



NEW FEDERAL TAX LEGISLATION

“RUNAWAY PRODUCTION” INCENTIVE – Immediate Write-off of Expenditures --

FREQUENTLY ASKED QUESTIONS

(1) Q: When do productions need to commence to qualify for the new incentive?

A: The incentive is available for qualified productions commencing after October 22, 2004, and before January 1, 2010.

(2) Q: If a film has started production before and continues through October 22, 2004 can it qualify for this tax incentive?

A: No, only productions **commencing after** October 22, 2004, and before January 1, 2010, can qualify.

(3) Q: Can the immediate write-offs be taken in more than one year?

A: Yes, if an election is made to use the incentive, the immediate deduction takes place in the year the expenditure is incurred. Therefore, if production expenditures are incurred in more than one year, the immediate tax deduction will be taken in more than one year.

(4) Q: When, where, and how does the “election” to immediately deduct the qualifying expenditures apply?

A: The election is to be made on the tax return for the taxable year in which the production costs are first incurred. The election must be made by the due date (including extensions of time) of such return. The manner and form of the election will be determined by the IRS at a later date.

(5) Q: Does it apply to all productions (e.g., big budget productions)?

A: No, the immediate write-off provision does not apply to productions whose aggregate cost exceeds \$15 million (\$20 million in the case of productions in certain low-income and eligible areas of the country). However, all productions including those below and in excess of \$15 million (\$20 million) have other new potential incentives including a new 9% tax deduction for U.S. production activities.

(6) Q: What is the real benefit of this incentive?

A: This is a significant new Federal tax incentive that allows producers of qualifying productions to take a tax deduction for the full costs of a production in the year the cost is incurred (as opposed to having to spread or amortize those costs over a period of years). Deducting the costs up front, while deferring the income from the films until later years when it is incurred will significantly reduce or eliminate taxable income for the film in the early years of exploitation.

(7) Q: How do I determine if it is beneficial to my production?

A: Since the new incentive is elective, producers can run numbers both with or without the new incentive and determine whether or not to elect to immediately expense the production costs in the first year(s).

(8) Q: What tax form do I need to fill out to get the incentive?

A: Currently, there is no specific form to fill out. The IRS is expected to issue further guidance on the incentive. In the absence of specific guidance, the legislative history states that: "deducting qualifying costs on the appropriate tax return shall constitute a valid election." Therefore, deducting the production costs (that would otherwise be capitalized) on your tax return will qualify as electing to take advantage of this incentive.

(9) Q: Is the incentive transferable?

A: No. However, different entity structures such as limited liability corporations, partnerships, and others, should be considered to properly allocate costs that could be immediately expensed.

(10) Q: What happens in the case of a co-production or a film financed by multiple investors?

A: The \$15 million (\$20 million) threshold refers to the qualifying film. Thus, a qualifying film that is co-produced must in total come under the threshold. The benefits of the provision must be allocated among the owners of a film in a manner that reasonably reflects each owner's proportionate investment in and economic interest in the film.

(11) What is considered "aggregate costs" to determine if my aggregate production costs exceed the \$15 million (\$20 million) threshold?

A: The determination of what costs are included in the calculation of the threshold is not specifically addressed in the legislation. These costs should be the costs that would otherwise be capitalized and amortized as part of the production. IRS guidance in the form of Notices or regulations may help clarify this issue.

(12) In order to qualify for the higher (\$20 million) threshold what does it mean to require that a "significant" amount of the expenditures be incurred in an eligible area?

A: The term "significant" is not defined in the new statute, but IRS regulations have defined the term in other contexts. Those definitions of what constitutes significant have ranged from 2.5% to 20% of an activity. This is another issue that will be subject to further clarification by IRS guidance, not only to determine the precise percentage, but also to clarify what it means to incur the expenditure in a particular geographic area.

(13) How will other practical issues related to this new incentive be determined?

A: Like other tax issues, producers should consult with their professional tax advisors on any issues related to this new Federal tax incentive. It is expected that the Treasury Department and the IRS will issue guidance to further interpret the statute. This guidance may come in the form of Notices and Regulations. A number of groups that worked on this important legislative change are expected to continue working with the Treasury Department and the IRS to ensure the incentive fulfills its objective and provides the industry with meaningful tax relief.

THIS HANDOUT IS FOR INFORMATIONAL PURPOSES ONLY AND SHOULD NOT BE VIEWED AS TAX ADVICE WITH RESPECT TO YOUR PRODUCTION ACTIVITIES. FOR SUCH ADVICE, YOU SHOULD CONSULT WITH YOUR TAX ADVISOR.