

ENTERTAINMENT LAW UPDATE

June 13, 2008

MICHIGAN LAUNCHES NATION'S MOST AGGRESSIVE FILM INCENTIVE PROGRAM

By: Karl Butterer and Maria Saez, Attorneys

This spring, Michigan leapt to the front of the pack with the nation's most aggressive film incentive program, which includes tax rebates disbursed as cash, film production loans, and free use of state owned land for filming. Since then, the Michigan Film Office has approved approximately twenty-one feature films and television programs and scores more are waiting for approval. Michigan's Treasury Department estimates that it is likely to give out over \$127 million in tax rebates in fiscal year 2008-09. Here are some of the major elements of the package that entertainment businesses looking to take advantage of the rebate should know about:

Production Tax Rebate / Credit

Michigan awards a **40% credit / rebate** against Michigan's business tax liability, for **direct production expenditures** for a qualified production. The rebate is awarded in cash in the amount exceeding the company's Michigan business tax liability. (See enclosed related article titled *Understanding the Michigan Business Tax*). For example, if a production company spends \$5 million, then the credit would equal \$2 million. If the Michigan tax liability was \$500,000, then the movie producer would receive a \$1.5 million rebate from the State. Michigan increases the rebate to **42%** if the expenditures are for a production in one of **103 core communities**.

The only cap is a maximum of \$2 million compensation per employee, contractual or salaried. This includes payments of wages, benefits or fees for talent, management, or labor. There are no other caps and no sunset.

Who Is Eligible for the Incentives?

Any production company that spends at least **\$50,000** in Michigan for the development, preproduction, production, or postproduction costs of a qualified production is eligible to apply for the incentives.

NEWS & HAPPENINGS

West Michigan Film Forum

Smith Haughey attorney Karl Butterer participated with local film industry leaders in a film incentive package forum sponsored by the West Michigan Chamber Coalition on June 4. State Representative Bill Huizenga, a primary sponsor of the legislation, updated participants on recent developments at the Michigan Film Office (MFO), including the approval of 21 feature film and television projects valued at \$220 million dollars. Controversy remains regarding the inclusion of commercials in the tax incentive program. Because money spent on a project before approval by the MFO does not enjoy the hefty tax rebate, and the MFO has not yet approved any commercials, prudent producers of commercials are on the sidelines until further word.

Traverse City Film Festival

Smith Haughey will sponsor a movie screening at the Open Space venue during the Traverse City Film Festival. The festival will take place July 29-August 3 in one of the most beautiful and unique resort areas in the country—and the home of our northern Michigan office. The festival recently announced that Michigan native Madonna will attend the screening of her new film "I Am Because We Are," during the festival.

Industry Insider Speaks at Smith Haughey

Sheryl Hayward, who is currently the executive director of the Traverse City Opera House and who formerly worked in many facets of the TV and film industry in Hollywood, will speak at Smith Haughey and address the State's current tax incentives and how they will impact the industry.

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Productions that qualify include: motion pictures, documentaries, television series, television miniseries, television specials, interstitial television programming, long-form television, interactive television, music videos, interactive games, video games, commercials, internet programming, internet videos, sound recordings, digital animation, or interactive websites. Trailers, pilots, video teasers, or demos created primarily to stimulate the sale, marketing, promotion, or exploitation of future investment in a production are also eligible.

How Does a Qualified Production Get the Incentives?

The production company for the project must apply for the incentive program through the State of Michigan Film Office. The application must include the project's estimated expenditures in Michigan including rental/purchase of Michigan equipment, materials (i.e., set construction, wardrobe), products and services, rental of Michigan buildings, and Michigan contracted services (i.e., casting, security). The application should also include expenses related to Michigan lodging, Michigan food and Michigan labor, a script/storyboard, insurance documents, the project's budget and any confidential information requirements. All approved projects must commence filming in Michigan **within 90 days of approval**.

At the completion of the production, the production company must request a **postproduction certificate, a job training expenditure certificate, and/or an infrastructure investment certificate**, if applicable, from the Michigan Film Office. These certificates are granted once the Michigan Film Office determines that the production company complied with the terms of the approval. The production company must then submit the certificates to the Michigan Department of Treasury. If the amount of the production credit exceeds the company's tax liability for the tax year, the Michigan Department of Treasury will refund the excess. Job training expenditure and infrastructure investment credit will not be refunded but may be carried forward as a credit against future tax liability for up to 10 years.

Direct Production Expenditures

Direct production expenditures include, but are not limited to, payments to vendors doing business in Michigan, expenses for optioning or purchasing intellectual property, production work, equipment and software, development work, postproduction work (includes advertising, marketing, and distribution), equipment and software, set design and construction, set operations, props, lighting, wardrobe, makeup, photography, sound mixing and editing, special effects, visual effects, audio, film processing, music, commercial airfare if purchased through a Michigan-based travel

agent or company for travel to, from or within Michigan, and insurance coverage or bonding if purchased from a Michigan-based insurance agent.

Personnel Expenditures Rebate

Michigan applies the **40-42%** cash rebate for all **above the line personnel expenditures**, and for **Michigan residents below the line**.

Michigan offers a smaller **30%** cash rebate for **below the line crew** who were **not residents of Michigan** for at least 60 days before approval from the Michigan Film Office.

Job Training Expenditures

A qualified production receives a state **tax credit equal to 50%** for qualified **job training expenditures** (if not already credited as a production expense). These expenditures may include money spent to provide on-the-job-training for **below the line crew**, who are **Michigan residents** with prior experience or training in the film and digital media industry. The state will not award a cash rebate, but a production company may claim the credit for up to 10 years.

Tax Credit for Equipment and Bricks and Mortar

Michigan now provides a **25% tax credit** on a production company's base investment (including fabrication and installation) in **assets located in Michigan** including film, video, television or digital media production and postproduction facilities, property and equipment and other facilities that are a necessary component of the primary facility. The investment must be greater than **\$100,000** prior to the end of 2008, and greater than **\$250,000** starting in 2009. The state will not award a cash rebate, but a production company may claim the credit for up to 10 years.

Loans

Production companies can **borrow against up to 80% of their estimated tax credit** (up to \$15,000,000 to any one eligible production company or film and digital media private equity funds for any one qualified production). The loan program also provides for **loans** to production companies or film and digital media private equity funds that are eligible for a tax credit under the Michigan Economic Growth Authority Act. These loans have an interest rate of no less than 1%, must be for a **minimum of \$500,000** and for a maximum term of 10 years.

For more information regarding the film incentive package, and how to qualify, contact Karl Butterer, chair of the Entertainment Law Industry Group at Smith Haugey, at kbutterer@shrr.com or 616.458.9294.

TIPS FOR HIRING IN MICHIGAN: INDEPENDENT CONTRACTORS VS. EMPLOYEES

By: Rachel Brochert Roe, Attorney

Many businesses hire independent contractors for project-based assignments. Some businesses attempt to take advantage of the benefits of independent contractors by calling their workers independent contractors when in fact, they are employees. Whether a worker is an independent contractor or employee is a legal question, and not just a matter of what your contract with the worker states. The general rule is simple to articulate: does your business have the right to control or direct only the result of the work done by an independent contractor, and not the means and methods of accomplishing the result. In application, however, this test can be very complex to analyze, and has caught many well-intentioned businesses off guard when challenged.

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According to the Michigan government, the “misclassification” of workers has risen to epidemic levels in the state leading to a drain on the state’s tax base. Smith Haughey has seen a rise in the number of government challenges to the classification of workers coming from different government agencies. Ultimately, if a misclassification is found, the possible adverse consequences to the business include payment of back taxes and steep penalties.

Until now, however, the various government agencies did not share information about worker misclassification. This meant that, for example, if the

Michigan Department of Labor received an overtime complaint from an improperly classified “independent contractor,” that information would not be conveyed to the Michigan Unemployment Insurance Agency and other government agencies.

Enter Governor Granholm’s Executive Order 2008-1, which creates a Task Force on Employee Misclassification. The task force consists of representatives of state agencies that administer employee programs such as the unemployment and workers’ compensation systems. It is charged with a number of duties, including evaluating employee misclassification enforcement mechanisms already present in the law; creating a system for sharing information on suspected

employee misclassification violations; and developing strategies for systematically investigating employee misclassification within those industries in which the practice is most common.

For those businesses that routinely use independent contractors, now is the time to get professional assistance to evaluate whether these relationships are designed on paper and in practice to comply with applicable law.

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UNDERSTANDING THE MICHIGAN BUSINESS TAX

The Michigan Business Tax (“MBT”) recently replaced the Single Business Tax (“SBT”), which expired at the end of 2007. The new MBT uses a combination of taxes and incentives to collect the same amount of revenue—\$1.9 billion—as the expiring SBT. It also reduces personal property taxes by 65 percent for manufacturers and 23 percent for commercial businesses; gives small companies the

option of paying a 1.8 percent tax on adjusted business income; and provides more than \$600 million in credits for research and investment.

The package of bills that created the tax—Senate Bill 94, and House Bills 4369-4372—are considered to be key to Michigan’s economic recovery and are

intended to help the state attract jobs and job providers.

Components of the MBT

The MBT has two components: an income tax and a modified gross receipts tax. Taxpayers that have nexus for both types of taxes are required to pay **both** taxes. Unitary business groups are required to file on a combined basis for both types of taxes.

Income Tax

Income tax is imposed at the rate of 4.95 percent on business income after allocation and apportionment. It is imposed on every taxpayer with “business activity” within Michigan, unless prohibited by federal law. Business income generally means that part of federal taxable income that is derived from business activity, with several adjustments. Adjustments before apportionment include adding back:

- Interest income and dividends derived from obligations or securities of states other than Michigan;
- Taxes on or measured by net income, including the entire MBT liability; and
- Carryback or carryover of a net operating loss, to the extent deducted for federal taxable income purposes.

Deductions from federal taxable income before apportionment, to the extent included in federal taxable income, include:

- Dividends and royalties received from foreign persons;

- Income attributable to another entity whose business activities are taxable or would be subject to tax if business activities were in Michigan;
- Royalties, interest, or other expense paid to a related person for the use of an intangible asset if the person is not included in the taxpayer’s unitary business group;
- Interest income from U.S. obligations; and

Modified Gross Receipts Tax

The modified gross receipts tax is imposed on all taxpayers with gross receipts sourced to Michigan exceeding \$350,000 that have a physical presence in Michigan of one or more days *or* that actively solicit sales in the state. It is imposed at the rate of 0.8 percent of a taxpayer’s gross receipts, less purchases from other firms. “

With the signing of the MBT, the taxing system on business entities in Michigan has been completely overhauled. These new statutes will need to be reviewed to determine their impact on your business’s Michigan tax liability. Additionally, since a component of the MBT is a tax based on income, and most taxpayers in the past treated the Michigan SBT as a non-income tax, several accounting principles may need to be considered for the first time.

Smith Haughey attorneys can assist your company in determining the impact of the MBT. Our attorneys will monitor the legislation and Michigan Department of Treasury communications on these matters to ensure that the most up-to-date information on this new tax structure.

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