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Tax Deductions

TV Channels Can Be 'Qualified Films' for Production Deduction

By Allyson Versprille

A TV channel licensed to customers in the normal course of business can be a "qualified film" for purposes of the domestic production activities deduction, the IRS said.

Revenue Ruling 2018-03, released Dec. 21, clarifies that licensing a "package of films"—such as a TV channel—in the normal course of business can produce domestic production gross receipts.

Snapshot

- Revenue ruling contradicts IRS position in 2016 memos
- Two practitioners praise ruling; one says it may not be so favorable

The ruling contradicts two 2016 Internal Revenue Service technical advice memorandums—TAM 201647007 and TAM 201646004.

Rev. Rul. 2018-03 is "big news," because it reverses the position the agency took in those TAMs, Paul DiSangro, a partner at Mayer Brown LLP who helps taxpayers resolve tax code Section 199 disputes with the IRS, said in an email.

The ruling also seems contrary to the purpose of the IRS Large Business and International Division's compliance campaign announced in January targeting multichannel video programming distributors and television broadcasters claiming groups of channels or programs are a qualified film for purposes of domestic production activities deduction.

"I was surprised" by the revenue ruling, said Connie Cunningham, a tax managing director at BDO USA LLP. The 2016 TAMs indicated the IRS was "going in the opposite direction," she said.

Favorable for Taxpayers?

Cunningham said this revenue ruling is favorable for taxpayers and will help those in the media and entertainment industries.

"And I think from the practitioner standpoint, it's the correct answer," she said. "We were scratching our heads when that 2016 TAM came out because we couldn't figure out why the IRS came to that conclusion when they'd already weighed in on a very similar issue back in 2010"—TAM 201049029—"and concluded differently."

Cunningham said based on her interpretation of the Section 199 regulations, the conclusion reached in the new revenue ruling is correct.

Matthew D. Lerner, a partner and co-leader of the tax controversy practice at Sidley Austin LLP, agreed. "The Revenue Ruling is significant in that it corrects what in my

view was an erroneous interpretation of 'qualified film' and how section 199 applies to such property put forth by the IRS in 2016 in two TAMs," he said in an email.

'Devil Is in the Details'

The revenue ruling looks positive for taxpayers on the surface, but the "devil is in the details," DiSangro said.

"The ruling allows a subscription package to be an eligible item, but then interprets the production rules in a way that may be all but impossible to satisfy," he said.

Subscription packages typically include content produced by taxpayers and third parties, DiSangro said. "The ruling states that for a taxpayer to satisfy the 20% safe harbor, the taxpayer's direct labor and overhead for the package of films must be 20% or more of the taxpayer's unadjusted depreciable basis in the package," or cost of goods sold. The safe harbor under the Section 199 rules says that taxpayers may be eligible to take the production deduction if the manufacturing activities performed in the U.S. account for 20 percent of the costs.

DiSangro said several provisions in the revenue ruling, including the treatment of license fees paid for third-party-produced content, make it difficult to meet the 20 percent requirement.

"The ruling then says if the subscription package fails to qualify, then the taxpayer can shrink back to an individual qualified film within the package," he said. "That all along has been the IRS's desired outcome."

The revenue ruling is scheduled for publication in Internal Revenue Bulletin 2018-02, dated Jan. 8.

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For More Information

Text of Rev. Rul. 2018-03 is in TaxCore.

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