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Entertainment

THE IMPACT OF THE NEW REVENUE RECOGNITION STANDARD ON THE MEDIA AND ENTERTAINMENT INDUSTRY

By Anant Patel and Dan Landes

On May 28, 2014, the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) issued their long-awaited converged standard on revenue recognition. The standard is expected to improve the financial reporting of revenue and also improve comparability of entity financial statements on a global scale.

What's the Deal with IASB and FASB and Why Change Revenue Recognition?

Revenue serves as a vital metric for users of financial statements and is used to assess a company's financial performance. However, the previous accounting treatment of revenue recognition in the United States under US Generally Accepted Accounting Principles (U.S. GAAP) and the treatment of revenue recognition under international standards were different and often resulted in disparate accounting treatment for transactions that were economically similar. To make matters even more confusing, revenue recognition requirements under international standards generally lacked sufficient detail, while requirements under U.S. GAAP were considered to be overkill.

I'm Intrigued, but What Exactly is Going to Change?

The objective of the new revenue standard is to provide a single, comprehensive revenue recognition model for all contracts with customers to improve comparability within industries, across industries and across capital markets. This standard will have a profound effect, not only on the measurement of revenue, but also on the timing of when an entity will recognize their revenue from contracts with customers.

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

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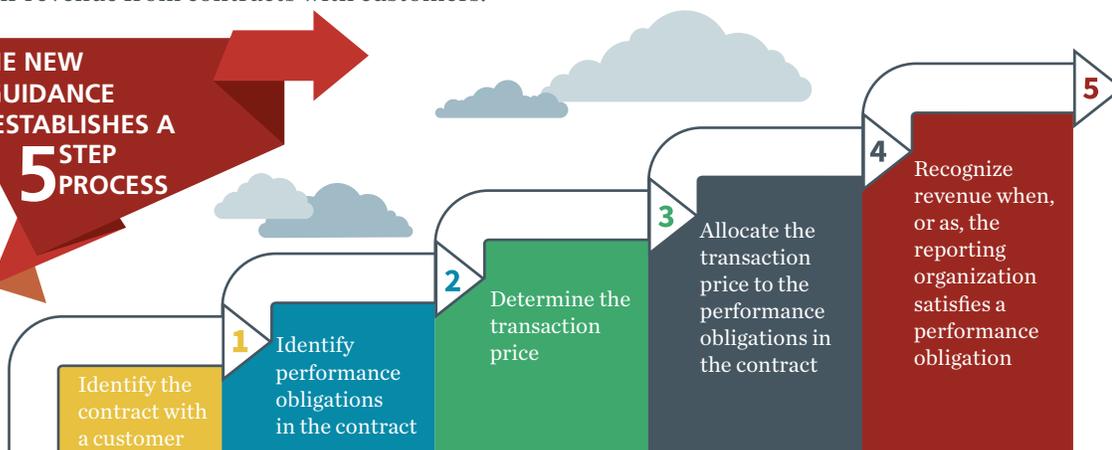
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THE NEW GUIDANCE ESTABLISHES A 5 STEP PROCESS



4 key changes to U.S. GAAP:

TODAY

There are numerous requirements for recognizing revenue.

Other than specific entity related disclosures, most companies provide limited information about revenue contracts.

Many promises in contracts are not deemed to be revenue-generating transactions, when in fact such promises might represent separate obligations to the customer.

In the case of multiple performance obligations, revenue is recognized when all contingencies are satisfied.

UNDER NEW GUIDANCE

There will be consistent principles for recognizing revenue, regardless of industry and/or geography.

The new guidance includes a cohesive set of disclosure requirements that will provide users of financial statements with useful information about the organization's contacts with customers.

Promised goods or services will be identified, and any performance obligations will determine the amount of revenue recognized, and the timing in which revenue is recognized.

Companies will allocate the transaction price to each performance obligation, and recognize revenues as each obligation is satisfied.

As you can see, there are significant developments in the way that all media and entertainment companies will have to recognize and disclose their revenue generating contracts. For motion picture, television and other new media production companies, this could mean recognizing large “chunks” of revenue earlier, according to the terms of various performance obligations in contracts with distributors and other entities, regardless of the timing in which cash is actually collected. In contrast, for an advertising agency who has a contract to produce media for multiple television spots, revenue may be recognized over the time it takes each television spot to air if that is determined to be a performance obligation per the customer contract. This could result in revenue being recognized later than under previous standards, where revenue may have been recognized once the media begins to air on television.

When Will This Be Effective and What Can I Do Now?

For public organizations, the guidance is effective for annual reporting periods beginning after December 15, 2016 with no early adoption. For nonpublic companies, the new guidance will be required for annual reporting periods beginning after December 15, 2017. Early adoption is permitted for nonpublic companies, but no earlier than the effective date for public entities.

Although the effective dates may seem to be far in the future, understanding the revenue recognition changes today will allow your company to be better prepared, saving time and avoiding confusion when changes become effective. &

GREEN HASSON JANKS AT THE BEVERLY HILLS BAR ASSOCIATION

Royalty Income Meets Marital Dissolution: Dividing, Managing & Accounting

Green Hasson Janks' royalties expert, **Cedar Boschan**, served as a panelist at the Beverly Hills Bar Association's Family Law Section Dinner this May.

Cedar joined attorney Cheryl Hodgson of Hodgson Legal and wealth advisor Kristin Edmonds of Morgan Stanley in speaking about clients who have a community property right in intangible assets. The talk was geared toward family lawyers who represent clients with community property interests in income streams from music, film and television, rights of publicity and other intangible assets.

Topics covered included:

- Types of intellectual property
- Property settlement pitfalls and drafting tips to avoid them
- Conflicting interests of the parties

The panelists also discussed Smokey Robinson's legal dispute over recaptured copyrights with his ex-wife Claudette Robinson. To learn more about this interesting case, which highlights a conflict between California State Law and Federal Law, see the following articles by Eriq Gardner of the Hollywood Reporter:

- **Smokey Robinson's Ex-Wife Demands Share of Hit Songs**
- **Smokey Robinson Points to U.S. Constitution in Fight with Ex-Wife Over Song Rights**

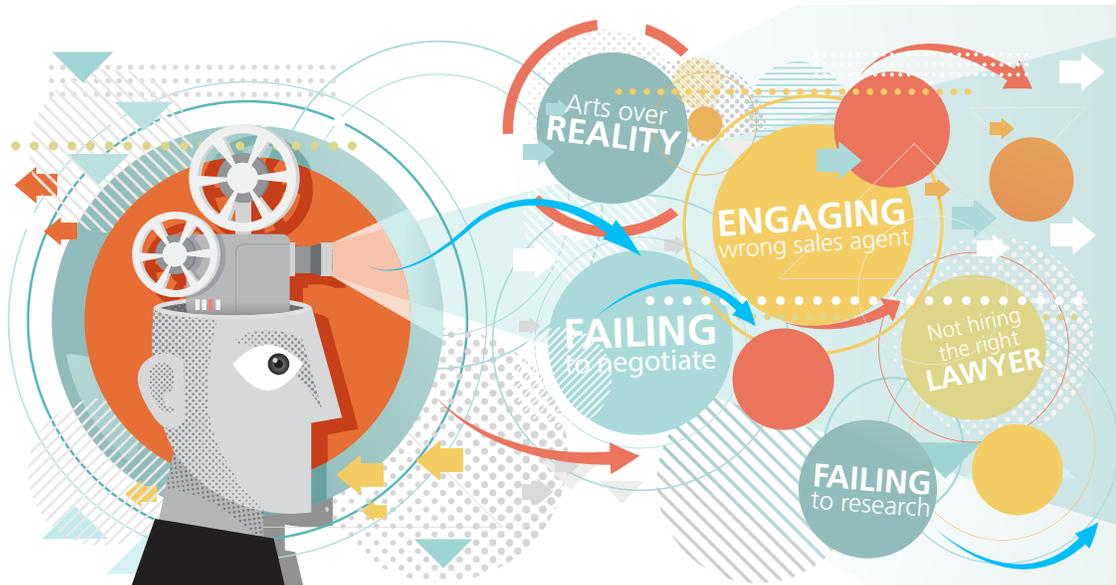
[Click here](#) to purchase a video of the Beverly Hills Bar Association's panel discussion. &



L-R: Cheryl Hodgson, Esq. of Hodgson Law, Cedar Boschan of Green Hasson Janks, Kristin Edmonds of Morgan Stanley

THE 5 COMMON MISTAKES BY INDEPENDENT PRODUCERS WITH FILM FINANCING

By *Ilan Haimoff* and *Adrian Ward*



1. Failing to negotiate hard enough on their talent deals

Dealing with talent agencies can be challenging for an independent producer, who may be less able to negotiate the cost of their above-the-line talent cost. Often, the independent producer ends up paying too much for talent, making the production budget uneconomical from the start.

2. Engaging the wrong sales agent for their project

Producers need a sales agent who can sell to the market most appropriate for the film based on genre, budget, talent, etc. When a sales agent doesn't have relationships with the correct buyers, films may struggle to sell regardless of the quality or marketability of the film itself. With the time sensitivity of film sales, a well-connected sales agent is a must.

3. Failing to fully research tax incentive locations

Before deciding on where to shoot a film, producers need to identify a location that is suitable for creative needs and financial benefits. Any available financial benefits need to be thoroughly investigated to ensure tax incentives can be easily monetized by a lender.

4. Not hiring the right lawyer

Trying to document a complicated loan transaction with a lawyer who does not have sufficient experience will end up costing the producer. Working with inexperienced lawyers can prevent loans from closing, derailing the entire film.

5. Believing that artistic merit will overcome commercial reality

Producers need to be in touch with the market for their films. Decisions should be made with an eye on the economic model for the film and how that model translates in to territorial sales around the world, starting with the choice of script and the talent involved.

Click here for more information on **Adrian Ward** and **Pacific Mercantile Bank**. &

GREEN HASSON JANKS IN THE MARKETPLACE



Green Hasson Janks' Partner, **Michelle Gentile**, spoke at the *Women in Film and Television International Summit* on a panel discussing "Understanding Profit Participations in the Motion Picture Industry". **Click here** to read more.

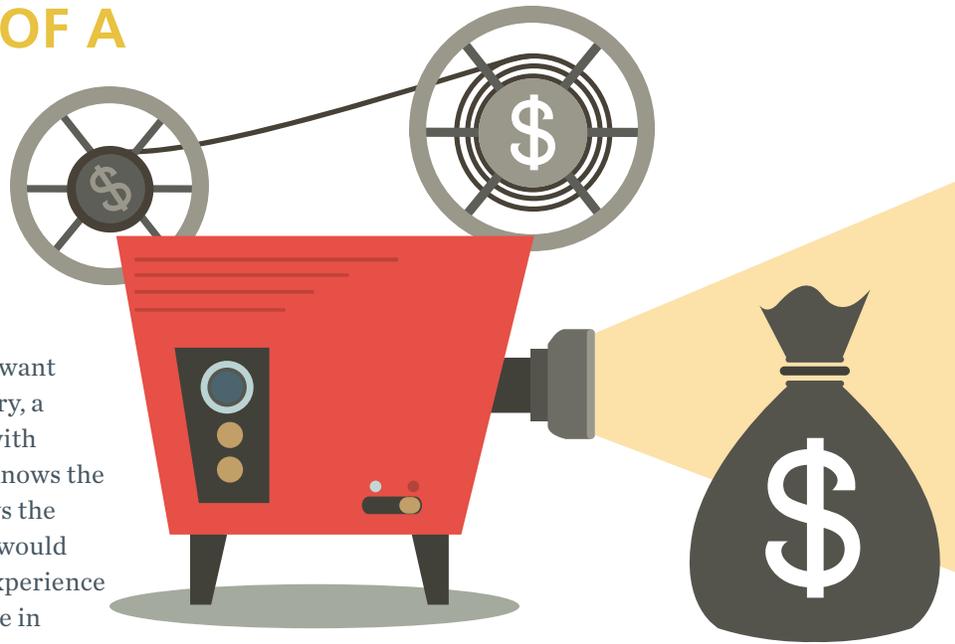


Watch **Ilan Haimoff** and other members of Professional Advisory Network (PAN) of the Motion Picture Television Fund (MPTF) in this **video recap**.

Ilan Haimoff moderated Royalty Audit and Contract Compliance: What You Need to Know panel at **Licensing Expo** in Las Vegas and co-chaired the **CalCPA Entertainment Industry Conference 2014**. &

5 CHARACTERISTICS OF A GREAT PRODUCTION ACCOUNTANT

By *Ilan Haimoff* & *Melissa Wiseman*



- 1. The Right Experience:** Experience working on similar projects at similar locations is essential. For example, if you want to produce an independent film in Hungary, a production accountant who has worked with local vendors before, knows the culture, knows the budgeting of foreign currencies and knows the regulatory requirements of the territory, would have a competitive edge. Genre specific experience is also important. For example, experience in episodic television is much different from a motion picture production, making specific project experience critical. Budget levels are important factors when considering production accountants for certain projects. A producer or financier should gravitate towards production accountants in that same budget skill level to include non-union projects versus union projects.
- 2. Being Proactive:** Since the production manager, the director, and the rest of the crew have different goals and interests, it is the job of the production accountant to keep everyone realistic and efficient. The production accountant should complete cost reports weekly to keep financiers, producers, department heads and pertinent staff abreast of the estimated funds needed to complete principal objectives. Also, as unanticipated costs are needed to be expanded, exceptional production accountants look for ways to finance the costs with reductions elsewhere in the budget or through proactive planning and communication with all involved parties.
- 3. Effective Wrap Up:** It is essential that production accountants keep an audit trail and are organized in wrapping up and communicating final results to the production company and other stakeholders. Once a production is handed over to the post production accountant, this person will need a full synopsis of past dealings, present dealings and future needs. A sloppy work product could also result in issues with getting the territory production credit, or other incentives down the line.
- 4. Ethics:** A production accountant has control over the money, so picking a production accountant should be as critical as picking the bank where you put your money!

Do background checks and check the production accountant's references! If a production accountant has worked consistently with the same line producer for many years be sure to obtain additional references or check with the financiers of the productions. Accountants are the CFOs of each production and producers should have the utmost trust in the accountant and their team.

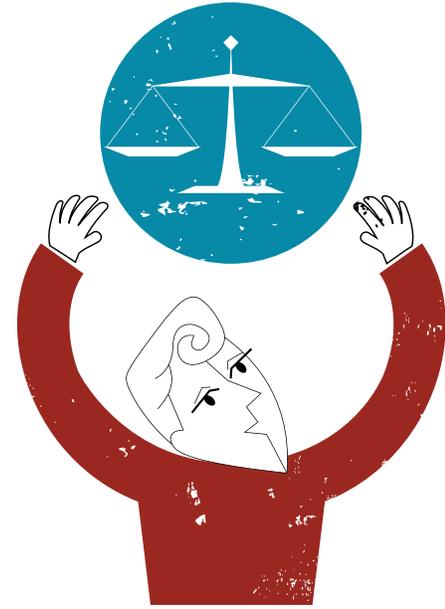
- 5. Effective Communication:** If you think it's just about numbers, you are wrong! The production accountant is someone who often comes into conflict with various parties, including the talent. It is critical that your production accountant understands any underlying issues with the director, talent and the production company who funds the project. For example, talent might demand more benefits on the set, which may not have been budgeted. It is important for the production accountant to know what to do when such issues come up, and with whom they should communicate under different circumstances. The production accountant needs to be in communication both internally and externally with labor unions, vendors, and any third parties. In the event a production goes over budget it should come as no surprise to anyone if the production accountant has kept all relevant parties informed. For example, if hot costs (a daily synopsis given to financiers and producers on how much the production spent to film that day) are reported accurately and timely the next week, then associated additional costs to the ledger will be expected. At any given point during a project the accountant should be able to tell producers and financiers how much money is needed to complete the production.

Please [click here](#) to email **Melissa Wiseman**. &

ADVANTAGES AND DISADVANTAGES OF A LOAN-OUT COMPANY

By Dan Li and Akash Sehgal

While the term “loan-out company” is frequently used in the entertainment industry, fully understanding the advantages and disadvantages of loan-out companies is important. What is a loan-out company? A loan-out company is a service corporation with an individual shareholder that is also the sole shareholder and employee. The corporation then lends out the services of its employee-shareholder, e.g., an actor, director, writer, etc., by entering into contracts with another party, such as studios or production companies. A loan-out company in turn pays a “salary” to the sole employee, as well as certain benefits. Instead of entering into contracts personally, talent will often utilize a loan-out company to legally enter into agreements for service. Loan-out companies can be organized as a Limited Liability Companies (LLCs), S-Corporations or C-Corporations. So what value do loan-out companies actually provide to talent? Why is this extra legal entity so common?



Advantages

First, loan-out companies are widely used by entertainers because they provide liability protection. A corporation, in this case a loan-out company, is a separate legal entity. When a corporation acts or fails to act in a way that incurs liability, the corporation, rather than the individual owner, will generally be liable. As a result, a corporation can allow the owner to shield, to some degree, his or her personal assets from liabilities associated with the business. However, there are exceptions to these limitations on personal assets in the case of fraud, misrepresentation and insolvency.

In addition to corporate liability protection, loan-outs may also produce significant tax advantages by providing personal services through an entity, rather than performing services directly as an employee or an independent contractor:



Employment Taxes: A loan-out company becomes an employer of the entertainer, and then enters into contracts with producers, production companies, etc., on behalf of the entertainer, essentially “lending” the entertainer’s services for individual projects. This normally saves the production company money because the performer is not an employee of the production company. The production company need not withhold employment taxes from the payments to a loan-out company. Instead, the loan-out company is responsible for its own taxes and for handling the payroll taxes for the owner. Additionally, the loan-outs can leverage their control over payroll withholdings to utilize certain advantages for their employee-owner, including control the time of the withholding; employer’s share of social security and employee loans.



From a state and local tax perspective, loan-out companies need to be aware of the obligation to withhold employment taxes from W-2 wages of nonresident employees. For example, if an employee performs services outside of his/her state of residence, then generally the loan-out company would be obligated to withhold and report income tax withholding to the state in which the services are performed.



Deductibility of Expenses: Typically, the entertainer’s employment contract with the loan-out company creates the opportunity for 100 percent deductibility of business expenses. The deduction of such expenses would be otherwise limited if the entertainer were an employee of the production company.

Medical Expense Reimbursement: Loan-out companies can adopt medical expense plans for employees, spouses and their dependents.

Pension Plan Benefits: Loan-out companies can obtain significant retirement plan benefits - the entertainer’s loan-out company can create and fund pension plans for the entertainer within the maximum applicable limitations, as well as allow employee-owners to borrow from the plan.

Continued on page 6 ►

Insurance Benefits: Loan-out companies can deduct both the cost of disability coverage and up to \$50,000 of group term life insurance.

High Level of Employee-Owner Compensation: A loan-out company can deduct a “reasonable allowance” for compensation paid with regards to personal services, defined as the unique abilities of an entertainer-owner proven to be essential to the success of the business. The loan-out company should be able to support a high level of compensation, particularly if personal services are involved. In the case of a loan out C-Corporation, compensation to an employee-owner may be large enough to reduce taxable income of the C-Corporation to a de minimis amount, thereby, largely negating the effect of any double tax. In order to avoid imposition of personal holding company tax, most loan-out corporations pay out all their annual income in form of compensation or dividends.

Most state taxing jurisdictions will treat loan-out companies in a similar manner to how the company is treated from a federal income tax perspective. However, loan-out companies could be subject to state sales and use tax and property tax requirements depending on whether the services performed by the loan-out company are subject to sales tax in a state and/or if the loan-out company owns tangible personal property in a state.

Disadvantages

The downsides of forming a loan-out company include its cost and the technical formalities required to maintain the company. Formation and maintenance costs vary from state-to-state and include filing fees and taxes. Depending on the amount of income the entertainer earns, these costs may be offset by savings at the personal income tax level. Additionally, the choice of the form of the loan-out company (C-Corporation, S-Corporation or LLC) will affect the tax benefit mentioned above as certain benefits may be limited to a certain form of entity.

Loan-out companies may not be respected legally or for tax purposes if there is a failure to establish an employer/employee relationship or a failure of the loan-out company to properly contract for employee’s services. It is also important that the loan-out company properly contracts with third parties for service of the employee.

The Internal Revenue Service has made attempts to question loan-out companies because of the significant tax savings they can provide including employee/independent contractor issues and other deductions and benefits that might not otherwise be available to direct employees. However, when good corporate minutes have been maintained and an employment agreement between the employee and the loan-out company has been created, loan-out companies have generally prevailed against challenges from the Internal Revenue Service. For this reason, consultation with a qualified attorney or tax professional is highly recommended. &

Please click here for more information about our services to the *entertainment industry: motion picture and television participation services, royalty and licensing audit services, expert witness and litigation support, transaction advisory services, assurance and advisory and tax planning and compliance.*

To submit future topics or provide feedback, please contact Ilan Haimoff at ihaimoff@greenhassonjanks.com

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