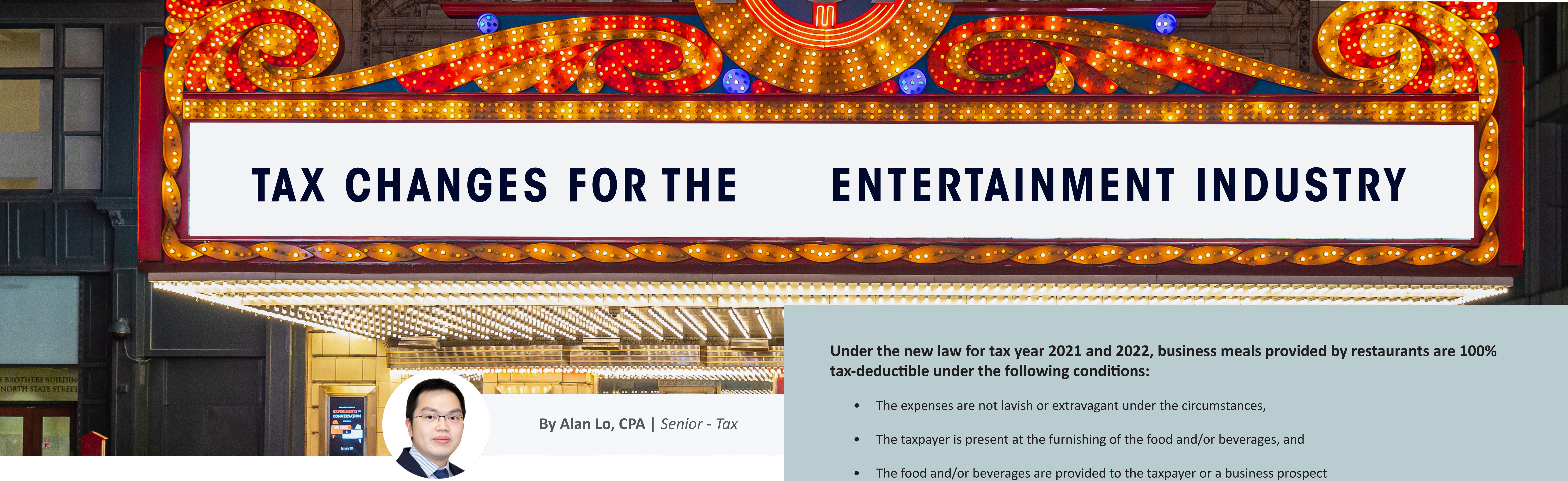

TAX CHANGES FOR THE ENTERTAINMENT INDUSTRY

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IMMEDIATE EXPENSING OF QUALIFIED PRODUCTION COSTS

The Internal Revenue Code (IRC) Section 181, which allows immediate expensing of qualified production costs associated with a Television Series, Films, and Live Theatricals, is now extended through 2025. The extender allows taxpayers to deduct up to $15 million ($20 million in certain qualified low-income/distressed areas) of qualified production costs as they are incurred. In order to qualify for the immediate expensing, IRC Section 181(d) requires at least 75% of the production compensation costs are incurred within the United States.

Rather than deducting the expenses after the release date through amortization, Section 181 is an alternative tool for production companies to minimize the timing difference between production costs and the revenue it generates. On the other hand, the opportunity to use Section 181 can dramatically change the outlook of an investor's risk assessment on a film project. The money invested and spent is expensed as incurred and will create a loss that can be passed-through to the investor. This could be a considerable tax benefit in the same year as the production.

Before deciding how to utilize a Section 181 deduction, producers should also examine their state's laws. Many states, including Georgia, recognize Section 181 on the state return, while California does not.

Before determining whether or not to make the Section 181 election, a thorough analysis should be performed based on the company's short-term and long-term financial position, current tax situation for both Federal and States, and perhaps most importantly, the ability to attract investors.[1]

100% DEDUCTION OF BUSINESS MEALS

As businesses within the field of restaurant and hospitality have suffered mightily during the Coronavirus pandemic, the Consolidated Appropriations Act creates a meaningful tax incentive to spend more on business-related food and beverage expenses.

Under the new law for tax year 2021 and 2022, business meals provided by restaurants are 100% tax-deductible under the following conditions:

- The expenses are not lavish or extravagant under the circumstances,
- The taxpayer is present at the furnishing of the food and/or beverages, and
- The food and/or beverages are provided to the taxpayer or a business prospect (customer, client, supplier, professional advisor, employee, etc.)

A special note worth pointing out is that while entertainment is 100% nondeductible, food and beverages provided during the entertainment activity are deductible when purchased separately from the entertainment or separately stated on the bill.[2]

TAXABILITY OF PAYCHECK PROTECTION PROGRAM (PPP) LOANS

The Paycheck Protection Program (PPP) Loan was created under the CARES Act to provide relief for business owners during the pandemic. The loan is forgivable and tax-free if the funds were spent for qualified use such as rent, utilities, payroll expenses, etc.

Are expenses paid also tax-deductible if they were paid with the PPP Loan? The IRS initially argued that a tax-free treatment on forgiven loans and tax deduction paid from the forgiven loans is essentially "double-dipping," and thus ruled that the expenses paid with PPP loans were not tax-deductible. However, the ruling was subsequently overturned under The Consolidated Appropriations Act, and the IRS conformed with the act by issuing Revenue Ruling 2021-2.

For California, under Assembly Bill 80 (AB80), there is a small catch to qualify for the double-dipping treatment under Federal law. In order to qualify for the tax deductions, a business must demonstrate at least a 25% reduction in quarterly gross revenue in 2020 compared to 2019, and the taxpayer cannot be a publicly-traded company.[3]

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[1] Internal Revenue Code Section 181
[2] Consolidated Appropriations Act 2021 / Internal Revenue Code Section 274
[3] Coronavirus Aid, Relief and Economic Security Act 2020, Consolidated Appropriations Act 2021, Internal Revenue Ruling 2021-2, and California Assembly Bill 80

FEDERAL EMPLOYEE RETENTION TAX CREDITS (ERTC)

The Federal Employee Retention Tax Credit (ERTC) originated as part of the CARES Act to encourage businesses to continue paying employees by providing a credit to the eligible employer for wages paid to eligible employees. Under the American Rescue Plan Act, the ERTC was extended through the end of 2021, and the recipients of PPP loans are now eligible to qualify retroactively for the credit in 2020 and 2021.

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For tax year 2020, there is a maximum credit of $5,000 per eligible employee. The 2020 credit is computed at a rate of 50% qualified wages paid, up to $10,000 per eligible employee for the year. For eligible employers with less than 100 average full-time employees in 2019, the credit is available for all employees receiving wages in 2020.

For tax year 2021, there is a maximum credit of $7,000 per eligible employee per quarter. The 2021 ERTC is computed at a rate of 70% of qualified wages paid, up to $10,000 per eligible employee per quarter. For eligible employers with less than 500 average fill-time employees in 2019, the credit is available for all employees receiving wages in 2021.[4]

DEFERRAL OF FEDERAL PAYROLL TAXES

Under Section 2302 of the CARES Act, employers can defer the deposit due date of their share of social security taxes from the 2nd quarter to the 4th quarter of the 2020 payroll filing. The deferral only applies to the employer's share of social security taxes and does not apply to employer Medicare taxes nor tax withholdings from employees. Instead of the weekly/quarterly required deposit due date, the deferral allows employers to deposit 50% of their share of social security taxes by 12/31/2021 and the remaining 50% by 12/31/2022. On the other hand, self-employed individuals are also eligible for the same treatment to defer 50% of their social security tax (employer's share) imposed on their net earnings from self-employment.

A special note in relation to PPP: employers with PPP loans were initially ineligible to defer any payroll taxes on the amount due after receiving their PPP loan forgiveness. However, the Paycheck Protection Program Flexibility Act subsequently eliminated this restriction, and therefore, employers with PPP loans can now make payroll tax deferrals even after their PPP loan forgiveness.[5]

In summary, numerous significant tax changes could help businesses survive the pandemic and nevertheless opportunities to succeed down the road if they are carefully addressed. If you have any questions or need assistance, please contact KROST. ■

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[4]Coronavirus Aid, Relief and Economic Security Act 2020 and American Rescue Plan Act 2021
[5]Coronavirus Aid, Relief and Economic Security Act 2020 / Paycheck Protection Program Flexibility Act 2020

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