NOVEMBER 2012

VOLUME 1 • ISSUE 3

Green Hasson Janks

Entertainment

Featuring people, news and business issues for the entertainment and media industry.

In This Issue

Film production tax credit extended

Real taxes in a virtual world

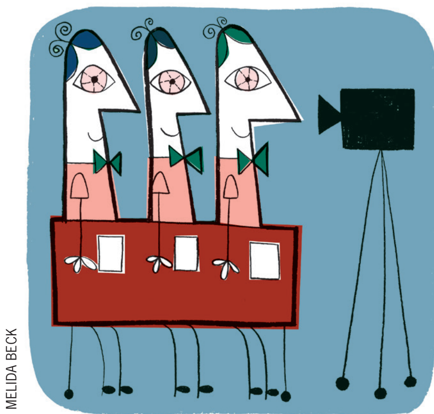
Possible adjustments to fair value measurements of film

Field work in Tokyo

In-State Film Production Tax Credit Extended

On September 30, 2012 Governor Brown extended the tax credit for California based television and film productions through 2017. The $100 million annual program is designed to provide incentive for local production while slowing the trend towards out of state and overseas production.

Former Governor Schwarzenegger originally enacted the credit in 2009 to encourage local production and stimulate economic growth. Under California's Film & Television Tax Credit Program, qualified taxpayers are allowed a credit against state income, sales, or use taxes based on qualifying expenditures. The credit provides for a 20 percent to 25 percent credit for qualifying expenses depending on the circumstances of the specific production. Total credits throughout the state are limited to $100 million annually and all applications for the next fiscal year are due by June 1, 2013.



MELIDA BECK

The extension was cheered by a range of industry groups including the Motion Picture Association of America and talent union SAG-AFTRA, which issued a joint statement.

"The state of California took a big step forward today, thanks to Governor Brown and the legislature," said Senator Chris Dodd, Chairman and CEO of the Motion Picture Association of America. "The two-year extension of the state's production tax credit will keep California competitive for tens of thousands of production-related jobs. This is an important victory for California's economy, our national economy, and the hardworking men and women who comprise the film and television industry."

© 2012 Green Hasson & Janks, LLP. All rights reserved. greenhassonjanks.com

Real Taxes in a Virtual World

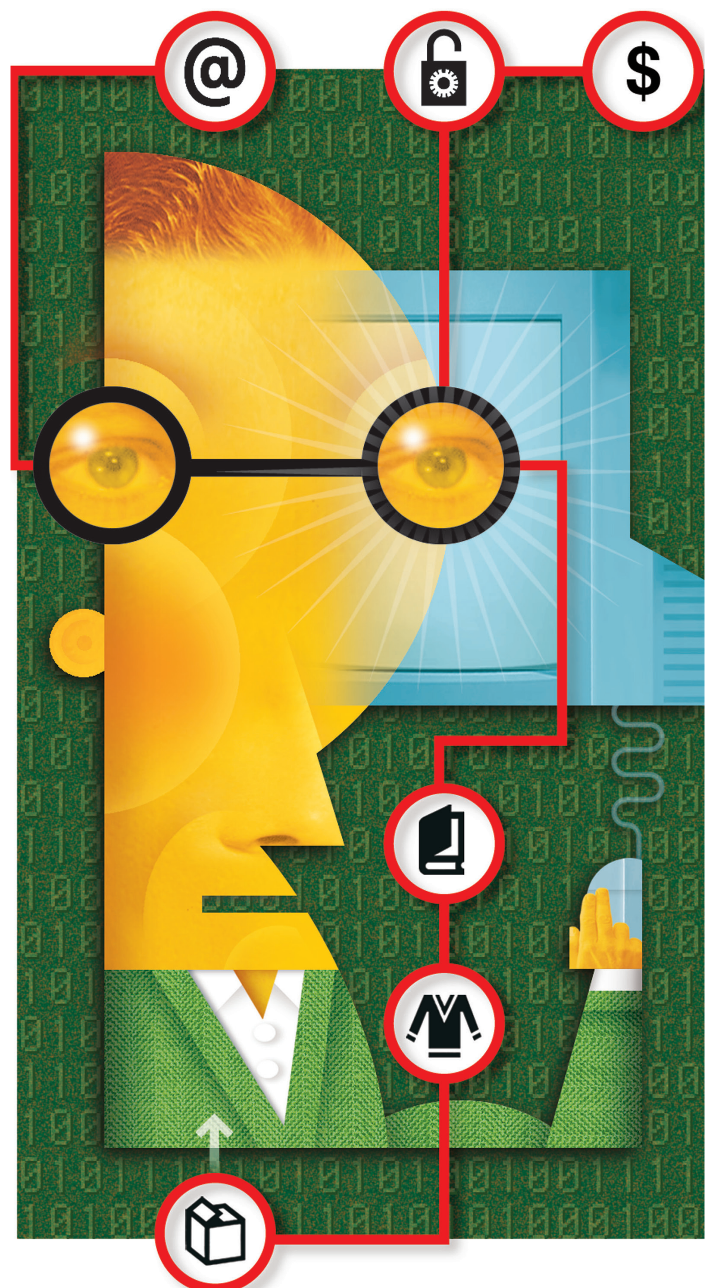
By: Polina Chapiro, Tax Partner and Akash D. Sehgal, Tax Director

As technological advances fundamentally change the way products and services are sold, state tax rules have struggled to keep pace. Existing rules focus on the taxation of businesses based on a "physical presence" nexus standard and generally apply tax to the sale of property within a specific jurisdictional boundary. Under the due process and commerce clause of the U.S. Constitution, a taxpayer must have some minimum connection or "physical presence" with a state in order for the state to impose tax on the taxpayer's business activities. This "physical presence" standard was upheld in the landmark 1992 U.S. Supreme Court Decision, *Quill vs. North Dakota.*[1]

> Many transactions that would have physically taken place within a state's borders just ten years ago, now take place virtually.

But much has changed since 1992, and the proliferation of e-commerce has created a major challenge for cash strapped states struggling with declining tax revenues. Many transactions that would have physically taken place within a state's borders just ten years ago, now take place virtually as digital content is sold and transferred online. So while traditional taxing guidelines may have been reasonable in 1892 and even 1992, states are now challenging whether "physical presence" should be the barometer of whether the state has the right to tax a business.

As the consumer economy continues to shift more and more away from point of sale transactions, states have been looking for ways to bypass the "physical presence" standard with other creative standards of establishing nexus. One such standard - ***economic nexus*** – holds that a taxpayer can be deemed to have a taxable presence in a state simply by creating a "market" for the sale of goods or services. ***Affiliate*** or ***agency nexus*** occurs when another party creates a "market" for a business within a state by conducting activities on behalf of the business. Using these standards, states are arguing that physical presence is no longer needed in order for a business to create a "market" for itself in a particular state. Instead, they are taking the position that states should be



GORDON STUDER

[1] Quill Corp. v. North Dakota, 504 U.S. 298 (1992)

allowed to expand their taxing power to reach any business that has created a "market" in the state.

California, New York, Texas and Washington have been actively pursuing internet based retailers and technology companies such as Amazon.com over the past few years. The states asserted that Amazon's affiliate program creates nexus for sales and use tax purposes. After much debate and deliberation with state taxing authorities, Amazon has now agreed to collect sales tax from its California, New York and Texas customers.

A number of state legislative proposals have recently focused on sales and use taxation of digital content delivered over the internet. In 2009, the state of Washington expanded its definition of digital goods subject to sales and use tax to include downloaded digital goods, streamed and accessed digital goods, digital automated services, and remote access software.[2] Kansas and Missouri issued letter rulings in 2011[3], addressing the taxation of downloaded software, remote access software and virtual currency.

Still, many states have been slow to address the tax consequences of e-commerce. Even the states that have addressed the taxation of digital goods have not uniformly agreed on what should be taxed. This has resulted in insufficient guidance for businesses that generate revenue through the sale or rental of digital content and virtual currency. An even greater concern for these taxpayers is the increased likelihood that states will assert sales and use tax nexus on taxpayers who do not have a physical presence in the state but who generate revenue through the sale of goods and services to customers located in the state. As more and more states grapple with the taxation of digital goods, virtual currency and cloud computing, businesses that generate revenue through the sale of digital content should be proactive in understanding state tax issues. It is essential to effectively manage the potential tax collection and reporting responsibilities in order to remain compliant and avoid unexpected tax liabilities.

---

[2] Washington State Digital Products Rule 15503

[3] Kansas Private Letter Ruling P-2011-004 (June 26, 2011) and Missouri Private Letter Ruling No. LR 6866 (Aug 18, 2011)

Possible Adjustments to Fair Value Measurements of Films

As accounting standards continue to move towards a simpler, more consistent model, the Accounting Standards Board (ASB) is working to assess the application and consistency of standards currently in practice. One key area addressed by the ASB pertains to the accounting for fair value measurement of film costs.

ELLEN WEINSTEIN

Accounting for fair value of film costs, which represent management's best estimate of how much future cash will be generated from the release of a film, is among the most complex and judgmental standards utilized by entertainment companies. These fair value measurements can result in significant write-offs when management feels that future cash inflows are less than the cost to produce a film. The ASB has proposed changes that may eliminate certain assessments frequently used by management in the film industry to determine impairment issues. Understanding these changes will help companies more accurately determine if any events or circumstances which would necessitate write-offs are present at the balance sheet date.

Although the ASB has not yet decided on an effective date for the newly proposed standards, understanding the potential changes to fair value measurements will allow your company to create efficiencies and avoid headaches even before the standards become final.

Green Hasson Janks and HLB Work Together in Japan

By Gregory Sills

Ryoko Honda and Gregory Sills, Tokyo, Japan 7/24/12

In July 2012, I traveled to Tokyo, Japan to work on a theatrical film audit at the local offices of a major studio. My work required me to review support documentation for revenue and expenses related to the distribution of a major motion picture. Without any fluency in reading, writing or speaking Japanese, this could have proven to be a difficult challenge. Fortunately, we were able to rely on HLB International, our world-wide network of independent accounting firms, to provide the resources we needed to complete the work.

Prior to the trip, we contacted the Meisei Corporation, our HLB affiliate firm in Tokyo. They agreed to provide us with translation and analytical assistance. I was assisted on the audit by Ryoko Honda, a senior auditor at Meisei.

Ryoko translated invoices and supporting documentation from the local language, and also helped analyze those documents as they related to the specific deal our client had with the studio. She was able to help me understand the documentation and provide literal translations for the descriptions of the reviewed revenue and expenses. Together we identified potential issues and successfully completed the project.

In addition to all of her help with the engagement, Ryoko was also able to help me order lunch, which was no easy task. Without Ryoko, I would have been eating at McDonald's every meal.

The trip to Japan also laid the groundwork for future audits in the territory. Ryoko's skill and awareness, along with the training I gave her during my trip, created increased confidence that Meisei can assist in future audits in Japan.

Following my visit, Ryoko completed an English language training program at the University of Arkansas, which was fully funded by her country's accounting board. This program further bolstered her impressive English skills and will allow for even better communication and cooperation in the future.

If you are an individual, company stakeholder or the beneficiary of a trust or estate with profit participation rights to movies or television shows, you could be at risk for underpayment. A detailed periodic review of your distributions, such as a profit participation audit, is a great way to ensure equitable treatment.

But when should you consider a profit participation audit? Ilan Haimoff and Peter Klass have created a road map to help you assess your risk as a profit participant. Download it at greenhassonjanks.com/publications

To submit future topics or provide feedback, please contact Kari Schott at kschott@greenhassonjanks.com

10990 Wilshire Blvd, 16th Floor
Los Angeles, CA 90024

310.873.1600

greenhassonjanks.com/entertainment

© 2012 Green Hasson & Janks, LLP.
All rights reserved.