TAX CONSIDERATIONS FOR ATHLETES & ENTERTAINERS

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Howard J. Wiener, Esq.
Howard J. Wiener & Associates, P.L.
2161 Palm Beach Lakes Blvd., Suite 102A
West Palm Beach, FL 33409
(561) 686-2220
hjwiener@gmail.com
TAX PLANNING CONSIDERATIONS FOR ATHLETES AND ENTERTAINERS

By
Howard J. Wiener, JD, LL.M. Taxation
Howard J. Wiener & Associates, P.L.
2161 Palm Beach Lakes Boulevard, Suite 102A
West Palm Beach, FL 33409
(561) 686-2220
hjwiener@gmail.com

I. Introduction.
   1. Types of Compensation. Actors, producers, directors, and others who participate in motion picture or television films sometimes receive contingent compensation measured by net profits or gross receipts of those motion pictures or television films (commonly known as “participations”). In addition, these individuals are sometimes entitled to fixed future payments (commonly known as “deferments”), and under various guild agreements, these people may be entitled to receive additional payments upon future exhibitions of the film (commonly known as “residuals”).

   In the case of a recording Artist, the recording contract will normally provide that the Artist is entitled to royalties measured by future record sales. From a tax perspective, the word “royalty” means compensation for the license of an intangible asset. In the case of a recording artist, though, there is no intangible asset being licensed, but rather the Artist is simply agreeing to provide recording services.

   All these “assets” (whether designated as participations, deferments, residuals, or royalties) are different ways of denoting deferred compensation which the Entertainer is entitled to receive as consideration for services rendered.

   In the case of authors, Athletes and songwriters, the situation becomes more complete. An author’s, Athletes’ or songwriter’s efforts give rise to a property right – copyrights, the sale or license of which are protected under the copyright laws (and which may give rise to favorable capital gains treatment) – as distinguished from a mere contractual right to receive compensation for personal services (ordinary income).

   In addition to entertainers being highly compensated for their services, Athletes also derive income from bonuses, awards, interest-free loans, gift products, personal appearances, endorsements, and/or royalties from merchandising and licensing. As with any taxpayer, an Athlete’s gross income includes all income from whatever source derived unless it is specifically excluded. IRC Code Section 61.

   Tax planning for Athletes and Entertainers generally involves deferral of income and maximizing the deductibility of expenses. The following is an overview of various forms of compensation and planning ideas to minimize an Athletes’ and Entertainer’s taxes.
II. **Loan-out Corporations.**

A. In this economy, the endorsement market has dried up significantly, except for perhaps some smaller local or regional deals. Only a small pool of players in each sport makes a significant number of endorsements. Consider setting up a Loan-Out Corporation for the Athlete where he/she loans his or her services to his or her own corporation. The outside world conducts business with the Athlete's corporation, and then the corporation pays the Athlete's "salary". The Athlete must be sure to comply with all the tax requirements and be certain that there's a Loan-Out Agreement in place between the Athlete and his or her corporation for services rendered.

B. Athletes and Entertainers frequently use personal service corporations to furnish their services; these corporations are commonly referred to as “loan-out corporations.” The Athlete or Entertainer enters into an employment contract with his or her loan-out corporation, and that corporation in turn enters into contracts to furnish the services of the Athlete or Entertainer to third parties. When an Athlete or Entertainer uses a loan-out corporation, he or she will not individually own Assets, but rather, his or her loan-out corporation will own these assets. Athletes and Entertainers customarily operate through their wholly owned loan-out C or S corporations or Limited Liability Company (LLC) to obtain tax benefits.

C. **C Corporations.**

1. In addition to limited liability for its shareholders, the C corporation’s major advantage is that it is a separate taxable entity. See table of corporate income tax rates below.

**Table of Corporate Income Tax Rates for a C Corporation.** The rates for domestic corporations (other than qualified personal service corporations (PSC’s) which are subject to a flat tax of 35% regardless of their income) are reflected in the following table (Code Section 11(b)):

<table>
<thead>
<tr>
<th>Taxable income over—</th>
<th>But not over—</th>
<th>The tax is:</th>
<th>Of the amount over—</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>$50,000</td>
<td>15%</td>
<td>0</td>
</tr>
<tr>
<td>$50,001</td>
<td>75,000</td>
<td>7,500 + 25%</td>
<td>$50,000</td>
</tr>
<tr>
<td>75,001</td>
<td>100,000</td>
<td>13,750 + 34%</td>
<td>75,000</td>
</tr>
<tr>
<td>100,001</td>
<td>335,000</td>
<td>22,250 + 39%</td>
<td>100,000</td>
</tr>
<tr>
<td>335,001</td>
<td>10,000,000</td>
<td>113,900 + 34%</td>
<td>335,000</td>
</tr>
<tr>
<td>10,000,001</td>
<td>15,000,000</td>
<td>3,400,000 + 35%</td>
<td>10,000,000</td>
</tr>
<tr>
<td>15,000,001</td>
<td>18,333,333</td>
<td>5,150,000 + 38%</td>
<td>15,000,000</td>
</tr>
<tr>
<td>Over 18,333,333</td>
<td></td>
<td>6,416,667 +35%</td>
<td>18,333,333</td>
</tr>
</tbody>
</table>

**Note:** Capital gains are taxable at regular corporate rates.
2. In addition, income is not taxable to owners of C corporation stock until actually or constructively distributed to them.

3. Note: If an Athlete or Entertainer does not intend to spend his or her earnings immediately, incorporation as a C corporation may make sense.

D. **S Corporations.**

Typically, loan-out corporations are S corporations, to (i) avoid the problems associated with “zeroing out” a C corporation at year-end, (ii) prevent double taxation, (iii) avoid personal holding company tax, and (iv) allow the pass-through of foreign tax credits to the Athlete or Entertainer. The S corporation has many of the same advantages and disadvantages as a partnership.

1. Unlike general partners in a partnership, S corporation shareholders have limited liability. This factor often is the major reason for incorporating a business.

2. An S corporation does not (with some exceptions) pay tax.

To be eligible for S corporation status:

- The corporation cannot have more than 75 shareholders.
- The corporation must be domestic.
- All shareholders must be individuals, estates, certain qualifying trusts, pension, profit-sharing, or stock bonus plans qualifying under § 401, or charitable organizations.
- No nonresident alien may be a shareholder.
- The corporation may have only one class of stock outstanding.

E. **Limited Liability Companies (LLC’s).** Limited liability companies (LLCs) are generally considered the most attractive form of doing business today. An LLC combines the best features of a partnership, limited partnership, S corporation and C corporation — limited liability, tax pass-throughs and flexibility.

1. **Advantages of LLCs**

   a. **Limited Liability.** One of the major advantages of doing business in LLC form is the liability protection provided through an LLC. Owners of LLCs (called “members”) are not personally liable for the debts and obligations of the LLC. Rather, members have the same type of insulation from liability that exists for shareholders in corporations and
limited partners in limited partnerships. Of significance is the fact that members retain limited liability even if they are actively involved in company management.

b. **Tax Considerations of LLC Status.** If properly structured, an LLC will be treated as a partnership for federal income tax purposes and all items of income and loss will flow through to the individual members of the LLC. Members are also able to make special allocations of items of income and loss pursuant to the partnership rules of Subchapter K; and they will be able to take a deduction for losses to the extent of their basis in the LLC in the same taxable year that “entity level” losses are incurred. Similar to an S corporation, property held by an LLC can be liquidated without triggering a taxable event at the entity (company) level.

c. **Entity of Choice.** An LLC taxed as an S corporation (“check the box” regulations) in most every aspect of entity selection will be the entity of choice for most Athletes and Entertainers. As previously mentioned, an LLC affords liability protection to owners that corporations can’t (i.e. charging order). Further, the LLC structure can avoid the incurrence of Medicare taxes (2.9%) on the income it earns.

F. **Partnerships/S Corporations/C Corporations Compared.** Generally, newly formed businesses provide greater benefits if organized as a partnership or an S corporation. This is because operations in the early years often produce net losses.

1. In these types of businesses, losses may be deducted by the owners (subject to the limitation on passive business losses).

   In contrast, a C corporation’s losses must be carried back (generally 2 years) or forward (usually 20 years) to offset corporate income in those years.

III. **Other Benefits of a Loan-out Corporation include the following:**

A. **Qualified Plans.** Most successful Athletes and Entertainers have the opportunity to participate in some form of qualified retirement plan, typically a defined benefit pension, profit sharing, cash balance or §401(k) savings plan. Retirement planning for Athletes’ and Entertainers’ share many elements common to retirement planning for other high-income taxpayers. The general strategy for most high-income taxpayers is to defer as much income as possible from current taxation through the use of a qualified retirement plan. There are unique aspects of retirement planning for successful Athletes and Entertainers. For example, the use of a corporate retirement plan is one of the attractions in deciding to form a Loan-out Corporation; should the planning strategy not include the use of a corporate retirement plan, the use of a Loan-out Corporation would not be as attractive.

1. **Advantage of a Qualified Retirement Plan.**

   (i) Contributions are tax deductible by the employer
(ii) Employee does not pick up contribution into income - it is deferred until withdrawn

(iii) Earnings accumulate within the Plan tax-deferred (tax-exempt trust)

(iv) Favorable tax treatment on distributions (i.e. rollover)

(v) Least likely audit exposure

2. **Types of Plans.**

   a. **Defined Contribution Plans.**

      (i) Defined Contribution (DC) Plans (e.g. profit sharing 401(k), money purchase, target benefit and age-weighted plans)

      (ii) $49,000 limit in 2010 (subject to COL adjustments) IRC § 415(c)(1)(A)

      (iii) Earnings and losses allocated to accounts of participants

      (iv) Participant gets what’s in account when 100% fully vested

1. **401(k) Plans**

   (i) 401(k) Elective Deferral remains unchanged at $16,500 for 2010. IRC § 402(g)(1)

   In 2010, the maximum allocation that may be made for any individual in a **401(k) Profit Sharing Plan** is $49,000. With a catch-up contribution allowed for individuals age 50 or over (catch up contributions remains unchanged at $5,500 in 2010), the total is $54,500. The allocation consists of the following sources of deposits:

   1. 401(k) deferral $16,500
   2. Profit Sharing $32,500
      Total $49,000
   3. Catch-up $5,500
      (If you are over 50)
      Total $54,500

2. **Roth 401(k) Plans.**
A. If an employer has a 401(k) Plan, the employer may amend such Plan to allow that future 401(k) deferrals be after tax (Roth 401(k)) deferrals with no future taxes due on the deposits or the earnings on deposits.

If 401(k) Roth provisions are added to the Plan, $16,500 plus the $5,500 may be recharacterized as Roth 401(k). Profit Sharing and pre-2006 balances may not be converted to 401(k) Roth. The advantages of this opportunity are as follows:

A. When the monies are withdrawn, the deposits and earnings are exempt from income tax.

B. If the accumulations are rolled over to a Roth IRA prior to age 70 ½, there are no minimum distribution requirements.

C. If the accumulations are rolled into a Roth IRA, the Spouse is exempt from the minimum distribution requirements.

D. If #3 (above) is followed, children could receive distributions forever without any tax!

E. The above scenario does not eliminate the estate tax; however, this opportunity eliminates the double tax.

The disadvantage is that the deferrals are after tax. If a participant is in the highest tax bracket, the loss of the tax deferral would cost 35%.

B. The 2010 Roth IRA Conversion Opportunity

Beginning January 1, 2010, Congress has relaxed the Roth IRA Conversion rules, eliminating income limits or restrictions for individuals converting from a Traditional IRA to a Roth IRA.

Prior to 2010, to open and contribute to a Roth IRA you need to meet modified adjusted gross income (MAGI) limits. Similar income limits apply if you want to convert an existing Traditional IRA to a Roth IRA. Income limits have prevented many people from taking advantage of the wealth creation power of a Roth IRA or a self directed Roth IRA. Starting January 1, 2010, anyone, no matter what their income, will be allowed to convert a pre-tax retirement account (Traditional IRA, SEP IRA, 401(k), etc.) to a Roth IRA. The previous $100,000 Modified Adjusted Gross Income (MAGI) limit will no longer apply to anyone wishing to convert.

In 2010, when you convert from a Traditional IRA to a Roth IRA it is a taxable event, but one of the benefits of this opportunity is that the government is allowing you 2 years to pay the tax owed on the conversion.
You don't want to miss the opportunity to take advantage of the many Roth IRA benefits if you haven't qualified in the past, including:

- Tax-free growth of IRA assets
- Tax-free withdrawals of IRA assets (assuming you are 59 1/2 or older and the Roth IRA is more than 5 years old)
- No minimum distribution requirements once you turn 70 1/2.

3. **Cross-Tested 401(k) Profit Sharing Plans**

   a. It's now possible to have a small group of people and decide who gets a $49,000 contribution ($54,500 with a catch up contribution for age 50 individuals or older), who gets a $20,000 contribution, a $5,000 contribution, *etc.*

B. **Defined Benefit (DB) Plans**

1. No limit on contributions

2. 2010 Limit on benefit @ retirement — 100% of compensation not to exceed $195,000 per year annual benefit (subject to COL adjustments) IRS § 415(b)(1)(A)

3. The higher the age, the greater the amount that can be salted away

4. Downside — other employees contributions; this can be offset by utilizing a 2 year waiting period

5. As of 1/1/00, the Internal Revenue Service repealed a law which made it disadvantageous to maintain a D.C. and D.B. Plan (because one plan would drag down the benefits of the other).

C. **Cash Balance (CB) Plans**

1. **Characteristics of Cash Balance Plans**

   - Cash balance plan is a defined benefit pension plan
   - Requires annual actuarial valuations and Schedule B
   - Must satisfy all of the funding and deduction rules that apply to defined benefit plans

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• Covered by PBGC if more than 25 active participants and a professional employer; or for non-professional employers, if the plan covers employees who are not substantial owners

• Employer contributions can be greater than the defined contribution plan limit of $49,000 (2010)

• Plan assets are pooled, as for all DB plans

• Employer contributions are tracked by the actuary/administrator in hypothetical accounts

• Earnings on hypothetical accounts are guaranteed by provisions in the plan document

• Participants typically receive annual statements showing the value of their hypothetical accounts

• At termination of employment, a participant receives the present value of his/her account balance

  - subject to the plan’s vesting schedule

• Actuarial gains and losses result from the difference between actual earnings and the rate credited under the plan

2. **Cash Balance Plan Annual Contributions**

• Credited to participant hypothetical accounts based on plan formulas or schedules

• Contribution formulas can be different for different groups of employees (similar to cross-tested plans)
• If the contribution formula is not uniform and Highly Compensated Employees (HCEs) are credited with larger contributions than Non-Highly Compensated Employees (NHCEs), the plan must satisfy the general test under IRC 401 (a)(4), as it applies to defined benefit plans.

• Contributions to the cash balance plan may be combined with contributions to defined contribution plans maintained by the employer to satisfy the rate group portion of the general test.

• If DC is combined with the CB for rate group testing, must satisfy the gateway test.

• CB contributions must be combined with all contributions to all defined contribution plans sponsored by the employer to satisfy the average benefits percentage test (ABPT) portion of the general test.

B. **Loans from Qualified Plans.** An Athlete or Entertainer-owner of a Loan-out Corporation is allowed to borrow up to $50,000 from the corporation’s retirement plan (if certain conditions are met).

C. **Medical Reimbursement Plans.** A Loan-out Corporation can set up a Medical Reimbursement Plan, which allows all medical costs and insurance to be deducted. By contrast, an employee-Athlete or Entertainer is allowed to deduct medical costs or insurance only to the extent that such expenses exceed 7.5 percent of his or her Adjusted Gross Income.

D. **Welfare Benefit Plans.** A Loan-out Corporation can deduct the cost of life insurance (to a limited extent) and disability insurance, while an Athlete or Entertainer who is an employee or self-employed individual is not permitted to deduct these costs.

E. **Deduction of 100% of Business Expenses.** A Loan-out Corporation can deduct 100-percent of its business expenses, while an employee can deduct employee-related expenses only to the extent the expenses exceed 2 percent of the employee’s Adjusted Gross Income.

IV. **Other Deductions.** There are numerous other types of deductions which may be available to Athletes and Entertainers; some apply only to Athletes and Entertainers and some are applicable to all taxpayers.
A. Generating Passive Activity Income. Passive activity losses may be offset only against passive activity income. Code Section 469. It may be possible to convert personal service income into passive activity income by giving an entertainer an equity interest in a film, (e.g., as a limited partner), rather than giving the entertainer contingent deferred compensation. This would enable the entertainer to shelter the passive income generated against passive activity losses from other sources, including tax shelters.

B. Agents Salary/Commission. A deduction that is very significant to an Athlete or Entertainer is the salary or commission paid to an agent. In today’s society, Athletes and Entertainers often enter into complex and very lucrative contracts so they find it advantageous to leave these negotiations to an agent. Additionally, agents act as public relations directors or promoters for the Athlete and Entertainer and are responsible for obtaining endorsements.

As a general rule under Code Section 162, a taxpayer may deduct salaries or other compensation paid for personal services rendered to the taxpayer. The test of deductibility is twofold:

First: The compensation must have been paid solely for services and for no other reason; and

Second: They must be reasonable in amount.

Agents often provide a wide range of services to an entertainer and are customarily compensated on a contingency basis (fixed percentage of income).

C. Athletes’ and Entertainers’ Physical Appearance. The following physical appearance expenses have been deducted, almost routinely, by entertainers, but based upon audit results, have been defended from IRS attack generally with only partial success: makeup or cosmetics, hairdressing, physical conditioning (e.g., personal trainer fees, health club dues, massages, facials, purchase or rental of exercise equipment, etc.) and cosmetic surgery and dentistry.

D. Miscellaneous Deductions. Other expenses an Athlete or Entertainer will likely be able to deduct are expenses for trade journals, answering fan mail “promotional” activities, costs of maintaining a telephone, television and VCR for business, theatrical clothing, and accessories not generally suitable for ordinary use.

1. These “miscellaneous expenses” are deductible only to the extent they exceed 2% of an Athlete or Entertainer’s Adjusted Gross Income, if he or she is an employee.

E. Wardrobe. It is generally entertainers who incur high wardrobe costs and may seek to deduct some or much of it. For any taxpayer to secure a valid wardrobe deduction,
the clothing must not only be inextricably related to the ordinary and necessary performance of their duties in their trade or business, but must also be unique in such a way as to not otherwise be useable in a common, everyday, nonbusiness setting. In that regard, most entertainers will usually look to the special purpose usage concept (i.e., costumes) to gain deductions for wardrobe costs.

F. **Car Expenses.** Car expenses incurred in connection with travel for business purposes are deductible from gross income to the extent that the expenses are attributable to business or income-producing activities, rather than to personal use.

G. **Moving expense to take first job.** Here’s an interesting dichotomy: Job-hunting expenses incurred while looking for your first job are not deductible; but moving expenses to get to that first job are. And, you get this write-off even if you don’t itemize. If you moved more than 50 miles, you can deduct the cost of getting yourself and your household goods to the new area. Including 16.5 cents a mile (and parking fees and tolls) for moving expenses.

H. **State sales taxes.** Congress has resurrected the chance for taxpayers to deduct state and local sales taxes. Although all taxpayers have a shot at this write-off, it makes sense primarily for those who live in states like Florida that do not impose an income tax. You must choose between deducting state income taxes or state sales taxes and, for most citizens of income-tax states, the income-tax deduction is a better deal.

V. **Entertainment**

**Entertaining for Business.** Athletes and Entertainers may deduct reasonable entertainment expenses incurred in connection with the performance of their duties. To be deductible, entertainment expenses must be ordinary and necessary and incurred in the operation of a business regularly carried on by the Athlete or Entertainer. Further, they must be “directly related to” or “associated with” the Athlete’s or Entertainer’s business. The furnishing of food and beverages, a hotel suite, a vacation cottage, a car, or a private airplane to business guests may also fall within the entertainment category.

**Travel Expenses.** Expenses incurred in traveling to and from an away-from-home business meeting are deductible in total only where the primary purpose of the trip is business.

**Substantiation Requirements.** It is incumbent upon every Athlete and Entertainer to maintain a complete set of records to substantiate any expense deductions as required by Code Section 274(d).

VI. **The IRS Specialization Program Affecting the Deductibility of an Entertainer’s Expenses.**

The IRS has a Market Segmentation Specialization Program (MSSP) for several industries. The Entertainment Industry Specialization Program in Los Angeles consists of one
group of revenue agents (approximately 15 agents) at the IRS mid-Wilshire office, and one
group of approximately 10 IRS auditors in West Los Angeles who perform office audits.

Key office audit issues include the following:

1. Verification of expenses in accordance with the Code Section 274
   substantiation requirements.

2. Expenses for massages, exercise trainers, make-up, and wardrobe, are
   being closely scrutinized to see if they are properly personal expenses.

3. The IRS is actively looking for people who are “non-filers.”

4. Determining whether an entertainer is an employee or an independent
   contractor.

VII. State Income Tax Implication For Entertainers.

A. Athletes and Entertainers can have multistate tax problems if they perform
   in more than one state. For example, an actor in a national tour of a Broadway play may be in 15
   to 20 states during the year. The actor does not have a state income tax allocation issue if he or
   she is an employee of the production, since the producer will normally handle state income taxes
   based upon the salary paid to the actor while in a particular state. However, an actor operating
   through a Loan-out Corporation will have the burden of allocating state income taxes, as well as
   filing, in the affected states. The amount of any tax credit (allowed by the state in which the
   actor resides for income taxes paid to another state) must be determined to offset any increase in
   the actor’s tax liability due to multistate income taxation. There may also be reciprocal
   agreements between the actor’s resident state and other states; these agreements may eliminate
   the income tax liability owed to a particular state.

B. Tax compliance and planning are a key part of representing an Athlete or
   Entertainer. One should always look at ways to minimize taxes. For sports clients paying agent
   fees basically every other year of a multi-year contract is an example. Employee business
   expenses, such as agent fees, need to exceed two percent of adjusted gross income, so if an
   Athlete signs a million-dollar contract, his miscellaneous expenses need to be greater than
   $20,000 to be deductible. Therefore - assuming an agent and a player agree - if a player has a
   two-year deal of a million dollars each year and the agent fee is $50,000 annually, he or she
   would receive greater benefit by "bunching" these deductions and paying the whole agent fee at
   once, in this case $100,000 in either year as opposed to $50,000 each year.

With the severe revenue shortfall that many states are experiencing, a hot
area is minimizing state taxes while adhering to all different state laws. If you were to travel to
California on business technically you would be responsible for paying taxes on your income in
California. But since you are not as high profile, highly paid and easy to identify as the
professional athletes, so while California may not pursue you to ensure you paid the proper
income tax, they may, like several states do, pursue Athletes. California and New York have taken the lead on this.

C. Take a professional football player who is a resident of South Carolina and plays for the New York Jets. Is he a resident of New York where the team plays, or is he a resident of South Carolina, where he may have a home and a driver’s license and is registered to vote? Most states have a rule about the number of days that you spend in state as part of the way to determine residency. For example, New York’s rule states if you spend more than 183 days and maintain a place of abode in New York, you are deemed to have a New York domicile for tax purposes and therefore are a New York resident even if your home is somewhere else. This may result in dual residence status and significant tax implications. There are ways to minimize taxes by residing in a no personal income tax state such as Alaska, Florida, Nevada, South Dakota, Texas, Washington and Wyoming. Additionally, New Hampshire and Tennessee limit their state income taxes to interest and dividend income only. It is not just having a residence but indeed having your true home there.

Another complex issue that arises is how to take tax credits from state to state. For example, if an Athlete resides in South Carolina but plays games in 15 different states, most of the taxes he or she pays would be creditable to South Carolina where there is a seven percent rate. However, a state like California has a higher tax rate, so even though, say, as much as 10.3 percent could be paid to California, the Athlete would only get a credit of seven percent in South Carolina.

VIII. Wealth Preservation Planning.

A. A core element of tax planning for successful Athletes and Entertainers is the provision of wealth preservation planning services for your clients and their families. Guidance should be given to proper insurance protection for their assets, possessions and most importantly, themselves. Purchasing disability insurance coverage from the beginning of their last amateur season through signing of a professional contract is critical. Wealth preservation also involves the preparation of wills, irrevocable trusts, charitable trusts, trusts for minors, 501(c) private foundation documents and other structures designed to assist in wealth preservation and inter-generational wealth transfers. Personal tax planning including the transfer of wealth through gift and estate planning, asset protection and the restructuring of business interests, need to be incorporated into a properly structured wealth preservation plan.

B. Charitable Foundations. In addition to giving back to the community, an Athlete in setting up a charitable foundation realizes a tax benefit through the charitable deduction. An Athlete with a windfall income of 10 million dollars could donate a million dollars to a foundation he or she set up as a 501(c)(3) charity and receive a deduction for that, even if the foundation has not yet decided which organizations will receive a donation. Athletes or Entertainers can donate the money to their foundation and get an immediate write-off. They do not have to give the money out in year one to get the deduction. The foundation also provides a central point for the Athlete's charitable giving so that he or she won't have to field solicitations from multiple charities.
IX. The 2004 American Jobs Creation Act Creates Domestic Tax Incentives for Independent Film Producers.

Both federal and numerous state governments have enacted innovative tax related incentives which attempt to make the U.S. a more tax friendly venue for producing and financing independent films and certain other media. Canada retains a strong competitive position, however.

1. U.S. Federal Tax Incentives. The most valuable incentive is included in new Internal Revenue Code Section 181, enacted as part of The American Jobs Creation Act of 2004 (the "Act"). The Act covers a wide variety of tax matters which includes what is likely the most significant tool for changing the independent film financing landscape as we know it.

A. The Act is designed to stimulate investment in film by granting a 100 percent write-off for the cost of film and television productions in the year the cost is incurred. The incentives are available for "qualified productions" commencing after October 22, 2004, and before January 1, 2009. Qualified film and television productions include any production of a motion picture (whether released theatrically or otherwise). The Act also covers miniseries, scripted, dramatic television episodes and movies-of-the-week.

B. The Act benefits producers and production companies by granting an immediate tax deduction for the full costs of a production in the year the costs are incurred (as opposed to having to spread or amortize those costs over a period of years). Deducting the costs up front while deferring the income from the film until later years when it is actually incurred will significantly reduce or eliminate taxable income for the film in the first years of exploitation. Also, production costs may include all direct and indirect costs of producing the film, including, development costs, an allocation of general and administrative costs based on a portion of production expenses, depreciation of property used in the production, and financing costs.

C. The new federal tax incentive program applies to those films that have production budgets between $1 and $15 million, and spend at least 75 percent of their total "qualified compensation" on work performed in the United States. "Qualifying compensation" includes payments for the services performed in the U.S. by actors, directors, producers and production personnel. The budget cap increases to $20 Million where the production and expenditures are in designated "depressed areas" and communities.

D. The relatively modest minimum budget threshold of the federal tax program (minimum of at least $1 Million) makes this provision a user-friendly tool for independent film producers, many of whom cobble financing from a variety of investment sources including private equity investors. In the typical scenario, where a film is co-produced by numerous investors, the deduction for qualifying expenditures must be apportioned among the investors/owners of the film in a manner that reflects each investor's proportionate investment and economic interest in the project.
E. Electing to use the new law also simplifies the tax reporting process. Under prior law, film expenses were most often depreciated under the income forecast method. Alternatively, film expenses could also be depreciated over 15 years, far exceeding most films' revenue streams. Using the deduction up front, a producer or production company can use the tax loss to offset other passive income with any excess to be carried over to future years.

2. New Tax Deduction for Domestic Production Activities. In addition to Section 181, a U.S. produced film may also allow the film producer to claim benefits under new Section 199 as income is generated from exploiting the film.

A. New Section 199 of the Internal Revenue Code provides a 9% deduction (when fully phased in) of so-called "qualifying production activities income." The deduction was phased in at 3% in 2005 and 2006, is 6% in 2007 through 2009, and 9% in 2010 and thereafter.

B. Qualified Production Activities Income refers to the net income from the license, sale, exchange, or other disposition of any "qualified film" produced by the taxpayer.

C. The tax benefit limits the deduction for a taxable year to 50% of the W-2 wages paid by the taxpayer with respect to domestic production activities during such taxable year. The law contains special rules in determining the W-2 wage limit for non-corporate business entities, like partnerships and S corporations; impacting whether production companies should be structured as a corporation or partnership to take advantage of the new deduction.

D. The deduction is available for any motion picture film or video tape (but not sexually explicit films as defined in 18 U.S. Code Section 2257), including television programming, if at least 50% of the total production compensation constitutes compensation for services performed in the United States by actors, production personnel, directors, and producers.

E. Effective Date. The law applies for taxable years beginning after December 31, 2004.

X. Intellectual Property Protection.

The protection of a name, image (and managing image rights) and likeness is also a critical element of comprehensive representation of Athletes and Entertainers and involves sophisticated tax planning mechanisms to provide for the protection and licensing of intellectual property rights – including valuable right of publicity.

XI. International Tax Planning for Entertainers and Athletes.

Entertainers have various kinds of income from personal appearance, from recording, writing and films and from sponsorships/endorsements and merchandising. This may
be taxed in the country of source and in the country of residence and may be taxed as business income royalties or otherwise. Entertainers are and have been for many years excluded from the benefit of modern Tax Treaties. Tax is charged sometimes on the remuneration actually paid to the entertainer or on the gross sum paid for the services of the entertainer and the tax may be charged either at graduated income tax rates or at a flat rate the entertainer sometimes being permitted to claim deductions.

The Entertainer should endeavor to ensure that he is treated for tax purposes in both the overseas country and his country of residence on a consistent basis so as, in particular, to obtain a credit in his country of residence for taxes paid abroad either by means of double taxation relief or unilateral relief. Credit may not be given for certain taxes including sales taxes, certain U.S. state taxes, although these may be allowed as deductions.

In the area of withholding taxes on royalties consideration should be given to the eligibility of a recipient to claim relief against for example corporation tax for taxes withheld at source, to the limitations on that relief where a portion of those royalties is paid to a third party, to the ability of the recipient to pass on a portion of any tax credit to a third party.

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Resources:

ENTERTAINMENT, ARTS, AND SPORTS LAW, ALI-ABA COURSE OF STUDY MATERIALS (January, 1998)


BARRY KLARBERG, CPA, TAX CONSIDERATIONS FOR PROFESSIONAL ATHLETES AND ENTERTAINERS, American Institute of Certified Public Accountants (April, 1996).

JEFFREY K. EISEN, ESQ. and ALLAN E. BIBLIN, ESQ., ESTATE PLANNING FOR CLIENTS IN THE ENTERTAINMENT BUSINESS, WG&L ESTATE PLANNING JOURNAL, 12/21/2005

PENSIONPROBE.COM NEWSLETTER, ROTH 401(K), KENNETH F. HACKETT & ASSOCIATES, INC., 12/24/2005

DIRECTORS GUILD OF AMERICA, INDEPENDENT FILM AND TELEVISION ALLIANCE. "DOMESTIC PRODUCTION ACTIVITIES", INCOME DEDUCTION, NEW SECTION 199 OF THE INTERNAL REVENUE CODE - A BRIEF GUIDE TO THE TAX PROVISION

TAX ADVANTAGE, THE 2004 AMERICAN JOBS CREATION ACT CREATES MUCH NEEDED DOMESTIC TAX INCENTIVES FOR INDEPENDENT FILM PRODUCERS.

PADDY GRAFTON GREEN, INTERNATIONAL TAX PLANNING FOR ENTERTAINERS AND ATHLETES, International Tax Planning Association, May, 1982


## Defined Benefit Pension Plan

### Participant Summary

<table>
<thead>
<tr>
<th>Employee #</th>
<th>Name</th>
<th>Date of Birth</th>
<th>Sex</th>
<th>Age</th>
<th>Date</th>
<th>% of Total Cash</th>
<th>Total Monthly Benefit</th>
<th>Total Benefits</th>
<th>Retirement Contribution</th>
<th>Monthly Benefit</th>
<th>Total</th>
<th>Total Cash</th>
<th>Date</th>
<th>% of Total Cash</th>
<th>Total Benefits</th>
<th>Retirement Contribution</th>
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</tbody>
</table>

### Grand Total

- **Employees**: 337000
- **122290**
<table>
<thead>
<tr>
<th>Cash Balance / DC Combo</th>
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<tbody>
<tr>
<td></td>
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<tr>
<td></td>
</tr>
<tr>
<td>Name</td>
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<tr>
<td>----------------------</td>
</tr>
<tr>
<td>Mark</td>
</tr>
<tr>
<td>Steven</td>
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<tr>
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<td>Kim</td>
</tr>
<tr>
<td>Nancy</td>
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<tr>
<td>Christian</td>
</tr>
<tr>
<td>Henry</td>
</tr>
</tbody>
</table>

Note: Employee participation in both the cash balance and profit-sharing portion of the DC Plan.

Plan Year Ending December 31, 2006
Cash Balance and DC Plan
Sample Company