

Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, §§ 446, 481; 1.446-1.)

Rev. Proc. 2004-36

SECTION 1. PURPOSE

This revenue procedure provides a safe harbor method of accounting under which a taxpayer within the scope of this revenue procedure may amortize creative property costs (as defined in section 2.01 below) ratably over a 15-year period. This revenue procedure also provides procedures for taxpayers to obtain the automatic consent of the Commissioner of Internal Revenue to change to the safe harbor method of accounting provided in this revenue procedure.

SECTION 2. DEFINITIONS

The following definitions apply solely for the purpose of this revenue procedure:

.01 Creative property costs. Costs paid or incurred for federal tax purposes to acquire and develop screenplays, scripts, story outlines, motion picture production rights to books and plays, and other similar properties (creative properties) for purposes of potential future film development, production, and exploitation.

.02 Film. Feature films, television specials, television series, and similar products (including animated films and television programming) that are sold, licensed or exhibited, whether produced on film, videotape, digital, or other video recording format.

.03 Set for production. Management, with relevant authority, implicitly or explicitly authorizes and commits to funding the production of a film, active pre-production has begun, and the start of principal photography is expected to begin within 6 months of being set for production.

.04 SOP 00-2. The American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 00-2, "Accounting for Producers or Distributors of Films."

.05 Initial write-off. The earliest date on which the taxpayer properly writes off under SOP 00-2 any creative property costs paid or incurred with respect to a particular creative property.

SECTION 3. BACKGROUND

.01 Film studios (studios) routinely incur costs to acquire, produce, and develop creative properties. Studios may acquire these creative properties with exclusive rights of ownership, or they may have limited exploitation rights. Sometimes the rights acquired survive indefinitely while in other situations, the studios may acquire rights with a limited term. Studios ultimately set for production only a small percentage of the creative properties acquired. Most of the creative properties set for production are set within 3 years of acquisition of the property. However, studios set some properties for production that have been held for longer than 3 years. Studios do not usually discard, release to the public domain, or otherwise dispose of the creative properties not set for production or sold. Generally, studios retain these properties indefinitely.

.02 On June 12, 2000, the AICPA issued SOP 00-2, and rescinded Statement of Financial Accounting Standards No. 53. SOP 00-2 is effective for fiscal years beginning after December 15, 2000. SOP 00-2 established new generally accepted accounting principles for financial reporting purposes for the way studios account for creative property costs. SOP 00-2 states that an entity should periodically review creative properties in order to determine whether they will be used in the production of a film. SOP 00-2 states that “[w]hen an entity determines that a property will not be used (disposed of), it should recognize any loss by a charge to the income statement.” SOP 00-2 further states that it is presumed that an entity will dispose of a property (whether by sale or abandonment) if it has not been set for production within 3 years from the time of the first capitalized transaction. Amounts written off should not be subsequently reestablished as assets.

.03 Section 165(a) of the Internal Revenue Code allows a deduction for any loss sustained during the taxable year and not compensated for by insurance or otherwise.

.04 Rev. Rul. 2004-58, I.R.B. 2004-24, concludes that a taxpayer may not deduct the costs of acquiring and developing creative property as a loss under § 165(a) if the taxpayer does not establish an intention to abandon the property and an affirmative act of abandonment, or identifiable event(s) evidencing a closed or completed transaction establishing worthlessness.

.05 Thus, taxpayers generally are required under the Code and regulations to capitalize creative property costs and, unless a film is produced from the creative property, are not permitted to recover those costs through deductions for depreciation or amortization. See Rev. Rul. 79-285, 1979-2 C.B. 91. However, to minimize disputes regarding the accounting for creative property costs, the Internal Revenue Service, as a matter of administrative convenience, will allow a taxpayer that complies with the requirements of this revenue procedure to use the safe harbor amortization method described in section 5 of this revenue procedure for these costs.

SECTION 4. SCOPE

This revenue procedure applies to taxpayers engaged in the trade or business of film production that choose to account for creative property costs under the safe harbor method provided in section 5 of this revenue procedure.

SECTION 5. SAFE HARBOR METHOD

.01 In general. The Service will not challenge the use of this safe harbor method of accounting by a taxpayer within the scope of this revenue procedure provided the taxpayer follows all of the requirements of this section 5 and, if the taxpayer is changing from another method to the safe harbor method, the provisions of section 6 of this revenue procedure regarding changes in method of accounting. Under the safe harbor method, the taxpayer must amortize creative property costs properly written off by the taxpayer under SOP 00-2 ratably over an amortization period of 15 years beginning on the first day of the second half of the taxable year in which the taxpayer properly writes off the costs under SOP 00-2. For example, for a calendar-year taxpayer with a full 12-month taxable year, the first day of the second half of the taxable year is July 1st. All creative property costs that the taxpayer begins to amortize under this safe harbor method in the same taxable year are treated as a single asset. Creative property costs that the taxpayer amortizes under this safe harbor method must not be subsequently reestablished as assets, even if a particular creative property is set for production subsequent to the initial write-off. See section 5.02 of this revenue procedure for rules regarding creative property costs paid or incurred subsequent to the initial write-off, whether or not the creative property has been set for production subsequent to the initial write-off. Except as provided in section 5.03 and 5.04 of this revenue procedure, no disposition or other event accelerates recovery of the creative property costs that the taxpayer has begun to amortize under this safe harbor method.

.02 Costs paid or incurred subsequent to the initial write-off.

(1) Property not set for production. Creative property costs that are (a) associated with a particular creative property that has not been set for production and (b) paid or incurred by the taxpayer subsequent to the initial write-off must be amortized by the taxpayer (in accordance with section 5.01 of this revenue procedure) ratably over an amortization period of 15 years beginning on the first day of the second half of the taxable year in which the taxpayer pays or incurs those costs.

(2) Property set for production. Creative property costs that are (a) associated with a particular creative property that has been set for production subsequent to the initial write-off and (b) paid or incurred by the taxpayer after the property is set for production must be capitalized by the taxpayer from the time the property is set for production and depreciated using an allowable depreciation method for produced films (for example, income forecast method) at the time the property is placed in service by the taxpayer.

.03 Costs associated with property upon disposition. If, during the 15-year amortization period, creative property rights are disposed of, the taxpayer must nevertheless continue to amortize the creative property costs over the remainder of the 15-year period. A disposition includes the sale, exchange, abandonment, or destruction of creative property or the rights relating thereto. A disposition also occurs upon the expiration of a taxpayer's rights to a particular creative property. Immediately before a disposition, the creative property or creative property rights are treated as having an adjusted basis of zero for purposes of § 1011. Therefore, no loss shall be realized upon a disposition. Any amount realized on a disposition shall be recognized as ordinary income (notwithstanding any other provision of the Code). However, these rules do not apply if a taxpayer disposes of all of its creative properties, for example, as a result of a sale (not including elective recognition of gain or loss transactions under § 338(h)(10)) of its entire trade or business. Thus, in the case of a disposition of an entire trade or business, any gain from the disposition of creative property rights, the costs for which were accounted for using this safe harbor method, will be treated as ordinary income to the extent of the amortization allowed under this safe harbor method.

.04 Special rule for certain transfers. In the case of any creative property transferred in a transaction described in §§ 332, 351, 361, 721, 731, 1031, or 1033, and in any transaction between members of the same affiliated group during any taxable year for which a consolidated return is made by the group, the transferee shall be treated as the transferor for purposes of applying the safe harbor method as described in section 5 of this revenue procedure with respect to so much of the adjusted basis in the hands of the transferee as does not exceed the adjusted basis in the hands of the transferor. However, this section 5.05 does not apply in the case of a termination of a partnership under section 708(b)(1)(B).

SECTION 6. CHANGE IN METHOD OF ACCOUNTING AND AUDIT PROTECTION

.01 Change in method of accounting. A change in a taxpayer's treatment of creative property costs is a change in method of accounting to which §§ 446(e) and 481 apply. If a taxpayer within the scope of this revenue procedure wants to change to the safe harbor method provided in this revenue procedure for creative property costs properly written off under SOP 00-2, the taxpayer must follow the automatic change in method of accounting provisions in Rev. Proc. 2002-9, 2002-1 C.B. 327 (as modified by Rev. Proc. 2002-19, 2002-1 C.B. 696 and Rev. Proc. 2002-54, 2002-2 C.B. 432, and as modified and clarified by Announcement 2002-17, 2002-1 C.B. 561) or any successor, with the following modifications:

(1) The scope limitations in section 4.02 of Rev. Proc. 2002-9 do not apply to a taxpayer that wants to change to the safe harbor method described in section 5 of this revenue procedure for either its first or second taxable year ending on or after December 31, 2003;

(2) A taxpayer that wants to change to the safe harbor method described in section 5 of this revenue procedure for its first taxable year ending on or after

December 31, 2003, and that on or before July 12, 2004, files its original federal income tax return for that year, and that did not change to the safe harbor method described in section 5 of this revenue procedure on that return is not required to comply with the filing requirement in section 6.02(3)(a) of Rev. Proc. 2002-9, provided the taxpayer complies with the following filing requirements. The taxpayer must instead complete and file the Form 3115, Application for Change in Accounting Method, in duplicate. The original Form 3115 must be attached to an amended federal income tax return for the taxpayer's first taxable year ending on or after December 31, 2003. This amended return must be filed no later than November 29, 2004. The copy of the Form 3115 must be filed with the national office (see section 6.02(6) of Rev. Proc. 2002-9 for the address) no later than when the taxpayer's amended return is filed; and

(3) For purposes of Line 1a of Form 3115, the designated number for the automatic accounting method change authorized by this revenue procedure is "85."

.02 Audit protection. If a taxpayer within the scope of this revenue procedure currently uses a method consistent with the safe harbor method described in section 5 of this revenue procedure, the method of accounting for the taxpayer's creative property costs will not be raised as an issue by the Service in a taxable year that ends before December 31, 2003. Also, if a taxpayer currently uses a method consistent with the safe harbor method described in section 5 of this revenue procedure, and its use of that method is an issue under consideration (within the meaning of section 3.09 of Rev. Proc. 2002-9) in examination, before an appeals office, or before the U.S. Tax Court for any taxable year that ends before December 31, 2003, that issue will not be further pursued by the Service.

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002-9 is modified and amplified to include this change in method of accounting in section 2 of the APPENDIX.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2003.

DRAFTING INFORMATION

The principal author of this revenue procedure is Lauren Ross Taylor of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Ms. Taylor at (202) 622-3040 (not a toll free call).