior Ct., July 24, 2006) The Department's regulations only broadly define qualified production expenditures, unlike other states whose program materials specifically address almost every category of expenditure (e.g., New York). Accordingly, many of the positions taken by the Department on audit will in effect be unwritten rules that could be challenged as violating the Administrative Procedures Act. This is especially the case when the Department attempts to enforce an unwritten rule on a retroactive basis to prior tax periods.

Further, both the incentive statute and the Department's regulations have a "catch all" statement that follows the categories of expenses listed as qualifying. This "catch all" language states that qualified production expenditures include "other direct costs of producing the project in accordance with generally accepted entertainment industry practices." O.C.G.A. § 48-7-40.26(b)(5); Ga. Comp. R. & Reg. 560-7-8-.45(6)(c) (emphasis added). Accordingly, if an expense is deemed to be a direct cost of production under generally accepted entertainment industry practices, any Department audit position inconsistent with such practices is arguably not supported by the statutory or regulatory language. Therefore, such an audit position could be challenged as violating the Administrative Procedures Act.

Generally, in an involuntary audit, the auditor will set out his or her findings in writing prior to the issuance of a formal assessment. Any audit positions with which a production company disagrees should be challenged as early as possible by setting out the taxpayer's position in writing, preferably before a Notice of Proposed Assessment is issued. If such a position is the basis for a Notice of Proposed Assessment, the taxpayer has 30 days to protest such an assessment and request an informal conference with the Tax Law & Policy Division of the Department, which is a different division than the Compliance Division which conducts voluntary and involuntary audits. If a resolution can't be reached with the Department via an informal conference, the Department will issue a Final Assessment & Demand For Payment. A final assessment may be appealed either to the relatively new Georgia Tax Tribunal, a special executive branch court that hears only tax disputes, or to the applicable superior court (trial court of general jurisdiction in Georgia).

For voluntary audits, it is the Department's position that its voluntary audit findings can't be directly appealed. Rather, the Department takes the position that the taxpayer must claim disallowed expenses on its tax return and wait for an involuntary audit and formal assessment, and then appeal such an assessment. However, Georgia law provides that any "order, ruling, or finding" of the commissioner may be appealed to either superior court or the Georgia Tax

Tribunal. O.C.G.A. §§ 48-2-59(a); 50-13A-9(a). A voluntary audit report is arguably a finding of the Department subject to immediate appeal.

Please call Peter Stathopoulos with any questions at 678-218-1396.