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INTELLECTUAL PROPERTY & TECHNOLOGY ALERT

April 16, 2009

Economic Stimulus Provision Seeks to Stimulate California Film Production

By Patty Mayer and Jill Rubin

On February 20, 2009, Governor Arnold Schwarzenegger signed legislation creating tax credits for film and television productions as part of an economic stimulus provision in the new state budget -- Section 17053.85 of the Revenue and Taxation Code of California.

The California Film Commission has announced that it currently is developing program guidelines and application procedures, noting that applications will be accepted on a first come, first served basis - no earlier than July 21, 2009 - as long as funds are available within each fiscal year. (Any unused funds from a fiscal year shall carry over to the following fiscal year.)

The credit is based on "Qualified expenditures" from fiscal year 2009/2010 through 2013/2014. The program will provide up to $100 million in tax credits annually, with $10 million set aside for independent films. Under the program, "qualified" taxpayers will be allowed a credit against income taxes beginning on January 1, 2011.

For a project to qualify for the program, there are a number of criteria:

- 75% of production days or "total production budget" must be spent in California.
- Principal photography must commence no sooner than application approval and no later than 180 days after application approval.
- Post-production (editing, foley recording, ADR, sound editing, scoring and music editing, beginning and end credits, negative cutting, negative processing and duplication, addition of sound and visual effects, sound-mixing, film-to-tape transfers, encoding, and color correction) must be completed within 30 months of receiving tax credit application approval.
- The copyright for the motion picture must be registered with the US Copyright Office.
- The following projects do not qualify for the tax credit: commercials; music videos; news programs; current events or public affairs programs; talk shows; game shows; sporting events; 1/2 hour (airtime) episodic TV shows; awards shows; productions that solicit funds; reality programs; student films; industrial films; clip-based programming where more than 50% of content is comprised of licensed footage; documentaries; variety programs; daytime dramas; strip shows; and pornography.
- Qualified taxpayers may carry over tax credits for five years and transfer tax credits to an affiliate.

Projects that qualify for a 20% tax credit of "qualifying expenses" are (1) a film project with a minimum of $1 million and a maximum of $75 million production budget, (2) a "movie of the week" or miniseries ($500,000 minimum production budget), or (3) a new television series licensed for original distribution on basic cable ($1 million minimum budget; one-half hour shows, and other exclusions apply).

Projects which qualify for a 25% tax credit of "qualifying expenses" are a television series (without regard to episode length) that filmed all of its prior season or seasons outside of California, and an "independent film" (i.e., one with a budget between $1 and $10 million produced by a production company that is not publicly traded and/or more than 25% owned by a publicly traded company).

Under the program, "Qualified expenditures" (essentially below-the-line costs) are defined as amounts paid or incurred for the purchase or lease of tangible personal property used within California and qualified wages for services performed in California. However, certain expenses are expressly excluded; namely: (1) expenses related to writers, directors, music directors, music composers, music supervisors, producers, and performers (other than background actors with no scripted lines), (2) expenses related to new use, reuse, clip use, licensing, secondary markets, or residual compensation or creation of ancillary products, (3) expenses related to acquisition and development of any rights, and (4) expenses related to financing, overhead, marketing, promotion, or distribution.

There are a few outstanding issues and questions that remain to be resolved. For example, it has not yet been determined what taxes this credit will be applied against and in what order (e.g., income tax, sales tax, use tax). It also is not clear what the definition of the "total production budget" is for the 75% test (e.g., does it include a salary paid to a star who lives in India when the star is working in Los Angeles?). The language of the statute provides that production budget includes "[a]ll expenses paid or incurred during the production period." Regulations promulgated by the California Film Commission will likely provide some guidance. Additionally, it remains to be determined how a project will be approved under the program. The California Film Commission has indicated that it will be "first come, first served," but it is unclear exactly how this will be addressed (e.g., first to apply, first to be approved?). Regulations promulgated by the California Film Commission will likely provide some guidance.

California's new film tax credit bill is extraordinarily complex, and will require substantial regulative guidance by the Film Commission. Managing the process in these early days -- from the initial application through management of the actual credit -- will likely require both diligence and flexibility as well as monitoring of any updates in regulation. Nevertheless, for many productions, the credit may provide the potential for reduction in tax liability

If MSK's Entertainment Group can assist with any matters related to the new California film incentive, please contact:

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