Tax Panel

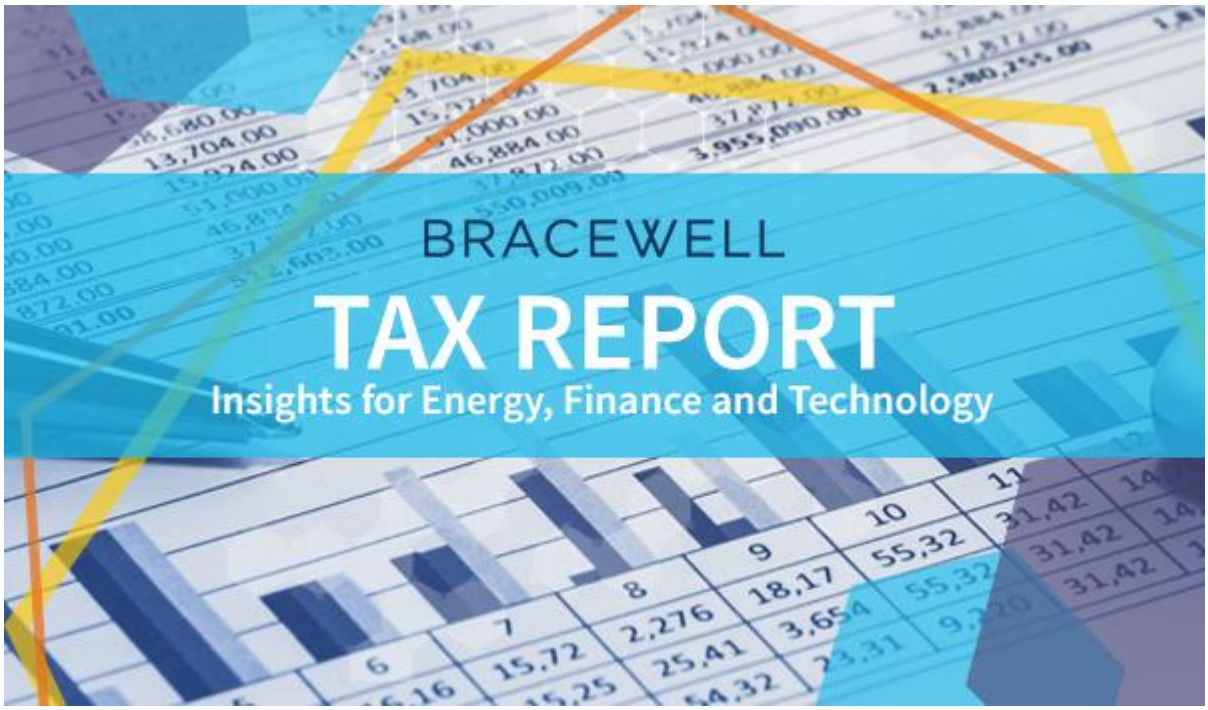
Michele Alexander, Esq.
Bracewell LLP, New York, NY

Fred Siegel, CPA
Fred Siegel CPA, NEw York, NY

BRACEWELL

From Hollywood to the Gray Lady: The Impact of Tax Reform on Film, Television and Print Media

March 29, 2018 | **Blog Posts** [/insight-type/blog-posts] | By: **Michele J. Alexander** and **Ryan Davis**



While the media has been reporting on recent tax reform since before the first draft of the bill was introduced, tax reform also will impact the media industry itself, in ways both expected and unexpected. As we will explore here and in future installments, the industry may be impacted in many ways, from a reduction in tax rates and new deductions, to the loss of important deductions and new international regimes that have kept tax experts waiting in anticipation of further guidance.

Considered some of the biggest winners as a result of the reduced corporate tax rate, media companies stand to reap billions from the 40% decrease (from 35% to 21%) provided for in the Tax Cuts and Jobs Act (TCJA). Most of the largest companies in this space operate as corporations (such as Disney, Comcast, and 21st Century Fox) and, as a result, the industry paid one of the highest effective tax rates of any sector.[1] [#1] Moreover, media companies operating in corporate form will be able to take advantage of the new 100% dividends received deduction (DRD) for distributions from a foreign subsidiary to its 10% U.S. shareholders. This deduction applies only to the foreign-source portion of dividends received from a foreign corporation by its U.S. corporate shareholders and is therefore not available to companies which operate as partnerships (or other entities treated as pass throughs, such as LLCs), resulting in an advantage for media companies over their competitors operating in these non-corporate forms. As a result of these factors, the media and entertainment industry is

expected to see one of the largest windfalls as a result of the TCJA's passage. This newfound surplus comes at a particularly precarious time for these media companies, as cord-cutting, competition from internet-based streaming and other services and the multiplication of alternative news sources have cut into the revenues of film, television and print media.[2] [#1] Consequently, these companies may use this income to reinvest in capital and labor, as many claim was evidenced by the widely publicized bonuses both Disney and Comcast paid to employees in the immediate aftermath of the TCJA's passage.[3] [#1] However, some argue that companies will not use the windfall for compensation but rather for stock buybacks and other actions to benefit stockholders.[4] [#1] These additional funds also may lead to an increase in M&A activity, as companies attempt to use the extra cash to fund both mergers and acquisitions in order to better secure their place in an increasingly difficult market.

Owners of smaller media companies that operate as partnerships also may benefit from the new qualified business income (QBI) deduction (click **here** **[https://www.bracewell.com/blog/impact-individuals-operating-business-directly-or-indirectly-through-pass-through-entity]** for more). New Code Section 199A generally permits a 20% deduction against taxable income for QBI, which, broadly-speaking, is taxable income earned through partnerships from certain U.S. trades or businesses. Under prior law, an individual taxpayer's QBI would have been subject to the ordinary federal income tax rates applicable to individuals, with a maximum rate of 39.6%. Under the TCJA, unless limitations apply, the QBI deduction could reduce the maximum effective rate imposed on an individual's share of a partnership's QBI to 29.6% (or 80% of the new maximum ordinary rate of 37%). However, new Code Section 199A seems to come at the cost of former Code Section 199, which provided a deduction for domestic production activities (the Domestic Production Activities Deduction or DPAD) and was relied upon heavily in the media and entertainment industry, most notably for film and TV production. This incentive brought film and TV production back from Canada and other jurisdictions that had initially lured companies abroad with low cost and tax incentives. U.S. states, such as Georgia, New York and North Carolina, and U.S. cities, such as New York City, followed suit by implementing incentives of their own. With the repeal of the DPAD, it remains to be seen if state and local incentives will be sufficient, along with lower tax rates and a new expense deduction (discussed below), to keep media production on shore or whether they will have to add new incentives and/or augment existing ones.

As noted, the loss of the DPAD may be partially counteracted by new production incentives for domestic film, television and live theater. The immediate expensing provision contained in Code Section 168(k) allows businesses to immediately deduct the full cost of new and used property placed into service between September 27, 2017 and (generally) January 1, 2023, at which point the percentage that may be expensed begins to be phased down through January 1, 2027. Code Section 168(k) specifically permits film and theater production companies to take advantage of this new immediate expensing with respect to their capital investment in projects where 75% of the compensation for services occurs in the United States, with the intention of increasing the number of projects undertaken domestically. The extent to which this new deduction mitigates the effect of the DPAD's repeal thus depends in part on how capital intensive a company's production activities may be.

Media companies debating the pros and cons of keeping production activities in the United States certainly will have to consider the implications of the TCJA's international tax reform provisions. In addition to the decreased corporate rate, the second primary aim of corporate tax reform was bringing the U.S. federal tax system more in line with the territorial model. These provisions seek to accomplish this by both encouraging the repatriation of income held abroad and punishing companies that refuse to do so. In order to encourage the return of this capital to the United States, the TCJA provides for a low one-time repatriation tax on income previously kept offshore (15.5% on foreign cash and other liquid assets and 8% on all residual assets, in each case, to the extent of earnings and profits). This will provide domestic media companies with much-desired access to money that has been kept offshore due to the high cost of repatriation before the passage of the TCJA.

Taxpayers operating in this sector will be further encouraged to take advantage of this one-time repatriation opportunity as a result of certain punitive measures found within the TCJA's international provisions. The new Base Erosion Anti-Abuse Tax (BEAT) generally operates to limit deductibility of payments to affiliates of U.S. taxpayers that are in low- or no-tax jurisdictions (click **here** **[https://www.bracewell.com/blog/provisions-affecting-renewable-energy-and-power-industry]** for more). The BEAT generally requires corporations with average annual gross receipts of $500 million to pay a tax on deductible payments made to foreign affiliates equal to 10% for years before 2025, with a phase in at 5% for 2018. Worldwide media companies might find themselves unexpectedly hit by BEAT, depending on the residency of their affiliates (i.e., in low-tax jurisdictions) as BEAT does not require an intent to evade tax.

Another new international provision in the TCJA, the global intangible low-taxed income (GILTI) tax, is designed to impose a tax on companies that hold valuable intangible assets offshore, a particularly important provision for a global industry reliant on licenses, copyrights and royalties. This requires U.S. shareholders holding at least a 10% share of a controlled foreign corporation to include in gross income for the tax year such corporation's income from intangible assets held abroad that would not otherwise be taxable in the United States (click **here** **[https://www.bracewell.com/blog/focus-finance-impact-tax-reform]** for more). Although there are deductions available that will allow corporations to be taxed on intangibles at an effective rate of 10.5% through 2025 and at 13.125% beginning in 2026, this still presents a liability that may push media companies to repatriate offshore assets. As we have noted in previous installments, these rules are under intense scrutiny for certain potential unintended consequences, so future guidance and regulations that could impact how this provision is interpreted and/or enacted may be forthcoming.

In addition to the benefits of reform described above, media companies—particularly television and print media which depend heavily on advertising dollars—dodged a bullet when Congress decided not to use the TCJA to remove certain advertising deductions.[5] [#1] [#1] Aside from its effect on the largest media corporations, the removal of these deductions would have had a particularly negative impact on local television and print media, which rely heavily on small business advertising. The possibility of removing this deduction in order to pay for other tax decreases in the bill was openly discussed throughout the drafting process, with many proponents of local media outlets claiming that its removal would prove to be a death knell for these already

struggling enterprises.[6] [#1] To the relief of these advocates, the deduction's removal did not find its way into the bill's final form.

---

[1] See **here** **[http://deadline.com/2017/12/tax-overhaul-hollywood-windfall-1202230059/]**

[2] See **here** **[https://www.pwc.com/us/outlook]** and **here** **[http://www.pewresearch.org/fact-tank/2017/06/01/circulation-and-revenue-fall-for-newspaper-industry/]**

[3] See **here** **[http://variety.com/2018/tv/news/media-firms-tax-reform-1202695792/]**

[4] See **here** **[http://www.syracuse.com/opinion/index.ssf/2018/03/gop_tax_law_will_devastate_new_yorkers_commentary.html]**

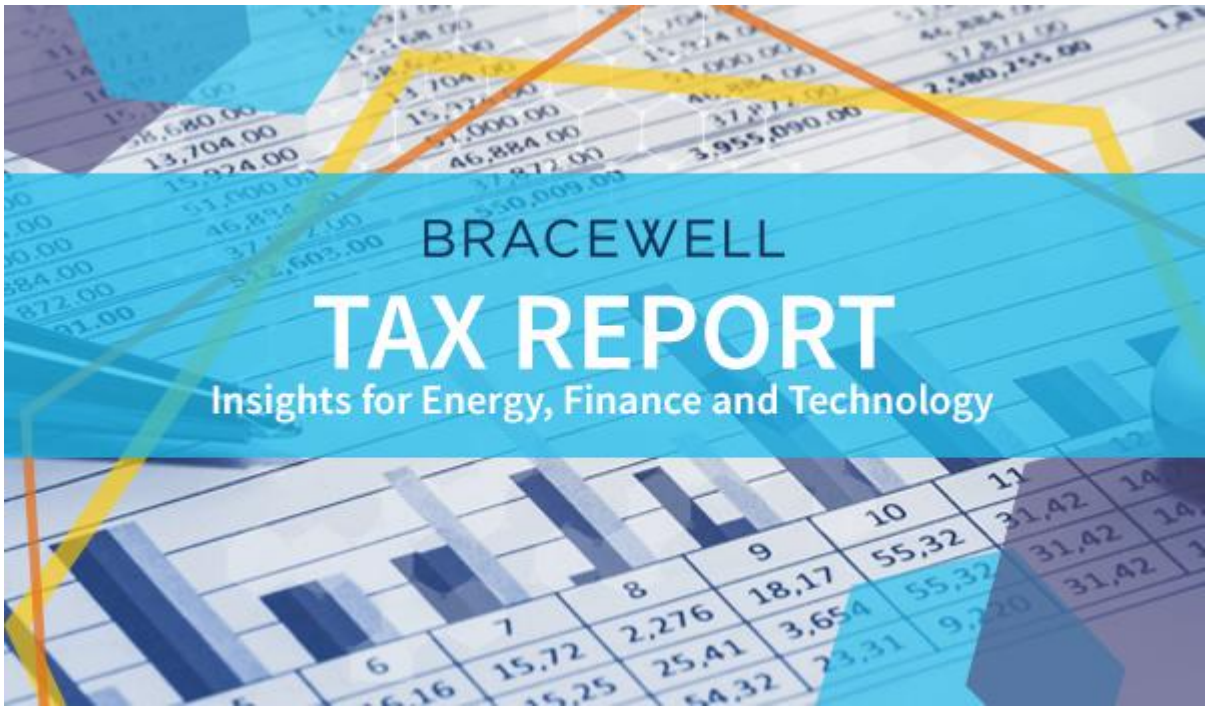
[5] See **here** **[https://www.bloomberg.com/news/articles/2017-10-31/big-media-makes-late-push-to-kill-advertising-levy-in-tax-bill]**

[6] See **here** **[http://thehill.com/policy/finance/333743-lawmakers-leave-advertising-tax-break-alone]**

BRACEWELL

From Hollywood to the Gray Lady: The Impact of Tax Reform on Film, Television and Print Media - Part 2

April 12, 2018 | **Blog Posts** [/insight-type/blog-posts] | By: **Michele J. Alexander** and **Ryan Davis**



As noted in our last report, tax reform will impact the media industry in many ways, including those in the industry responsible for reporting on the widespread effects of these sweeping changes to existing tax law. In this installment, we will explore new limitations which will specifically impact media companies' restructuring, acquisition and disposition strategies.

The Tax Cuts and Jobs Act (TCJA) contains new limits on a corporation's ability to take advantage of its net operating losses (NOLs), which may harm traditional media companies disproportionately operating as corporations (click **here** **[https://bracewell.com/blog/focus-finance-debt-restructuring-under-tax-cuts-and-jobs-act]** for more). As a result of the TCJA, corporations generally will be able to utilize NOL carryovers against only 80% of their taxable income in future years, and carrybacks are eliminated. Notably, this change affects losses arising in 2018, so NOL carryforwards from 2017 and earlier are not subject to the 80% limit (or carryback repeal) – which may accelerate business transactions that originally were contemplated to occur further down the road for media companies than 2018. While we already expect to see more M&A activity in this sector due to the 40% decrease in the corporate tax rate, target media companies with large NOLs otherwise may be considered less attractive due to the limited opportunity to use prior losses in future years. Of course, taxpayers already had been subject to limits in their ability to "traffic" in losses by purchasing such "loss companies" – namely, Code

Section 382 limits the ability of a corporation, following an "ownership change" (a defined term, but one that includes most M&A activity) to use "pre-change" losses against "post-change" income. Because the limitation is the value of the corporation at the time of the change multiplied by a prescribed rate, there may be circumstances where it is not a material impediment (i.e., where the value of the enterprise is high). However, even there, and certainly where the Code Section 382 limitation already is severe, this new NOL limit further devalues the tax benefit. As a result, 2018 may be a banner year for media acquisitions, as companies try to close transactions ahead of this change.

The new NOL limitation also may have a large impact on strategic decisions media companies must make on whether to restructure their debt. Generally, when debt is forgiven or reduced, borrowers are taxed on the amount of debt from which they are, or are deemed to be, relieved (cancellation of indebtedness, or COD, income). As noted **here** [https://bracewell.com/blog/focus-finance-debt-restructuring-under-tax-cuts-and-jobs-act] , a company looking to restructure its debt and facing the possibility of COD income could rely on: (1) large NOL carryovers to shield taxable COD income and (2) an exclusion of COD income from taxable income for a debtor who is in a bankruptcy case or insolvent (but, in the latter case, only to the extent the debtor's liabilities exceed its assets). Where the COD income is excluded, such exclusion is at the cost of reducing certain attributes of the debtor, notably NOLs and depreciable tax basis. As we have explored previously, but revisit here in the context of media restructurings, the new NOL limitation is a new headache for a taxpayer that cannot exclude COD income (in whole or in part). If the taxpayer has (noncash) taxable income from cancellation of debt and insufficient current year losses to shield such income, it could have tax for the year of the restructuring as a result of no longer having a full NOL carryover – and no related cash with which to pay it.

Again, given that the 80% limitation (and carryback repeal) applies to losses arising in taxable years beginning in 2018, more restructurings in 2018 may be expected. Of course, many restructurings will continue to result in excluded COD income. Though not specifically addressed in the new law, we would expect the entire NOL (i.e., not limited to 80% of current taxable income) to be available for reduction against such excluded COD income. Considering that insolvent media companies not in bankruptcy only can exclude COD income (and reduce its tax assets) to the extent of insolvency, following 2018 we may see more media workouts in bankruptcy (possibly prepackaged) to avoid the direct impact of the 80% limitation.

The new interest deduction limits also could be an issue for media companies. Under the TCJA, interest on indebtedness generally may be deducted only up to an amount equal to the sum of business interest income and 30 percent of adjusted gross income (the Interest Deduction Limit) (click **here** [https://bracewell.com/blog/focus-finance-impact-tax-reform] for more). The disallowed interest may be carried forward indefinitely to succeeding taxable years and also may impact media companies' restructuring decisions. As media companies do not typically function as lenders or invest in debt, the new limit effectively is 30 percent of adjusted gross income (and, beginning in 2021, without deduction for depreciation, amortization or depletion). Thus, the new provisions may act as a 30% taxable income limit (with no interest income buffer). However, media companies incur debt and, whereas the new NOL limitations may impact future restructurings, the Interest Deduction Limit may alter the manner in which media companies borrow and restructure existing debt. Generally, there is no COD income recognized to the extent the payment of a liability would have given rise to a deduction. Under

prior law, this meant that interest generally was not included as COD income if it was deductible. As we discuss **here** [https://bracewell.com/blog/focus-finance-debt-restructuring-under-tax-cuts-and-jobs-act] , it may be this exception could be read to apply only to the extent that the interest is deductible in the year after the Interest Deduction Limitation is applied. On the other hand, the indefinite carryover could be interpreted to mean that the interest will be deductible at some point (assuming no other limits apply), thus any unpaid interest should continue to be excluded from COD income. To the extent this issue remains unclear, it could impact the ability of media companies to restructure.

As we discussed in our first Bracewell Tax Report (click **here [https://bracewell.com/blog/focus-finance-impact-tax-reform]**), we may see more companies looking to preferred equity investment (rather than debt) as a result of the Interest Deduction Limitation (and the NOL limits, to the extent otherwise deductible interest creates or increases NOLs that now may be viewed as less valuable). Going forward, we may see both debt for preferred equity exchanges as well as new placements of preferred equity. Given to whom this type of investment typically is attractive, the media industry may be well-positioned to be an exciting new area for private equity investment.

Finally, the repeal of like-kind exchange treatment other than for real estate also stands to disproportionately affect media transactions. Prior to the TCJA, Code Section 1031 allowed for tax-free treatment where property held for use in a trade or business or for investment was exchanged for like-kind property (also held for use in a trade or business or for investment). Television and radio station owners historically switched stations amongst themselves in order to better take advantage of broadcast areas which provided them with more conducive audiences, often in multi-party transactions. This became especially attractive after 2000 once the IRS began ruling (albeit privately) that FCC licenses – even television and radio licenses – were like kind, a point that had been greatly debated due to the differing range, geography and demographics each station could provide.[1] [#1] However, new Code Section 1031(a)(1) limits like-kind exchanges to real property, leaving owners of personal property, such as FCC licenses, out in the cold. Moreover, as FCC licenses are not tangible personal property, they will not be eligible for the new immediate expensing provisions of Code Section 168(k) (click **here** [https://bracewell.com/blog/focus-finance-debt-restructuring-under-tax-cuts-and-jobs-act] for more) which would have offset the loss of like-kind exchange treatment. This repeal will likely have a chilling effect on such transactions, generally seen as beneficial and promoting efficiency the industry.

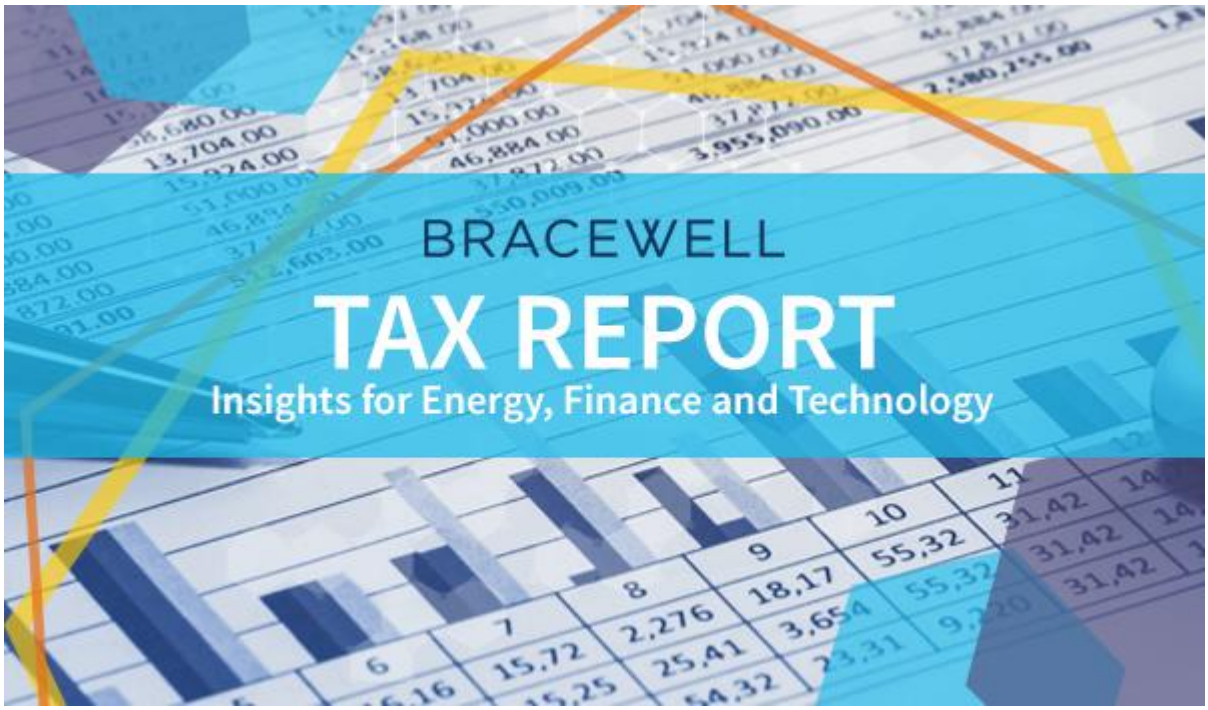
---

[1] See TAM 200035005.

BRACEWELL

From Hollywood to the Gray Lady: The Impact of Tax Reform on Film, Television and Print Media - Part 3

April 26, 2018 | **Blog Posts** [/insight-type/blog-posts] | By: **Michele J. Alexander** and **Ryan Davis**



As we have noted in past reports, tax reform is impacting the media industry in a number of important ways (click **here** [https://bracewell.com/blog/hollywood-gray-lady-impact-tax-reform-film-television-and-print-media] and **here [https://bracewell.com/blog/hollywood-gray-lady-impact-tax-reform-film-television-and-print-media-part-2]** for more). In this installment, we further explore new international and domestic provisions that will impact media companies' decisions regarding foreign versus domestic production.

Unlike many of the country's largest technology companies, media and entertainment companies generally did not benefit from inversions and other pre-tax reform practices that reduced their overall U.S. tax bill. However, they still find themselves casualties of the Tax Cuts and Jobs Act (TCJA) efforts to curb the parking of valuable assets, and payment of significant cash amounts, offshore. In order to encourage the return of valuable assets and capital to the United States, the TCJA provides for a low one-time repatriation tax on income previously kept offshore (15.5% on foreign cash and other liquid assets and 8% on all residual assets, in each case, to the extent of earnings and profits). Although the tax is intended as short-term encouragement for the return of capital to the United States (as it is imposed whether or not cash actually is repatriated), this also could act as a longer-term incentive for keeping domestic media production onshore. This longer-term domestic benefit is reinforced by other new provisions found in the TCJA. The new Base Erosion Anti-Abuse Tax (BEAT)

complements the repatriation tax by providing an incentive for American companies to hold assets onshore by doing away with the primary benefit they derived from not doing so – specifically, the avoidance of U.S. federal taxation. The new provision accomplishes this by limiting the deductibility of payments to foreign affiliates in lower-tax jurisdictions by U.S. taxpayers (click **here** **[https://bracewell.com/blog/hollywood-gray-lady-impact-tax-reform-film-television-and-print-media]** for more). The BEAT generally requires corporations with average annual gross receipts of $500 million to pay a tax on deductible payments made to foreign affiliates equal to 10% for years before 2025, with a phase in at 5% for 2018. While worldwide media companies do not appear to be the intended target, larger media enterprises may find themselves within the ambit of BEAT and thereby motivated to bring certain activities onshore. Of course, there are significant, often competing non-tax considerations for media/entertainment and film production companies, as location may very well impact production and finished product.

Similarly, the global intangible low-taxed income (or GILTI) tax targets American companies that continue to hold intangible assets offshore while maintaining the majority of their operations domestically. This could have a particularly important impact on U.S. media companies, which want to reap the benefits of being located in certain U.S. markets with notable advantages (such as New York or Los Angeles) while still being able to mitigate their tax burden by holding valuable copyrights or licenses abroad. However, just as in the case of BEAT, many international media and entertainment companies have legitimate non-tax reasons for holding these intangibles abroad, particularly in jurisdictions where filming and production actually take place. The new tax undermines this tax maneuver – but also disadvantages this latter category – by requiring U.S. shareholders holding at least a 10% share of a controlled foreign corporation to include in gross income for the tax year such corporation's income from intangible assets held abroad that otherwise would not be taxable in the United States (click **here** [https://bracewell.com/blog/hollywood-gray-lady-impact-tax-reform-film-television-and-print-media] for more). Although the FDII deduction (discussed below) may allow corporations to reduce their tax burden with respect to intangibles, this likely will lead U.S.-based media companies to reevaluate whether it remains profitable to keep these intangible assets abroad – but also to consider bringing activities onshore where the new status quo subjects even "innocent" media companies to the tax.

As a practical offset to the GILTI tax, the TCJA provides a new incentive for U.S. companies to provide goods and services to foreign markets by allowing domestic corporations to take deductions on their so-called foreign-derived intangible income (FDII). This deduction only is available to U.S. entities classified as corporations for tax purposes (including domestic corporate subsidiaries of foreign companies) – which provides a disproportionate boon to the media industry – and is determined using a complex calculation (which we will discuss more in-depth in later installments). A domestic corporation's FDII is 37.5% deductible (to the extent it has taxable income), which yields a 13.125% effective tax rate (the new 21% corporate rate multiplied by 37.5%) and may be further reduced with foreign tax credits where applicable. It should be noted, however, that for tax years beginning after December 31, 2025, the effective tax rate on FDII increases to 16.406%. As noted above, the FDII provision also reduces the tax rate on GILTI by 50% to an effective rate of 10.5% (increasing to 13.135% in 2026). One consequence of this provision is that it provides a tax incentive to earn income from the sale of property and services to persons outside the United States, even though media companies otherwise may have these streams without regard to tax. As a result, a number of countries have threatened to challenge the legality

this provision at the World Trade Organization under the theory that it provides an export subsidy to domestic corporations. At the same time, media and technology companies are undertaking detailed review of their tax projections taking into account GILTI and FDII – as we will explore in greater detail in future installments, it seems like a "mixed bag" within the industry as to how much the GILTI will sting, and how much the FDII will mitigate.

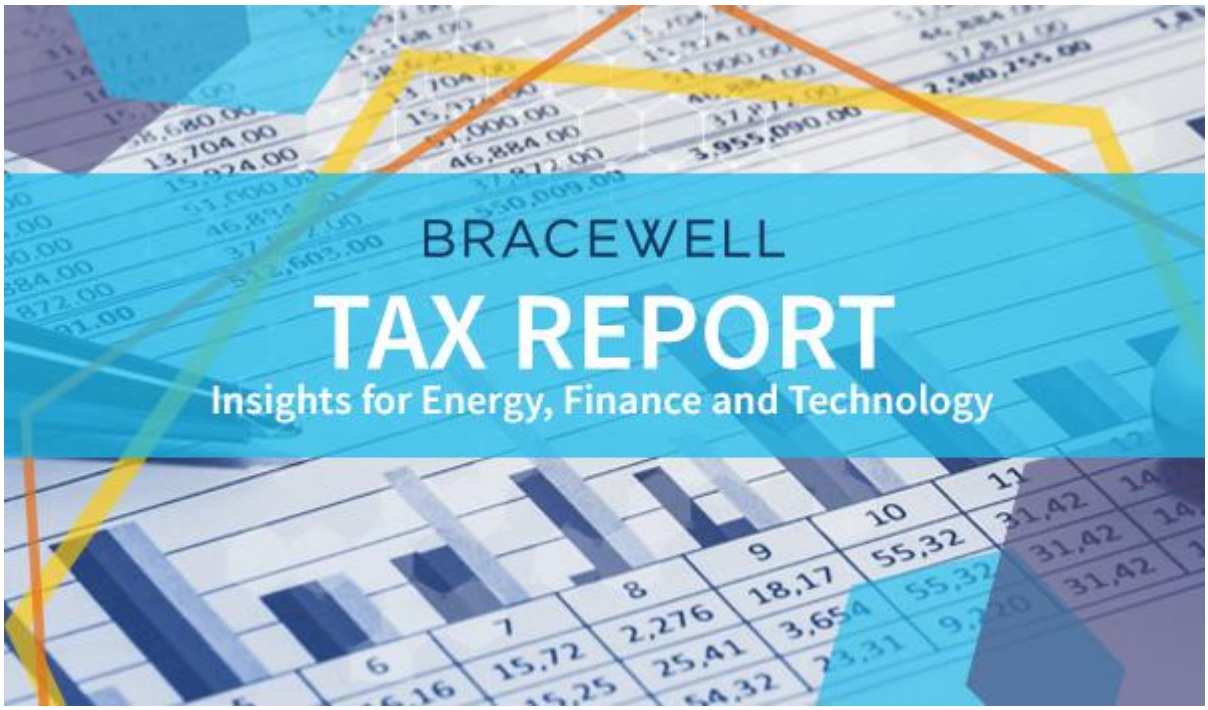
In addition to encouraging (or coercing) domestic media companies to return capital and investment to the United States, the TCJA also may spur new investment from non-U.S. investors. Specifically, the significantly lower corporate rate could encourage investment from foreign companies (and other types of foreign investors) that had previously refrained from doing so due to the relatively high U.S. corporate tax rate. It is possible that prior to the law's passage, potential television and film investors outside of the United States were hesitant to invest in productions without the presence of corporate blockers. However, blockers were viewed as unattractive options due both to the entity-level rate of taxation and the former so-called earnings stripping rules, which limited interest deductions for related party debt (click **here** **[https://bracewell.com/blog/finance-funds-%E2%80%93-how-tax-reform-may-impact-borrowing-and-investing-private-equity]** for more). Now the TCJA has repealed the earnings stripping rules and, at the same time, one of the largest drawback to using blockers – the entity level tax to which they are subject – now is mitigated by the aforementioned decrease in the corporate tax rate (from 35% to 21%). Particularly where the investment strategy does not rely on dividend payments, blockers actually may be a more attractive option following tax reform. In particular, private equity funds with a media focus may consider more U.S. investment, particularly since traditional fund investment does not contemplate dividend payments.

The alleviation of these concerns with corporate blockers also may encourage potential foreign investors in media to use them, or switch to them from an investment in media partnerships or joint ventures structured as partnerships for tax purposes. This is specifically due to the way in which the TCJA codified a controversial IRS ruling and subjected non-U.S. persons selling partnership interests to tax and withholding on so-called "effectively connected income" (ECI) to the extent that the gain from such disposition is attributable to ECI-producing assets (click **here** [https://bracewell.com/blog/tax-reform-and-foreign-partner] for more). While there has been some preliminary guidance issued on the withholding obligation, in general it may cause practical concerns, as foreign partners attempting to invest domestically may be forced to file federal income tax returns in order to obtain a refund of amounts withheld in excess of their actual tax liability. This may drive foreign investors to invest in media partnerships that plan to utilize blocker corporations in order to protect the foreign investors from both the taint of ECI and any personal reporting requirements to the IRS.

BRACEWELL

From Hollywood to the Gray Lady: The Impact of Tax Reform on Film, Television and Print Media - Part 4

May 14, 2018 | **Blog Posts** [/insight-type/blog-posts] | By: **Michele J. Alexander** and **Ryan Davis**



As we have noted in past reports, tax reform is impacting the media industry in a number of important ways. In this installment of our focus on tax reform and the media, we will further explore the Foreign-Derived Intangible Income (FDII) Deduction and its role in international tax reform.

As discussed briefly in our prior installment, the Tax Cuts and Jobs Act (TCJA) contains a new provision which provides an incentive for US companies to provide goods and services to customers abroad. This new provision allows a deduction for the taxpayer's so-called foreign-derived intangible income (FDII), which is only available to entities classified as corporations for U.S. federal tax purposes and reduces a corporation's effective rate to 13.125% with respect to such income (rather than the new 21% rate). As we have previously discussed, the largest actors in the media industry operate in corporate form, making the FDII deduction and its incentive for international commercial activity a particularly salient feature of reform for this sector.

The deduction is determined using a complex calculation. First, the domestic corporation must determine its "deduction eligible income" by determining its gross income and then reducing it by certain income items and deductions. Next, the taxpayer must determine the portion of this income which is from the sale of either property or services provided to a foreign person or for foreign use. Finally, the taxpayer must calculate its

deemed intangible income, which is its deduction eligible income minus its deemed tangible income return, or 10% of its qualified business asset investment, which is, in turn, defined as the quarterly average of its adjusted bases in certain depreciable tangible property used in the corporation's trade or business. Once these component parts are calculated, the FDII can be determined by multiplying the deemed intangible income by the percentage of the deduction eligible income that is foreign-derived. This FDII is then 37.5% deductible, which, when multiplied by the new 21% rate, yields a 13.125% effective tax rate. This may then be further reduced with foreign tax credits to the extent applicable. However, after December 31, 2025 the effective tax rate on FDII increases to 16.406% (again, based on the current 21 percent US corporate income tax rate).

The critical fact for the purpose of this provision is that the income in question is earned from foreign markets. In general, property must be sold or leased to a foreign person for use outside the United States, and services must be provided to persons, or performed with respect to property, located outside the United States. Consequently, the FDII deduction incentivizes domestic corporations to increase the percentage of their income they earn from foreign customers.

However, as the "simplified" description of the FDII above illustrates, the calculations are difficult, fact specific and pending further guidance, confusing. Time will tell how corporations are meant to, for example, allocate activity that takes place both within and outside the United States. Also, the FDII is a carrot in international tax reform, though it does not on its own encourage companies to bring production onshore, which seems inconsistent with the new international provisions otherwise. As we have discussed at length (**here** **[https://protect-us.mimecast.com/s/yjykC1wYEKfEV16Lc6YL3P]** and **here** **[https://protect-us.mimecast.com/s/NqFyC2kg2LTEMvV0cYLguB]**), the TCJA added a new tax (GILTI) on intangible assets held abroad. For some corporations, the FDII may serve only to mitigate the cost of that new tax. Further, media companies' production often is inflexible as it is driven by the location of news reporting, from live coverage to in-depth documentaries. These companies may find themselves with little room to minimize GILTI and/or maximize the FDII. On the other hand, large movie studios and networks may have sufficient planning opportunities to leverage the new system – moving intangibles onshore to avoid or lower GILTI while otherwise revamping their international planning to take advantage of FDII. It remains to be seen whether Treasury will view this as a favored effect of the new laws or see creative tax planning around these new provisions as abusive. Even absent abuse, media and entertainment companies are dedicating vast resources simply to figure out their GILTI tax exposure and potential FDII – and to know whether planning will be effective, they need to know their starting point.

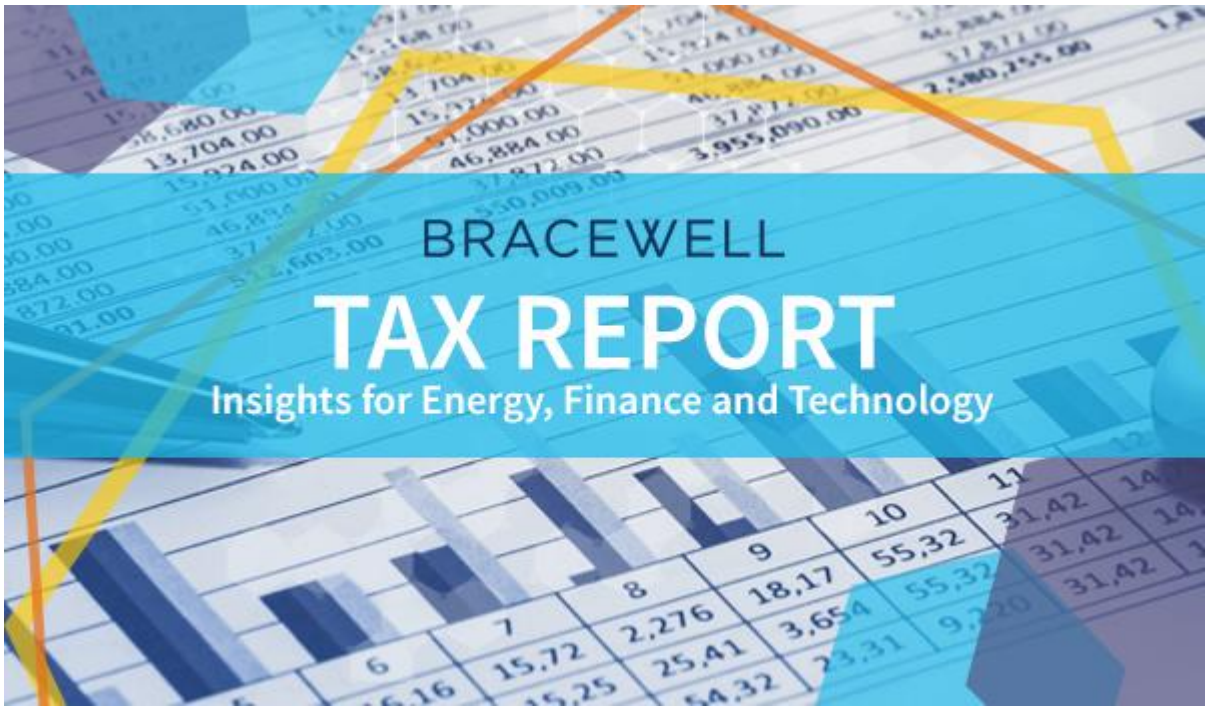
Even given the complexity of the FDII, and that it may be disingenuous to view it in isolation, it may be recognized as an attempt by Congress to allow truly international media and technology companies to compete on the global playing field, particularly where these companies have substantial non-tax reasons to hold intangibles and engage in production abroad. Of course, even in light of possible pre-TCJA tax abuse, the new taxes otherwise could have contained an exception for those companies with a non-tax business purpose for the location of these assets and activities.

Of course, the FDII is another way that Congress is favoring corporate form (in this case, given the assets at issue, in particular for media and tech). The FDII dovetails nicely with the new territorial corporate tax system with a lower tax rate. In an industry that already seems to favor corporate form, media stands to gain tremendously from tax reform – to the extent its actors have the flexibility for efficient tax planning. First, of course, they need to compute their new benefits.

BRACEWELL

From Hollywood to the Gray Lady: The Impact of Tax Reform on Film, Television and Print Media - Part 5

May 31, 2018 | **Blog Posts** [/insight-type/blog-posts] | By: **Michele J. Alexander** and **Ryan Davis**



As we have noted in past reports, tax reform is impacting the media industry in a number of important ways. When making investment decisions, potential investors will look to the overall health of the industry. The entertainment and media sector is unique in its outsized dependence on the creative talent of those who work in the field, as employees or otherwise. Accordingly, this fifth installment discussing tax reform and the media will focus on ways in which tax reform may help or hurt these individuals and, as a consequence, the industry at large.

The change for individual taxpayers resulting from tax reform that has garnered the largest amount of attention in the entertainment and media industry is the elimination (currently, through 2025) of the deduction for itemized expenses above 2% of adjusted gross income (the so-called 2% floor). This had been the means for employees to deduct business related expenses and was particularly important to individuals in the creative professions who are employees for tax purposes. This provision could have applied to the most famous of performers (such as those under contract with a show or network, or a concert promoter, in the case of musicians) who spent a disproportionate amount of their income on items that would qualify for this deduction. These expenses included such industry-specific necessities as acting and other training classes, travel costs for auditions and interviews, head shots and agent and manager fees. It is estimated that, whereas

an individual taxpayer taking this deduction only needed to spend approximately 2% of his or her income on the items that qualify under this provision, those in the creative professions spend between 20% and 35%.[1] [#1] This high percentage of income so spent, coupled with the modest salary earned by many individuals working in the entertainment industry, could result in fewer people from lower and middle-income backgrounds – who may have greater talent but lack the financial safety net (or luck) of their wealthier peers – from pursuing a career in the industry. Moreover, those who work "day jobs" in other fields otherwise may be unable to deduct expenses relating to an acting or creative career to the extent they cannot show a history of profit.[2] [#1] Indeed, this is possibly another illustration of how tax reform either has benefitted or spared high wage earners while harming the working class – the media and entertainment industry appears not to have escaped this wide spread effect, and criticism, of the new tax laws.

There are two options available to a taxpayer that wants to continue to deduct these expenses. First, an individual performing services in the entertainment industry instead could perform those services as an independent contractor. However, this would come at the price of certain employee benefits of particular importance to certain people in the entertainment industry, including the right to unionize. The other alternative is for the individual taxpayer to "incorporate" themselves and become a pass through entity, such as an LLC or an "S Corporation," that generally is not itself subject to corporate level tax. Similarly, the individual could form a C corporation and take advantage of lower corporate rates; the effective federal tax rate for an individual shareholder on corporate earnings (now taxed at the new 21% corporate tax rate) and dividends (if any, taxed at 20%) is 36.8%; as we have noted [here], this rivals the new rates on pass through income. In each case, the taxpayer could then "loan out" their services to the media or production company and still take advantage of the deduction. However, these entities may prove unpractical, as incorporation comes with steep attorney fees, both for the high upfront costs for legal filings required for incorporation as well as continued reporting and tax compliance (which can be surprisingly complex, particularly in the case of an S corporation). Consequently, this solution may prove most practical for only the highest earners who ironically otherwise might be least likely to feel the deduction's loss (though high earners operating as employees would not be indifferent, as their costs could have exceeded the 2% floor, even at high levels of compensation). The LLC could be an attractive, less expensive option (which we explore a bit more below), but may require a second member if the intent is to avoid a single member LLC, which generally is ignored for federal income tax purposes. Otherwise, if an actor forms a disregarded entity to perform services, it is no different than the actor herself being an independent contractor or, in certain circumstances, an employee (which is what this intended to avoid).

In addition to the realized concerns about losing the employee business deduction, there also had been concern that the trade and business expense deduction for performing artists would be revoked as a revenue raiser for the new legislation. Fortunately, this deduction was preserved, though the impact may be minimal after all. Code Section 62(a)(2)(B) allows a trade or business expense deduction for expenses of a qualified performing artist incurred in connection with his or her performances. The term "qualified performing artist" means (i) one which performed as an employee for two different employers during the taxable year, (ii) the amount of income eligible for deduction exceeds ten percent of the taxpayer's income, or (iii) the taxpayer

made less than $16,000 for the year. As a result of this provision not being repealed, performing artists may continue to take advantage of this valuable deduction while they chase the rise to fame – or settle comfortably in supporting or other roles that are more available. However, this deduction requires the individual to be an employee, which ought to prevent the individual from otherwise deducting job-related expenses (following the repeal of the deduction described above).

However, the new and much publicized strict limitations on deductions for state and local taxes also will negatively impact individuals in the entertainment and media industry, as it is overwhelmingly located in California and the greater New York area (comprised of New York, Connecticut and New Jersey). These jurisdictions all have some of the highest state taxes in the country, with New York City also leveling relatively high local taxes. Of particular concern is the non-deductibility of property taxes, which are particularly high in these states due to both the tax rates themselves and the high value of real property. The inability to deduct this hefty tax burden from their income may lead many in the entertainment and media industry to relocate. This potential dispersal of talent could lead to companies having difficulty filling positions and individuals finding it costly to attend auditions and interviews in other states. On the other hand, opportunities may abound for states and offshore locations that previously had trouble attracting talent away from NYC and LA. However, this is another reason that those not at the highest levels of the industry may be forced away from these epicenters, especially if the industry acclimates to the new higher costs and does not abandon historic locales for filming and production.

New Code Section 199A may be helpful for independent acts that consider themselves too small to warrant incorporation (or otherwise want to avoid corporations) and instead opt for passthrough status. These stand to benefit from the new so-called "qualified business income" (QBI) deduction (click here for more). New Code Section 199A generally permits a 20% deduction against taxable income for QBI, which, broadly-speaking, is taxable income earned from certain U.S. trades or businesses. Under prior law, an individual taxpayer's QBI would have been subject to the ordinary federal income tax rates applicable to individuals, with a maximum rate of 39.6%. Under the TCJA, unless limitations apply, the QBI deduction could reduce the maximum effective rate imposed on an individual's share of an entity's QBI to 29.6% (or 80% of the new maximum ordinary rate of 37%). This will help offset the advantage that larger entertainment and media corporations received over these smaller acts as a result of the forty percent decrease in the federal corporate tax rate. Note that new Section 199A also applies to income earned directly, but the use of a passthrough entity such as an LLC may help a group of performers – such as a band, or a group of actors in a performance – share income, as well as invest income and provide for governance and decision-making powers as desired. Typically, these entities also provide liability protection, which is a prime non-tax consideration – this includes single member LLCs, which provide the benefit of the new 199A deduction, add little to no tax complexity (as they are disregarded for federal and most state income tax purposes), and provides a legal form of doing business separate from the individual.

Although the creation of new Code Section 199A may help individuals in the industry, the repeal of old Code Section 199, which provided a deduction for domestic production activities (the Domestic Production Activities Deduction or DPAD) and was relied upon heavily in the media and entertainment industry, most notably for film

and TV production, may negatively impact opportunities for actors, producers and directors as well as other performers in the United States. This incentive brought film and TV production (and with it, jobs in this sector) back from Canada and other jurisdictions that initially had lured companies abroad with low cost and tax incentives. Futhermore, Code Section 181, which allowed the cost of qualified film, television or live theater productions (defined as those projects where 75% of the compensation for services occurs in the United States) to be treated as a deductible expense, does not apply to productions commencing after December 31, 2017.

However, taxpayers wondering what to do about later projects should be pleased to see that going forward, these qualified projects also are eligible for the so-called "immediate expensing" provision contained in Code Section 168(k) (click here for more). This provision allows businesses to immediately deduct the full cost of new and used property placed into service between September 27, 2017 and (generally) January 1, 2023, at which point the percentage that may be expensed begins to be phased down through January 1, 2027. Although there is hope that the new deductionwill result in an increase in the number of projects undertaken (and thus the number of jobs located) domestically, it has yet to be seen the extent to which it will counteract the DAPD's repeal, particularly since it is not yet clear how it will operate in place of the old Section 181 deduction for qualified productions. Combined with the loss of most deductibility for federal tax purposes for state and local taxes, historically favored locations such as NYC and LA also must be considering state and local incentives to keep movie, TV and music production from relocating. If nothing else, the reactions of state and local governments may impact planning for those in media and entertainment on the talent side as much as investors and those on the business side of the industry. Of course, the talent's reaction and tax planning can influence the industry as much as the industry can affect its actors (pun intended).

---

[1] https://www.hollywoodreporter.com/news/study-new-tax-bill-shafts-working-entertainers-but-stars-are-untouched-1067571

[2] See Section 183(d) (presumes that an activity is for profit if profitable for three years in a five year period).