

Michigan State Film Rebates Can Be Used With Section 181 Tax Incentives By Private Equity Investors

By Yuri Rutman

The State Of Michigan is offering a new 40% cash rebate of motion picture production which makes it the most aggressive program in the country. Its is trying to send a message to hedge funds, private equity groups, money managers, family offices, tax attorneys, high net worth investors, tax credit buyers, New Markets Tax Credit investors, and other international investors on the risk minimization of entertainment finance by getting a 40% cash back on the cost of equity.

However, on top of the 40% cash rebates, investors may also utilize Section 181 to offset their 75% and in some instances 100% dollar for dollar on the cost of film finance, all before operations, distribution, and international revenues.

In the past two years many institutional investors such as such as CITIGROUP, Deutsche Bank, JP Morgan, Morgan Stanley, Dresdner Kleinwort, GE Commercial Finance, ABRY Partners, AIG Direct Investments, Bank of America Capital Investors, Columbia Capital, Falcon Investment Advisors, and M/C Venture Partners are all involved with the finance of films.

Indiviudals who are financing films include Larry Ellison, Paul Allen, Steven Rales, Fred Smith, the CEO of Federal Express, Norman Waitt, the Co-Founder of Gateway Computers, Jeff Skoll Of Ebay, Marc Turtletaub of The Money Store, Roger Marino Of EMC Corp, Sidney Kimmel Of Jones Apparel Group, Minnesota Twins owner Bill Pohlad; Real Estate Developers Tom Rosenberg, Bob Yari; and, financiers Sheikh Waleed Al Ibrahim, Zeid Masri of SilverHaze Partners, Michael Singer, Mark Esses, David Larcher, Michael Goguen, Richard Landry, Michael Reilly, Rafael Fogel, and Philip Anschutz

The American Jobs Creation Act Of 2004, the 2004 enactment of Section 181 of the Internal Revenue Code of 1986 (the "Code") marked an unprecedented change in U.S. policy toward the phenomenon known as "Runaway Production".

Runaway Production refers to a film or television production that leaves one state or country to be filmed in another purely for economic reasons. This movement occurs because producers tend to film in the location where they can minimize production costs through tax incentives, cheaper labor.

Over the years, Canada has been the greatest beneficiary of U.S. runaway productions (according to some reports, Canada has claimed up to 80% of the U.S. runaways, generating an economic impact of \$10.3 billion in production output in 1998 alone).

Section 181 represents the first time that the U.S. federal government has recognized this impact by passing tax legislation to actively combat the flight of film and television programming.

Section 181 permits a 100% write-off for the cost of certain audio-visual works, regardless of what media they are destined for (e.g., theatrical, television, DVD, etc.).

An individual or company who makes an investment into Section 181 qualified productions can take a 100% deduction of their investment against their passive income in the year their investment was made.

The deduction can be made against active income should the investment be made by or through a widely held C corporation. The law is in effect until December 31, 2008, therefore investments must be made before that date and the money invested into qualifying productions must be spent by then by the productions.

But since Section 181 also allows for all other debt costs which are usually associated with film finance, a \$10 million dollar film, where only \$3.5 million is equity, an investor can deduct \$3.5 million dollars against the \$10 million, especially if the latter is mezzanine or gap finance.

Plus, an additional 20%-40% in state tax credits or rebates can be generated back to the Investors, before revenues. And with the The State of Michigan offering a 40% cash rebate for making a movie there, which is the most aggressive in the country. That translates to an additional \$4 million in rebates to an investor based on a \$10 million dollar film.

With the current appetite for alternative investing, real estate, and hedge funds starting to crunch, the viability of having an investment guaranteed up to 75-100% before operations and revenues is something that should be reviewed and considered carefully as part of a new asset class and portfolio holdings of private equity groups, money and wealth managers, and high net worth individuals.

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