

Green  
Hasson  
Janks

# Entertainment

## California's Withholding Tax Requirements Place an Extra Compliance Burden on the Entertainment Industry

Those involved in California's entertainment industry understand the coordination and effort it takes to pull off a major production. Independent contractors such as actors, singers, speakers, sports entertainers, and lighting and film crews are often critical to production. Frequently, these contractors are not residents of California.

California requires that state income tax be withheld on payments of California source income to nonresident independent contractors, whether the payments are made directly or to a legal entity in which the independent contractor owns an interest. California source income generally refers to income that is earned for services physically performed in California. The current state income tax withholding rate in California is 7 percent. Payments made to California residents are generally not subject to income tax withholding.



WILLIAM RIESER

In an effort to ensure compliance and maximize tax revenues, California has increasingly scrutinized payments made to nonresident independent contractors to ensure that California income tax is being withheld. California refers to those making payments to nonresident independent contractors in the entertainment industry as Entertainment Industry Withholding Agents (withholding agents) and requires them to withhold and remit income tax to the state. By putting the burden on the withholding agent, the state ensures that at least some portion of the overall tax burden will be paid. This protects the state in situations where the nonresident independent contractors fail to file an income tax return in California.

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

### In This Issue

CA Withholding Tax Creates Extra Burden on Entertainment Industry

“Hasta La Vista” First Dollar Gross Deals

Recent Trends: Packaged and Digital Media and the Licensing Industry

Content Partners Acquire Interest in “CSI”

In the News

# “Hasta La Vista” First Dollar Gross Deals

By Michael Sippel, CPA, CFE  
Manager Motion Picture Television  
Participation Services

Over the past 10 to 20 years, A-List actors such as Arnold Schwarzenegger, who made famous the quote “Hasta La Vista Baby,” were consistently receiving First Dollar Gross (FDG) deals from major studios. FDG deals provided payment to actors based on total revenue less only off-the-top expenses, which typically consist of taxes, dues, residuals, and checking and collections. Under FDG agreements, A-List actors were virtually guaranteed a back-end payday regardless of whether the picture was a blockbuster or a bomb.

A recent trend towards creating tent-pole pictures, such as “Harry Potter,” “The Dark Knight,” “Transformers” and “The Iron Man,” has seen studios spending enormous amounts on printing and advertising (P&A) and production costs. These extremely high budget films provide great potential, but also significant risk for the studios – risk that is compounded by FDG deals. When unforeseen marketplace trends, timing, or bad luck cause high-cost films to flop; FDG contracts still call for additional payments which add to the studio’s losses.

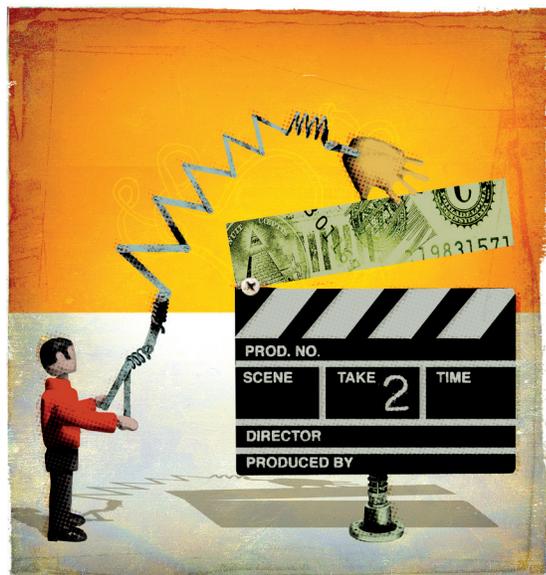
For example, let’s suppose an A-List actor had a \$5 million salary, a 10 percent FDG deal, and was working on a studio’s new blockbuster hopeful. The picture had large P&A and production costs of \$250 million each, totaling half a billion dollars. Unfortunately, the picture performed horribly in the box-office, and in-turn, poorly in subsequent markets such as home video and television and only achieved \$200 million of total

revenues. At first glance, the studio is already at a loss of \$300 million; however, due to their structured FDG deal, they now owe an additional \$15 million (\$200 million X 10 percent less \$5 million) to their A-List actor. Using the same example, if the picture had done significantly better and achieved apparent breakeven revenue of \$500 million, they would still be at a net loss of \$45 million (\$500 million X 10 percent less \$5 million) due entirely to the payout of the FDG deal.

To leverage this risk, studios have recently begun incorporating True Cash Breakeven (TCBE) contracts. TCBE deals are designed to find the point at which the studio has recouped all their actual, out-of-pocket expenses, prior to paying out backend participations. Different from many typical deals, which include distribution fees, home video royalties, and 10 – 15 percent overheads on advertising and production costs, TCBE contracts eliminate all of these elements. These deals remove all studio override and built-in profit and effectively create a partnership between the studio and the participant. Home video revenues are generally reported at the industry standard of 20 percent royalty; however, in reaching TCBE, this new structure implements a home video net arrangement (i.e. the participant receives 100 percent of the home video revenues and bears 100 percent of the home video costs).

While some of the major A-list talent may simply turn down TCBE offers and attempt to find FDG deals, TCBE deals

typically have larger potential upsides. FDG share percentages generally range from 2.5 - 15 percent while TCBE deals can range from 15 – 35 percent share after achievement of TCBE. In essence, the studios are asking the actors to share



RICHARD BORGE

more of both the risk and the reward associated with large budget films. With TCBE deals, if P&A and production costs are kept at a reasonable level and the picture is a success, the actor may now stand to make significantly more than with their old FDG arrangements. Conversely, the studios benefit when the picture does not do well, as they owe nothing additional to TCBE participants when films do not achieve the calculated breakeven revenue.

As such, show business is saying “Hasta La Vista” to First Dollar Gross and “Hello” to True Cash Breakeven.

# Recent Trends:

## In Packaged and Digital Media

Peter Klass, manager at Green Hasson Janks, led a discussion highlighting developments in the domestic home entertainment industry at the monthly Royalty Watch meeting. Klass discussed recent trends and key developments in packaged and digital media.

Here are some key excerpts from the discussion.

In 2011 total consumer spending on home entertainment in the United States topped \$18 billion. While the industry remains strong overall, consumer spending has actually been on a downward trend in recent years since peaking at \$21.8 billion in 2004. The primary reason has been the sharp decline in sales and rentals of packaged media, DVD's and Blu-ray discs. While digital exploitation of content continues to grow through streaming and downloads over the internet, spending in these areas has not grown at a rate sufficient enough to make up for lost revenues on DVD and Blu-ray sales. The expansion

of the digital distribution, electronic sell-through, video on demand, and subscription streaming, is not enough to compensate for the decline in spending on physical discs, as digital spending is still only a fraction of the marketplace. For the year 2011 digital accounted for 19 percent of the home video market. It is projected to exceed 40 percent in 2013.

Recently a new service has debuted in the marketplace. UltraViolet allows users to upload their content into a digital library enabling them to watch on multiple devices including

computers, internet-based televisions, smartphones, and tablets. Despite the initial excitement, it remains to be seen if UltraViolet will lead the expansion of revenue from digital media to replace the declining packaged media sales.

### KEY STATISTICS:

- Blu-ray unit sales comprise approx. 25% of all disc sales
- Electronic sell-through spending in 2012 jumped 35%
- More than 9 million UltraViolet accounts have been created through 2012

U.S. CONSUMER SPENDING (\$ in millions)	2010	2011	YOY
<b>PACKAGED GOODS</b>			
SELL-THRU	\$10,321	\$8,952	-13.3%
RENTAL	3,578	3,307	-7.6%
SUBSCRIPTION (Physical only)	2,272	2,366	4.1%
TOTAL PACKAGED GOODS	16,171	14,625	-9.6%
<b>DIGITAL</b>			
ELECTRONIC SELL-THRU	\$508	\$554	9.1%
VOD	1,752	1,869	6.7%
SUBSCRIPTION STREAMING	-	994	N/A
TOTAL DIGITAL	2,260	3,417	51.2%
<b>TOTAL U.S. HOME ENTERTAINMENT SPENDING</b>	<b>18,431</b>	<b>18,042</b>	<b>-2.1%</b>

Per the Digital Entertainment Group

## In the Licensing Industry

If you are familiar with the licensing industry, you probably know that the only constant is change. With an increased celebrity presence, expansion in digital media, and growth in the global marketplace, the industry is evolving before our eyes.

### INTERNATIONAL GROWTH:

While attending the Licensing Expo in June, it was hard to ignore the increased presence of Brazil and Russia. Brazil had a large pavilion at the Expo for the first time, demonstrating 25 characters, designs and brands. With Brazil scheduled to host both the upcoming Summer Olympics and the 2014 World Cup, we expect Brazil's international presence and licensing involvement to continue to grow. Russia was also well represented at the Expo and even

hosted its first international licensing industry show, with approximately 30 percent of the attendees coming from international markets. With continued growth in the areas of media, wealth and consumer demand, Russia represents a large untapped market and will likely be an area of future focus for licensors.

Beyond Brazil and Russia, other countries are also increasing their licensing influence. Japan, Hong Kong, Korea, Taiwan and others have shown an increase in licensing activities.

### CELEBRITY PRESENCE:

The last few years have seen a substantial increase in the number of celebrities launching licensing programs. Gwyneth Paltrow was the keynote speaker at the Licensing Expo, discussing her Goop brand and the use of a blog to establish a lifestyle brand. Other celebrities such as singer Flo-Rida and former supermodel Kathy Ireland have recently put their fingerprints on the licensing world.

Continued on page 4 ►

# NO CRIME HERE: Content Partners Acquires 50% Interest In “CSI”

In a landmark deal, L.A. based Content Partners acquired a 50 percent interest in the hit television series “CSI.” The acquisition, purchased for a reported \$400 million from Goldman Sachs, includes “CSI,” “CSI: Miami,” and “CSI: NY.”

The entire “CSI” library contains 724 one-hour episodes that air in more than 200 countries. Flagship “CSI” began its 14th season this fall, while “CSI: NY” wrapped its ninth and final season this past May. “CSI: Miami” finished its 10th and final season last year.

**Steve Blume**, COO & CFO of Content Partners, noted this to be the largest acquisition in the firm’s six year history. Blume believes it fits perfectly with the firm’s acquisition strategy. It’s a win-win situation for both seller and buyer. The acquisition liquidates the long-term value of future profits from the series to the seller, while allowing Content Partners the opportunity to secure low risk cash flows for its portfolio investors with an asset of perennial value. With the emergence of new media markets and new methods of exploitation, there also remains the possibility of a potential upside for Content Partners.

Content Partners was founded in 2006 by **Steve Blume** and partner **Steve Kram**, who previously served as the COO of William Morris. Content Partners buys profit participations from service participants such as actors, directors, show runners and producers, as well as financial participants such as banks, hedge funds and investors.

Content Partners is supported by **Krista Parkinson**, a former William Morris agent; **Dave Davis**, who previously managed the Entertainment Advisory Services for Houlihan Lokey Howard & Zukin; and **Brendan Haley**, formerly of New Line Cinema and Warner Bros.

For more information about Content Partners, please contact Krista Parkinson at [parkinson@contentllc.com](mailto:parkinson@contentllc.com) or 310-208-7300.

## In the News...



### STEVEN SILLS MODERATES PANEL

Steven Sills spoke on post-audit options at the 2013 Institute on Entertainment Law and Business. The event was presented by the USC Gould School of Law and the Beverly Hills Bar Association. Learn more [here](#).



### LA STAGE ALLIANCE OVATION AWARDS AND GREEN HASSON JANKS

Bryan Golerkansky from Green Hasson Janks (*above*), the official tabulators of the LA STAGE Alliance Ovation Awards, worked diligently to prepare the list of nominees for official awards ceremony taking place on November 3rd. More information about the awards is available [here](#).

*Continued from page 3* ▶

Selena Gomez, Cindy Crawford and Vera Wang have completed deals with large department and specialty store chains. Celebrities increasingly understand the power of licensing and the additional opportunities it holds. We expect an even greater celebrity presence with time.

### DIGITAL MEDIA:

Digital media continues its expansion into licensing. “Angry Birds” was one of the busiest attendees at the Expo, with numerous others such as “Candy Crush,” “Zombie Farm” and “Doodle Jump” not far behind. We are

witnessing both a large increase in the number of digital properties and an expansion of these brands into a wider array of licensing avenues such as movies, mobile apps, books, etc. For example, Sony holds the movie rights to “Angry Birds,” while Kappa holds the book rights.

The following examples describe common situations where the withholding agent may be unclear about their requirement to withhold taxes on payments made to nonresident independent contractors.



WESLEY BEDROSIAN

## PAYMENTS THAT ARE GENERALLY SUBJECT TO CALIFORNIA WITHHOLDING

1. A production company makes a 1099 payment to a film crew member who is not a resident of California for a feature film produced entirely in California. The entire payment is subject to California withholding if the film crew member performed 100 percent of the services in California.
2. A major film studio makes participation royalty payments in year three to an actor who is a nonresident of California for services physically performed both within and outside of California in year one. The portion of the payment made in year three that is attributable to services physically performed in California in year one is subject to California withholding.

## PAYMENTS THAT ARE GENERALLY NOT SUBJECT TO CALIFORNIA WITHHOLDING

1. A television production company hires a screen writer who is a nonresident of California to review television scripts for a future production. The screen writer physically performs this service entirely outside of California. No portion of the payment would be subject to California withholding because no portion of the services were physically performed in California.
2. A major film studio based in California makes payments to an LLC for services performed by an actress who is a nonresident of California on a feature film produced entirely outside of California. No portion of the payment would be subject to California withholding because no portion of the services were physically performed in California.

## RECOMMENDATIONS TO THE ENTERTAINMENT INDUSTRY TO ADDRESS CALIFORNIA WITHHOLDING OBLIGATIONS

1. Entertainment industry organizations should scrutinize all payments made to nonemployee nonresidents of California and assess whether withholding is required.
2. To the extent services are performed both within and outside of California, the portion deemed “California source” can be determined based on the ratio of the number of days the services were performed in California to the total number of days services were performed.
3. Organizations with significant prior year California withholding exposure should consult with their tax advisors to determine whether California’s recently enacted Withholding Voluntary Compliance Program (WVCP) is a good option. Information on the WVCP can be found here <http://www.greenhassonjanks.com/tax-alerts/tax-alerts-detail/state-local-tax-alert-august-2013>. Benefits of the WVCP include a limitation on the number of years to be reviewed and full abatement of penalties associated with the failure to withhold. Interest will still apply to those that participate.

**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](http://greenhassonjanks.com/publications)

To submit future topics or provide feedback, please contact Ilan Haimoff at [ihaimoff@greenhassonjanks.com](mailto:ihaimoff@greenhassonjanks.com)

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

310.873.1600

[greenhassonjanks.com/entertainment](http://greenhassonjanks.com/entertainment)

© 2013 Green Hasson & Janks, LLP.  
All rights reserved.