THE
NATIONAL LAW REVIEW

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

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Thursday, March 29, 2018

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] 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] 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] However, some argue that companies will not use the windfall for compensation but rather for stock buybacks and other actions to benefit stockholders.[4] 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** 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** 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. 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] 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] To the relief of these advocates, the deduction's removal did not find its way into the bill's final form.

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[1] See **here**

[2] See **here** and **here**

[3] See **here**

[4] See **here**

[5] See **here**

[6] See **here**

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