

## The Impact Of Tax Reform On Film, TV And Print Media: Part 3

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This article is part three of a series in which Bracewell LLP attorneys Michele Alexander and Ryan Davis examine different aspects of tax reform's impact on the media industry.

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As we have noted in past articles, tax reform is impacting the media industry in a number of important ways. In this installment, we further explore new international and domestic provisions that will impact media companies' decisions regarding foreign versus domestic production.

Unlike many of the country's largest technology companies, media and entertainment companies generally did not benefit from inversions and other pretax reform practices that reduced their overall U.S. tax bill. However, they still find themselves casualties of the Tax Cuts and Jobs Act's efforts to curb the parking of valuable assets, and payment of significant cash amounts, offshore. In order to encourage the return of valuable assets and capital to the U.S., TCJA provides for a low one-time repatriation tax on income previously kept offshore — 15.5 percent on foreign cash and other liquid assets and 8 percent on all residual assets, in each case, to the extent of earnings and profits. Although the tax is intended as short-term encouragement for the return of capital to the U.S. (as it is imposed whether or not cash actually is repatriated), this also could act as a longer-term incentive for keeping domestic media production onshore. This longer-term domestic benefit is reinforced by other new provisions found in TCJA. The new "base erosion anti-abuse tax," or BEAT, complements the repatriation tax by providing an incentive for American companies to hold assets onshore by doing away with the primary benefit they derived from not doing so — specifically, the avoidance of U.S. federal taxation. The new provision accomplishes this by limiting the deductibility of payments to foreign affiliates in lower-tax jurisdictions by U.S. taxpayers. 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 percent for years before 2025, with a phase in at 5 percent for 2018. While worldwide media companies do not appear to be the intended target, larger media enterprises may find themselves within the ambit of BEAT and thereby motivated to bring certain activities onshore. Of course, there are significant, often competing non-tax considerations for media/entertainment and film production companies, as location may very well impact production and finished product.

Similarly, the "global intangible low-taxed income tax," or GILTI, targets American companies that



Michele Alexander



Ryan Davis

continue to hold intangible assets offshore while maintaining the majority of their operations domestically. This could have a particularly important impact on U.S. media companies, which want to reap the benefits of being located in certain U.S. markets with notable advantages — such as New York or Los Angeles — while still being able to mitigate their tax burden by holding valuable copyrights or licenses abroad. However, just as in the case of BEAT, many international media and entertainment companies have legitimate non-tax reasons for holding these intangibles abroad, particularly in jurisdictions where filming and production actually take place. The new tax undermines this tax maneuver — but also disadvantages this latter category — by requiring U.S. shareholders holding at least a 10 percent 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 otherwise would not be taxable in the U.S. Although the "foreign-derived intangible income," or FDII, deduction (discussed below) may allow corporations to reduce their tax burden with respect to intangibles, this likely will lead U.S.-based media companies to reevaluate whether it remains profitable to keep these intangible assets abroad — but also to consider bringing activities onshore where the new status quo subjects even "innocent" media companies to the tax.

As a practical offset to the GILTI tax, TCJA provides a new incentive for U.S. companies to provide goods and services to foreign markets by allowing domestic corporations to take deductions on their so called FDII. This deduction only is available to U.S. entities classified as corporations for tax purposes — including domestic corporate subsidiaries of foreign companies — which provides a disproportionate boon to the media industry — and is determined using a complex calculation (which we will discuss more in-depth in later installments). A domestic corporation's FDII is 37.5 percent deductible (to the extent it has taxable income), which yields a 13.125 percent effective tax rate (the new 21 percent corporate rate multiplied by 37.5 percent) and may be further reduced with foreign tax credits where applicable. It should be noted, however, that for tax years beginning after Dec. 31, 2025, the effective tax rate on FDII increases to 16.406 percent. As noted above, the FDII provision also reduces the tax rate on GILTI by 50 percent to an effective rate of 10.5 percent (increasing to 13.135 percent in 2026). One consequence of this provision is that it provides a tax incentive to earn income from the sale of property and services to persons outside the United States, even though media companies otherwise may have these streams without regard to tax. As a result, a number of countries have threatened to challenge the legality this provision at the World Trade Organization under the theory that it provides an export subsidy to domestic corporations. At the same time, media and technology companies are undertaking detailed review of their tax projections taking into account GILTI and FDII — as we will explore in greater detail in future installments, it seems like a mixed bag within the industry as to how much the GILTI will sting, and how much the FDII will mitigate.

In addition to encouraging — or coercing — domestic media companies to return capital and investment to the U.S., TCJA also may spur new investment from non-U.S. investors. Specifically, the significantly lower corporate rate could encourage investment from foreign companies — and other types of foreign investors — that had previously refrained from doing so due to the relatively high U.S. corporate tax rate. It is possible that prior to the law's passage, potential television and film investors outside of the U.S. were hesitant to invest in productions without the presence of corporate blockers. However, blockers were viewed as unattractive options due both to the entity-level rate of taxation and the former so called earnings stripping rules, which limited interest deductions for related party debt. Now TCJA has repealed the earnings stripping rules and, at the same time, one of the largest drawback to using blockers — the entity level tax to which they are subject — now is mitigated by the aforementioned decrease in the corporate tax rate (from 35 percent to 21 percent). Particularly where the investment strategy does not rely on dividend payments, blockers actually may be a more attractive option following tax reform. In particular, private equity funds with a media focus may consider more

U.S. investment, particularly since traditional fund investment does not contemplate dividend payments.

The alleviation of these concerns with corporate blockers also may encourage potential foreign investors in media to use them, or switch to them from an investment in media partnerships or joint ventures structured as partnerships for tax purposes. This is specifically due to the way in which TCJA codified a controversial IRS ruling and subjected non-U.S. persons selling partnership interests to tax and withholding on “effectively connected income,” or ECI, to the extent that the gain from such disposition is attributable to ECI-producing assets. While there has been some preliminary guidance issued on the withholding obligation, in general it may cause practical concerns, as foreign partners attempting to invest domestically may be forced to file federal income tax returns in order to obtain a refund of amounts withheld in excess of their actual tax liability. This may drive foreign investors to invest in media partnerships that plan to utilize blocker corporations in order to protect the foreign investors from both the taint of ECI and any personal reporting requirements to the IRS.

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*Michele J. Alexander is a partner and Ryan Davis is an associate in the New York office of Bracewell LLP.*

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