

Effective Wealth

A Newsletter of Rothstein Kass®

Second Quarter 2010

Inside:

Asset Protection Planning

3

Accessing State Film Production Incentives What film producers need to know

When filming in the United States, it has become common practice, if not a necessity, to film in states that offer production incentives in order to subsidize production costs. Much to the chagrin of the creative teams behind such productions, selecting a location for the production incentives it offers has become more important than selecting a location for the location itself.

There are currently forty-four states, the District of Columbia, and Puerto Rico that offer some form of film production incentive available. However, not all states' incentives are created equally, nor are they administered similarly, and it is important for film producers to understand the differences, and potential issues, resulting from choosing one state over another. It is also important for film producers to plan accordingly once the location has been chosen. The following is an overview of some of the potential tax, accounting and political issues that film producers should consider when accessing state film production incentives.

OVERVIEW OF PRODUCTION INCENTIVES

State film production incentives may be in the form of a rebate or grant, refundable tax credit, non-refundable, transferable tax credit, or non-refundable, non-transferable tax credit, all of which are generally calculated based upon a percentage of qualifying local production and/or payroll spend. Select tax exemptions (e.g., sales tax, hotel occupancy tax) may also be available in certain states. Among these incentives, rebates or grants are most preferable because cash is paid by the local government directly to the film producer and a tax return is not required to be filed. A refundable tax credit also provides for a cash payment to the film producer; however, the credit can only be claimed by filing a tax return, regardless if the production company owes tax

to the state. The amount received is equal to the credit, less any tax due. In most circumstances, the production company will have little, if any, income tax liability in the state, so the amount received will usually be the entire credit, however, the receipt of those funds may be delayed due to the tax return filing requirement, as discussed further below.

NON-REFUNDABLE, TRANSFERABLE OR NON-TRANSFERABLE TAX CREDITS

Film producers should be wary of non-refundable, transferable tax credits or non-refundable, non-transferable tax credits. Non-refundable, transferable income tax credits can be used to offset state income taxes and any unused credits can be transferred to local taxpayers for use against their state income tax liabilities. As mentioned above, the production company may have little or no income tax liability in the state, so the credit will have to be sold to be monetized. If sold, the film producer will likely not receive a dollar for dollar benefit, but instead will most likely sell the unused credits at a discount. If there is significant production activity during the year in that particular state, and few interested buyers, the law of supply and demand may result in an even greater discount. If the film producer uses a broker to assist in the sale of the credits, which is the norm, the amount received will be further reduced after deducting the broker commission. Two states offering transferable credits, Louisiana and Massachusetts, allow film producers to transfer the credits to the state for 85% (Louisiana) or 90% (Massachusetts) of their face value, if the credits can not be sold on the open market at a more favorable rate.

Therefore, film producers should be aware that the amount of the non-refundable, transferable credit as calculated based upon qualifying spend

(continued on page 2)

Accessing State Film Production Incentives

(continued from page 1)

“Certain states require that an audit be performed by a certified public accountant to verify the qualifying spend before the state certifies the credit.”

most likely will not equal the amount they will receive to offset production costs. Ten states (Alaska, Arizona, Connecticut, Georgia, Illinois, Missouri, New Jersey, Pennsylvania, Rhode Island and West Virginia) and Puerto Rico currently provide non-refundable, transferable credits (there is proposed legislation in New Jersey to make their credit refundable), and, as mentioned above, two states (Louisiana and Massachusetts) have partially refundable, transferable credits.

Non-refundable, non-transferable tax credits are the least preferred because these credits can only be utilized if the production company has a tax liability in the current year, or in a future year to which the credit may be carried forward. These credits can not be utilized if no tax liability exists, and can never be monetized. Two states, California and Michigan, have non-refundable, non-transferable income tax credits. However, California allows credits to be transferred to affiliates, or by producers of independent films that are neither publicly traded nor owned more than 25% by publicly traded companies. Michigan offers a refundable and transferable business tax credit in lieu of a non-refundable, non-transferable income tax credit.

TAX RETURN COMPLIANCE

Film production tax credits, whether refundable, non-refundable, transferable or non-transferable, can only be claimed by filing a tax return, which means that the tax credits are not issued until the production company's tax return is filed. For this reason, it is important to consider electing a tax year-end for the production company that will close shortly after the production wraps, to accelerate the filing of the tax return and subsequent receipt of the credits. Where the production company is a member of a consolidated group of companies, electing a tax year-end different from the parent corporation is not an option.

The tax year election is also important when producing a film or television series where the production expenses straddle a calendar year. For example, if your production company will be shooting a television series in New York, with its production season commencing in November, and wrapping in April, electing an April 30 year-end will allow for the capture of the entire season's production expenses in the company's tax year.

In addition to tax year-end considerations, there are choice of entity considerations for the production company. For example, a film producer may form a single member limited liability company (SMLLC) to act as the production company for purposes of producing the film. A SMLLC is generally disregarded as an entity separate from its owner for federal tax purposes, which means it is not recognized for federal tax purposes. While some states may

recognize SMLLCs, most states follow the federal treatment of SMLLCs as disregarded entities. In those states that do not recognize SMLLCs, and thus do not have a tax return filing requirement, the film producer (whether an individual, partnership or corporation) will be required to file a tax return in the state to claim the credit, even though the film producer otherwise may not be required to file in that state.

AUDIT REQUIREMENT

Certain states (including California, Illinois, Louisiana, Massachusetts, and Michigan) require that an independent audit be performed by a certified public accountant to verify the qualifying spend before the state certifies the credit. As extra cash is a rare commodity in the independent film world, the producer may need to reserve additional funds to cover the audit expense, which typically arises after the production is complete. Further, the costs incurred to perform the audit are not considered qualifying spend for purposes of calculating the credit.

STATE FUNDING

Film producers need to know whether the state has an annual funding cap, and if so, how the funds are allocated (e.g., first-come, first-served basis) and how much is still available for the year. With the current state of the U.S. economy, film producers seeking an incentive in the form of a rebate, grant or refundable credit need to receive a firm commitment from the state that the funds are available, and will be received.

POTENTIAL SUSPENSION OR REPEAL OF FILM PRODUCTION INCENTIVES BY STATES

Film producers should also be aware of the current status of the state's film incentive program before choosing to film there. Some states are questioning if their film incentive programs are actually stimulating their economies as was originally contemplated when the legislation was passed, which could possibly lead to those states deciding to suspend or repeal their respective programs. Iowa, after creating a panel to review this very issue, suspended its incentives program after the panel found evidence of mismanagement, and possible corruption. Kansas, while still offering hotel occupancy tax relief, has suspended its film production credit for 2010 due to state budgetary constraints. The Tax Foundation, a nonpartisan, nonprofit organization that monitors federal, state and local fiscal policy, recently released a study on the cost-benefit of film production incentives, concluding that these incentives fail to spur economic growth or raise tax revenue. For more information, see *Tax Foundation Special Report No. 173, "Movie Production Incentives: Blockbuster Support for Lackluster Policy."*

CONCLUSION

The issues discussed in this article are just the tip of the iceberg; there are many other issues that film producers need to consider when deciding between states' incentive programs. Perhaps, as suggested by Schuyler M. Moore, partner at Stroock, Stroock & Lavan LLP, in his May 29, 2009 commentary in *The Hollywood Reporter*, the U.S. federal government should preempt state laws granting production tax credits and institute a federal production tax credit. This will not only stop the competition between states that is driving them toward insolvency

and allow the U.S. to compete as a whole against the many foreign countries offering film incentives, as Schuyler opined, but also simplify the film credit process for film producers and put the decision as to choice of location back into the hands of the creative team. [®]

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Asset Protection Planning:

Choosing the best strategy for financial security

Asset protection is becoming significantly more important as part of an overall financial plan. Without asset protection, high-net-worth individuals or public figures could experience substantial declines in wealth due to litigation, matrimonial disputes, or unforeseen economic conditions.

It should be clear from the outset that asset protection strategies do not involve any illegal activities. We have all recently heard about individuals who have not reported assets held in foreign bank accounts.

Asset protection planning may include titling assets in a specific way, transferring assets to specific types of entities that offer asset protection, or purchasing assets that afford more asset protection than others.

TITLING OF ASSETS

Tenancy by the entirety is a form of joint property ownership that can only exist between a husband and wife. In states that follow the common law rule, creditors of one spouse cannot execute or levy upon property held in this form. This protection may not be available if the creditor is a state, local or the federal government. This form of ownership does not provide protection against joint creditors of the husband and wife.

Tenancy in Common provides minor asset protection. Under common law, each tenant owns an undivided fractional share of the property, and the interest of each co-tenant is unilaterally severable and devisable; consequently, a creditor can reach the co-tenant's undivided fractional interest. The value of this interest to the creditor may not equal the fair value of the interest as the creditor cannot enjoy the property without the involvement of the co-tenant.

A Power of Appointment is a power given to a donee by a will or a deed that allows the donee to choose one or more recipients of the donor's estate. The power can be general (the power holder can choose anyone,) or limited (the power holder can only choose from a limited class of people). From an asset protection standpoint, some states do not recognize a general power of appointment as property of the donee until that power is exercised, consequently, one can give a general power of appointment, instead of the actual property, and subsequently remove that property from the reach of the power holder's creditors.

SPECIFIC ENTITIES

Different types of entities offer various levels of asset protection. A shareholder's personal assets are generally beyond the reach of the corporation's creditors; however, if a shareholder is sued personally,

(continued on page 4)

“It should be clear from the outset that asset protection strategies do not involve any illegal activities.”

Asset Protection Planning

(continued from page 3)

the shareholder's stock in the corporation could be reachable by the shareholder's creditors.

A more common form of ownership is the limited liability company (LLC). Similar to corporate shareholders, members of a limited liability company are generally liable for the debts of the LLC, only to the extent of their investment in the LLC. Creditors of the LLC cannot satisfy debts of the members with assets of the LLC, since the LLC is treated as a separate legal entity. Creditors can only receive a "charging order" which, generally, does not entitle the creditor to become a member of the LLC, and does not entitle the creditor to vote on LLC matters. It entitles the creditor to receive distributions that the member would have otherwise received; therefore, a membership interest in an LLC is not attractive to a creditor because they have no control over the amount or timing of distributions.

When structuring business and personal assets, you should consider segregating the ownership of specific assets in different entities to help prevent a lawsuit related to one asset, from affecting other assets. Business assets should be held in a separate entity from real estate holdings. Each real estate investment should be held by a separate legal entity. Music catalogs, the rights to royalties, and certain intellectual properties should also be held in separate legal entities.

Trusts can also be used to protect assets. They can help protect assets from a beneficiary's extravagant lifestyle, bankruptcy, and from the claims of a beneficiary's spouse, and trusts can determine who will ultimately receive your assets.

Trusts commonly referred to as self settled domestic asset protection trusts (DAPTs) can be structured to protect assets from creditors while still providing you with the enjoyment of those assets. DAPTs are created by you, the settlor, and generally contain provisions that grant the trustee the discretion to distribute principal and income, to you. DAPTs generally contain a spendthrift provision that prevents a voluntary or involuntary alienation of a beneficiary's interest in the DAPT.

In 1997, Alaska became the first state to enact a usable DAPT statute. Twelve states currently have enacted some form of domestic asset protection law. Alaska, Delaware, Nevada and South Dakota have the best self-settled trust legislation¹. Each state has their own requirements regarding DAPTs and these include, among others, where the assets must be maintained, if a resident trustee is required, and where the trust must be administered.

Offshore asset protection trusts can also be considered. These trusts require adherence to foreign and United States reporting requirements.


TYPES OF ASSETS

The United States Bankruptcy Code exempts certain assets from a debtor's bankruptcy estate, i.e., these exempted assets are outside the reach of creditors. The Bankruptcy Code provides the states with the ability to substitute their own laws on a more or less favorable basis. When determining the exempt nature of an asset, it is important to consider both federal and state bankruptcy regulations.

A significant majority of states exempt personal residences from the bankruptcy estate. In certain situations, annuities are wholly or partially exempt from the bankruptcy estate. Assets held in a qualified retirement plan under the Employee Retiree Income Security Act of 1974 (ERISA), such as a profit sharing plan, are exempt from the bankruptcy estate. To a certain extent, assets in individual retirement accounts may be beyond the reach of creditors. Life insurance and related cash surrender values may be exempt from the bankruptcy estate depending on applicable state laws. Consideration must be given to who owns the life insurance policy and who is the beneficiary.

Other things to consider in asset protection planning include pre and post nuptial agreements, personal liability insurance coverage, and Officer's and Director's Liability insurance, if applicable.

Finally, although your assets may be titled properly, held in the appropriate vehicles, and structured in the most efficient manner from a bankruptcy perspective, you should also consider how to reduce the risks of identity theft.

All the topics discussed in this article have variations and options that should be thoroughly analyzed with a qualified team of advisors. Please contact your Rothstein Kass professional to discuss these ideas and help you choose the strategies that are best for you. 

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¹ See Daniel Worthington and Mark Merric, *Which Situs is Best*, Trusts and Estates, January 2010



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