IRS

Capitalization of Motion Picture, Master Recording, and Video - Entertainment Tax Tips

When a taxpayer produces or creates a product (video, film, recording, etc.), the taxpayer will generally incur a great portion of the expenses before the product is ready to produce income. When this happens, the taxpayer is usually required to capitalize those expenses and recover (deduct) them over the period of time that the product is producing income. Several different provisions apply depending on whether the taxpayer is already in the business and the specific business the taxpayer is in.

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Internal Revenue Code Section 195

Expenses for investigating, creating, or acquiring a new business are nondeductible capital expenses. This applies to all expenses before the day the active trade or business begins. These provisions apply to someone starting out in the industry - before offering a completed product for sale, production, or distribution.

IRC Section 263A

Update for Tax Cuts and Jobs Act, P.L. 115-97:

Effective for tax years beginning after 12/31/2017, a small business taxpayer is not required to capitalize costs under section 263A. See section 263A(i).

Small business taxpayer. A small business taxpayer is a taxpayer that (a) has average annual gross receipts of $25 million or less (indexed for inflation) for the 3 prior tax years and (b) is not a tax shelter (as defined in section 448(d)(3)).

These rules apply to people who are already in the trade or business. This code section requires the capitalization of expenses to produce a creative work. The total costs of creating the assets are required to be capitalized. This includes cost of researching, preparing, producing, recording, etc. It also includes an allocation of indirect costs such as utilities, tools, clerical, rental of equipment, etc.

Prior to the enactment of Section 263A, it was unclear what indirect costs were required to be capitalized for tax purposes with regard to self-constructed assets.

- Most companies do capitalize general and administrative overhead, as well as interest, to be consistent with the Generally Accepted Accounting Principles (GAAP) requirements of SOP 00-2
- The uniform capitalization rules of Section 263A of the Internal Revenue Code require that certain costs relating to self-constructed assets be capitalized
- The uniform capitalization rules of Section 263A apply to real and tangible personal property. Section 263A specifically states that these assets are considered tangible personal property for this section

Abandonment

As with any other business venture, if a project is abandoned, the taxpayer can claim a deduction for the unrecovered basis. Abandonment requires that the taxpayer show an intent to abandon and makes an affirmative act of abandonment in such a manner that the asset is not retrievable.

Example One:
Putting a script on the shelf for a while, with the possibility of selling it at a later date, is not abandoning it.

Example Two:
Not attempting to promote a master recording is not abandoning it, since it may still be released in the future.

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