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Tax Law: Sense and Sensibility in Film and Sound Recording Depreciation, 1984-1986 Legislative Developments

Raymond L. Towne

TAX LAW: SENSE AND SENSIBILITY IN FILM AND SOUND RECORDING DEPRECIATION, 1984-1986 LEGISLATIVE DEVELOPMENTS

In our universe even stars wear out. Thus a "bronze Grammy"[1] and even a "tin Oscar"[2] brought a golden moment of satisfaction to our favorite contestants, the sound recording and film production companies, under the Tax Reform Act of 1984.[3] But Oscar's countenance will leaden, and Grammy will tarnish, if Congress decides to enact the 1985 House and Senate tax committee proposals[4] to treat motion pictures, videotapes[5] and sound recordings as intangible property for purposes of Internal Revenue Code section 167.[6]

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1. The phrases were coined by J. Eustice in J. EUSTICE, THE TAX REFORM ACT OF 1984, A SELECTIVE ANALYSIS 5-45 (1984) ["EUSTICE"]. The sound recording industry garnered a "bronze Grammy" since Congress granted sound recording owners the option to elect the very favorable 3-year recovery property depreciation through new Internal Revenue Code (I.R.C.) § 48(r); the less generous § 167 straight line and accelerated methods for tangible property still remain available.

Section 48(r)(1) states that "[f]or purposes of this title [Internal Revenue Code], in the case of any sound recording, the original use of which commences with the taxpayer, the taxpayer may elect to treat such recording as recovery property which is 3-year property to the extent that the taxpayer has an ownership interest in such recording." I.R.C. § 48(r)(1) (West Supp. 1986).

To compare depreciation methods, *see infra* notes 31, 35 and accompanying text.

2. The 98th Congress awarded the film industry a "tin Oscar" in that it disallowed further use of the very favorable five-year "Accelerated Cost Recovery System" (ACRS) depreciation method (set forth in I.R.C. § 168 (1982)) by enacting new § 168(e)(5), which states that "[t]he term 'recovery property' [i.e. property qualifying for ACRS treatment] shall not include any motion picture film or video tape." I.R.C. § 168(e)(5) (West Supp. 1986).

At the same time it did leave open the use of the accelerated tangible property methods set forth in I.R.C. § 167 (1982). EUSTICE, *supra* note 1. For § 167 depreciation methods, *see infra* notes 6, 31 and accompanying text. For general discussion of the § 168 ACRS methods, *see infra* note 31 and accompanying text. For implications of new § 168(e)(5), *see infra* text accompanying note 65.

3. Tax Reform Act of 1984, Div. A of the Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 113, 98 Stat. 494, 635-38.

4. H.R. 1800, § 109(c), 99th Cong., 1st Sess., 131 CONG. REC. H1630, H1636 (daily ed. March 28, 1985); S. 814, § 109(c), 99th Cong., 1st Sess., 131 CONG. REC. S3687, S3693 (daily ed. March 28, 1985).

The proposed amendment is to I.R.C. § 167(c) (1982), the subsection that limits the application of accelerated depreciation methods (*see infra* note 68 and accompanying text) to tangible property. The amendment proposed in § 109(c) of the companion House and Senate bills adds at the end of § 167(c) the following new sentence: "For purposes of the preceding sentence, any motion picture film, video tape, or sound recording shall be treated as intangible property." 131 CONG. REC. H1636, S3693.

5. In this paper, "film" includes motion picture and television film, and videotapes.

6. Section 167(a) (1982) provides:

Even the tax code acknowledges that things wear out. The general depreciation provision is set forth in Internal Revenue Code section 167(a): "[t]here shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—(1) of property used in the trade or business, or (2) of property held for the production of income."[7] In our case, the initial creative work that goes into a motion picture or sound recording is preserved on a "master negative"[8] or "master tape,"[9] respectively. These masters are paid for by producers in the trade, or financed by

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There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

In the case of recovery property (within the meaning of section 168), the deduction allowable under section 168 shall be deemed to constitute the reasonable allowance provided by this section . . . .

Section 167(b) (1982) states:

For taxable years ending after December 31, 1953, the term "reasonable allowance" as used in subsection (a) shall include (but shall not be limited to) an allowance computed in accordance with regulations prescribed by the Secretary [of the Treasury], under any of the following methods:

(1) the straight line method,

(2) the declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in paragraph (1),

(3) the sum of the years-digits method, and

(4) any other consistent method . . . which . . . does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used had such allowances been computed under the method described in paragraph (2).

Nothing in this subsection shall be construed to limit or reduce an allowance otherwise allowable under subsection (a).

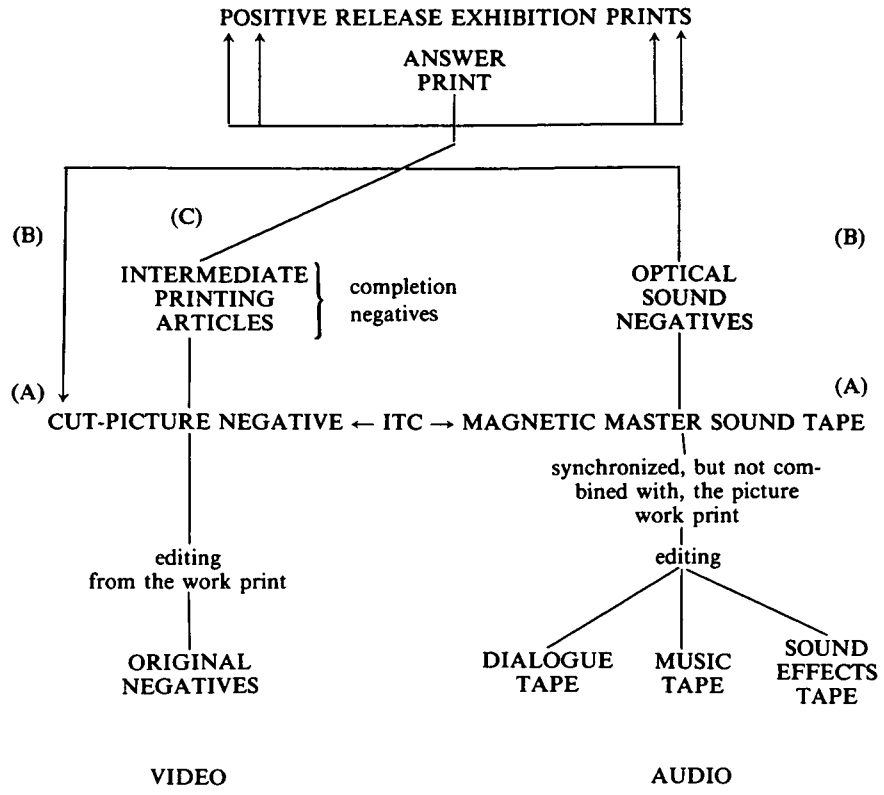
Section 167(c) (1982) states that:

"[p]aragraphs (2), (3), and (4) of subsection (b) shall apply only in the case of property (other than intangible property) described in subsection (a) with a useful life of 3 years or more—. . . (2) acquired after December 31, 1953, if the original use of such property commences with the taxpayer and commences after such date.

Thus if films and sound recordings are treated as intangible property, the declining balance, sum of the years-digits and equivalent accelerated methods will no longer be available. Only the more modest benefits of § 167's straight line method will remain. To compare results, *see infra* note 31, Tables 1-2.

7. I.R.C. § 167(a) (1982).

8. *Diagram of film manufacturing process,* excerpted from Walt Disney Prods. v. United States, 549 F.2d 576, 579 (9th Cir. 1976) (*Disney III*).



(A)

The cut-picture negative and magnetic master sound tape are the property for which Disney claims the investment tax credit and will be referred to collectively as the "master negative."

(B)

Intermediate printing articles include duplicate negatives, matrixes, color reversal internegatives, and other articles derived from the cut-picture negative. These articles and the optical sound negatives constitute the "completion negatives."

(C)

The optical sound negative can be combined with either the cut-picture negative itself or with the intermediate printing articles to produce the exhibition prints.

In Bing Crosby Prods. v. United States, 588 F.2d 1293 (9th Cir. 1979), the court set forth the manufacturing process in some detail:

> The manufacturing of the prints which are actually shown to the public should be viewed in a vertical framework. For explanation purposes, a three-step analysis best serves to illustrate this:
>
> Step (1): When a program or movie is shot, the video and audio portions are each recorded and then edited separately. The sound portion consists of three parts (dialogue, music, and sound effects) which are combined and edited into a finished version referred to as the master sound tape or magnetic master. The visual portion is edited into a cut picture negative which is also referred to as the original picture

negative. These final edited versions of the audio and visual portions are called the master negatives or simply the negative elements.

Step (2): From the respective master negatives, various intermediate or secondary film and tape articles are made. These consist of 16 and 35mm negatives of the video portion (duplicate picture negatives or duplicate action negatives). The sound portion is recorded on 16 and 35mm tapes (optical sound track negatives). Although they actually go a step further by combining the sound and picture, answer prints and protective masters are included within this category. Also included are various duplicate sound tapes which are made and retained by the production companies. The distinguishing feature of this category is that the films and tapes contained within it are generally the ones which are either used by the company to manufacture the release prints in step # 3, or are items which are made from the master negatives and retained by the company to make other intermediate printing articles.

Step (3): The final step involves the actual manufacture of the release prints (exhibit or composite release prints). These combine the audio and visual portions onto a single property, which are then shown at movie theaters, by television networks, or by individual television stations. The release prints are generally struck from the different intermediate articles contained within step # 2.

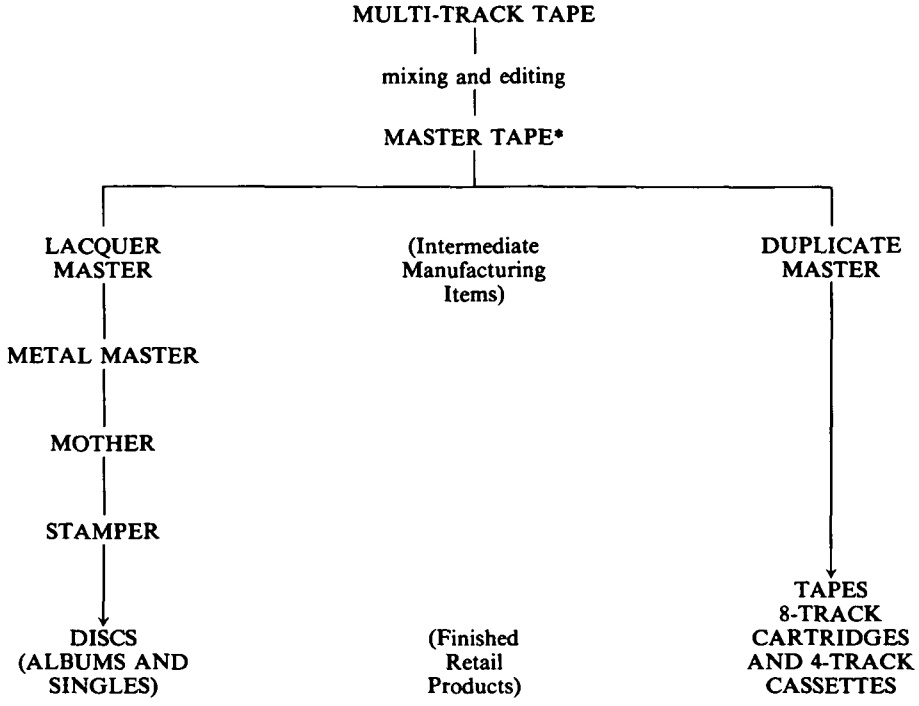
Id. at 1294-95.

Some companies (e.g. Walt Disney and MCA) use the intermediate and answer prints so extensively in the manufacturing process that they quickly wear out, as do all release prints. Id. at 1295. For example, for the 1970 tax year Disney did not claim costs for ITC or depreciation purposes beyond the production of the answer print [Step 2] viewed by executives. Also, exhibition print costs [Step 3] and wear and tear were expensed instead of depreciated. *Disney III,* 549 F.2d 576 at 580 n.3. In calculating the cost basis for depreciation of the film titles, Disney did not include the costs of the intermediate visual prints used to produce the answer print, but it did include the costs of producing the film master negative and magnetic master sound tape, and the optical sound negative [Step 1]. These costs included expenses for preparing a script from a story, building sets, hiring and rehearsing talent, editing the original film negatives, and mixing the audio. *Id.* at 580 n.2.

outside investors. They are concededly physical;[10] the question is whether they are tangible for depreciation purposes.

Since the film and sound masters are used to produce a copyrighted end product and a copyright is an intangible right,[11] one can argue that

9. *Diagram of Capitol's record and cassette manufacturing process.*



*The master tape is a magnetic tape which contains two tracks of sound for stereo separation. The master tape is the property for the costs of which Capitol claims the investment tax credit.

Brief for Appellees at A-7, EMI North America Holdings, Capitol Industries-EMI, and Capitol Records v. United States, 675 F.2d 1068 (9th Cir. 1982).

10. In Walt Disney Prods. v. United States, 327 F. Supp. 189, 192 (C.D. Cal. 1971) (*Disney I*), the trial court noted that "the motion picture negatives here certainly are tangible—weighing between 27 and 51 pounds, between 5000 and 11,800 feet in length and capable of being seen and touched." In the more recent case Walt Disney Prods. v. United States, 1975-2 U.S. Tax Cas. (CCH) ¶ 9824 at 88,633 n.3 (C.D. Cal. 1975) (*Disney III*), the trial court noted that "[t]he parties have stipulated that the [film] negatives are tangible personal property."

11. Section 202 of the Copyright Law states:

> Ownership of a copyright, or of any of the exclusive rights under a copyright, is distinct from ownership of any material object in which the work is embodied. Transfer of ownership of any material object, including the copy or phonorecord in which the work is first fixed, does not of itself convey any rights in the copyrighted work embodied in the object; nor, in the absence of an agreement, does tranfer of ownership of a copyright or of any exclusive rights under a copyright convey property rights in any material object.

17 U.S.C. § 202 (1982).

the cost of the intangible property includes all production costs. The Secretary of the Treasury took this position in Treasury Regulations section 1.48-1(f), which concerns the application of the Investment Tax Credit ("ITC") to motion picture and television film masters.[12] Even if the masters were held to be intangible, Treasury Regulations section 1.167(a)-3 still provides that "an intangible asset may be the subject of a depreciation allowance" if the length of its use "can be estimated with reasonable accuracy."[13] But more to the point, the trial court in the first of three cases styled *Walt Disney Prods. v. United States*[14] explicitly rejected the thesis in Regulation 1.48-1(f) that the costs of producing a film are intangible because the copyright is intangible:

> When the Secretary [of the Treasury] includes in cost of copyright or patents, the "costs of purchasing or producing the item patented or copyrighted," he misconstrues the very nature of patents and copyrights.
>
> A copyright, when secured in accordance with applicable laws is the *right* to multiply copies of a literary, intellectual or artistic property. Nowhere in the constitutional or statutory scheme does the law create a right by copyright *in the property.* It is an incorporeal (intangible) right existing independently from the corporeal (tangible) property out of which it arises.[15]

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12. Treas. Reg. § 1.48-1(f) states that

> [t]he cost of intangible property, in the case of a patent or copyright, includes all costs of purchasing or producing the item patented or copyrighted. Thus, in the case of a motion picture or television film or tape, the cost of the intangible property includes manuscript and screenplay costs, the cost of wardrobe and set design, the salaries of cameramen, actors, directors, etc., and all other costs properly includible in the basis of such film or tape.

Treas. Reg. § 1.48-1(f); T.D. 6731, 1964-1 C.B. 11, 38.

13. Treas. Reg. § 1.167(a)-3; T.D. 6500, 25 Fed. Reg. 11,402, 11,533 (1960).

14. Walt Disney Prods. v. United States, 327 F. Supp. 189 (C.D. Cal. 1971), *aff'd as modified*, 480 F.2d 66 (9th Cir. 1973), *cert. denied*, 415 U.S. 934 (1974) (*Disney I*); Walt Disney Prods. v. United States, 1974-2 U.S. Tax Cas. (CCH) ¶ 9623 (C.D. Cal. 1974), *appeal dismissed per stipulation*, No. 74-2988 (9th Cir. Jan. 17, 1975) (*Disney II*); Walt Disney Prods. v. United States, 1975-2 U.S. Tax Cas. (CCH) ¶ 9824 at 88,632 (C.D. Cal. 1975), *aff'd in part and rem'd in part,* 549 F.2d 576 (9th Cir. 1976) (*Disney III*); Bing Crosby Prods. v. United States, 588 F.2d 1293 (9th Cir. 1979); Hanna Barbera Prods. v. United States, 77-1 U.S. Tax Cas. (CCH) ¶ 9365 (C.D. Cal. 1977). *Compare* Texas Instruments v. United States, 551 F.2d 559 (5th Cir. 1977) (holding that master tapes on which seismic information was recorded are tangible property).

The cases were collected by Wm. P. McClure in his 22-page opinion letter to Assistant Secretary of the Treasury J. E Chapoton, dated February 23, 1983, Treas. Doc. No. 83-2082 (published in Tax Notes Today, March 14, 1983). He wrote on behalf of nine member companies of the Motion Picture Association of America, advocating the tangibility of film master negatives for depreciation and Investment Tax Credit purposes.

15. *Disney I,* 327 F. Supp. at 192 (emphasis in original).

In the three *Disney* cases, the Ninth Circuit Court of Appeals consistently overruled Treasury Regulation 1.48-1(f) as applied to films.[16] The *Disney* cases and their progeny,[17] and the subsequent *EMI* case concerning sound recordings,[18] have all dealt exclusively with the question of tangibility as applied to qualification for the ITC, which is the focus of Regulation 1.48-1(f).[19] Nevertheless, members of Congress, the California senators P. Wilson (R.) and A. Cranston (D.) among them, appear to have relied on the same legal principles enunciated in these ITC cases to evaluate the tangibility of films and sound recordings for depreciation purposes.[20]

In *Disney I*,[21] and later in *Disney II* and *III*,[22] the Commissioner of the Internal Revenue Service had disallowed Disney's claim for the Investment Tax Credit on the theory that Disney's production costs were investments in intangible property, namely a copyright protected motion picture. Throughout this line of cases, the courts agreed with the District Court's 1971 holding in *Disney I* that master film negatives were

16. *Disney III*, 549 F.2d at 581.

17. The rationale for the government's persistence is the doctrine of separable facts, as set forth in Comm'r v. Sunnen, 333 U.S. 591 (1948). A prior judgment acts as collateral estoppel only as to those matters in the second proceeding which were actually presented and determined in the first suit. Thus if a dispute arises with respect to a subsequent tax year, the prior judgment is conclusive only "if the very same facts and no others are involved in the second case." *Id.* at 601.

This proposition was cited by the *Disney III* trial court, 75-2 U.S. Tax Cas. (CCH) ¶ 9824 at 88,633. Of course, the doctrine of res judicata would govern claims raised in a subsequent proceeding but involving the same claim in the same tax year. *Disney III* at 88,633. The trial court noted, "[t]he parties have stipulated that the [film] negatives are tangible personal property." *Disney III* at 88,633 n.3.

18. EMI North America Holdings v. United States, 675 F.2d 1068 (9th Cir. 1982). *See infra* note 82 and accompanying text.

19. Specific ITC provisions are outside the scope of this Note. For a discussion of its waxing and waning popularity as a device to stimulate business from 1961 to the present, see J. FREELAND, S. LIND AND R. STEPHENS, FUNDAMENTALS OF FEDERAL INCOME TAXATION 785 (1985).

Section 211 of the "Tax Reform Bill of 1985," H.R. 3838, passed by the House on December 19, 1985, abolishes the ITC. 131 CONG. REC. H12597 (daily ed., December 17, 1985). Section II. C. of Senate Finance Committee Chairman Packwood's (R.-Or.) Markup Proposal contains the same provision. Telephone conference with Senate Finance Committee staff. March 20, 1986. (Full text of the March 21, 1986 Joint Committee Print (JCS-8-86) is printed at Tax Notes Today, March 21, 1986.)

20. *See infra* notes 63-64 and accompanying text.

21. *Disney I*, 327 F. Supp. 189 (C.D. Cal. 1971), *aff'd as modified*, 480 F.2d 66 (9th Cir. 1973), *cert. denied*, 415 U.S. 934 (1974).

22. Walt Disney Prods. v. United States, 1974-2 U.S. Tax Cas. (CCH) ¶ 9623 (C.D. Cal. 1974), *appeal dismissed per stipulation*, No. 74-2988 (9th Cir. Jan. 17, 1975); Walt Disney Prods. v. United States, 1975-2 U.S. Tax Cas. (CCH) ¶ 9824 at 88,632 (C.D. Cal. 1975), *aff'd and rem'd*, 549 F.2d 576 (9th Cir. 1976).

tangible personal property within the meaning of the ITC property definitions, and that accordingly the Disney company could claim the ITC for the production costs of these audio and visual film masters.

In *Disney III*, the government reasoned that since Disney had used the income forecast method of depreciation, "that property should likewise be treated as an intangible for ITC purposes."[23] The court conceded that the income forecast method was "generally used for depreciating intangible personal property."[24] But since Disney's use of this method was not decisive,[25] the Ninth Circuit reasoned that a "machine which stamps out patented products for sale is tangible. The character of the acquisition costs of that machine is not affected by the character of the end product, even if the value of the entire system is dependent on . . . an intangible."[26] So even though motion picture production companies do secure a statutory copyright on the sequence of images and sound to preserve the value of exhibition rights, the cut-picture and sound negatives (the "machine") that produce that intangible property are tangible. As the trial court in *Disney III* characterized the dispute,

> [t]he government's argument that Disney is not investing in tangible personal property, but rather in the intangible copyright, was squarely rejected by the [Ninth Circuit] Court of Appeals. In effect, the government would have this Court resurrect Treas. Reg. § 1.48-1(f) struck down in *Disney I*, which could have allocated the costs of production to the intangible copyright. The Court declines to do so.[27]

But in two major pieces of tax legislation, the "Tax Reform Act of 1984" and the "Technical Corrections Bill of 1985,"[28] two influential tax committee leaders, former (Ninety-eighth Congress) Senate Finance Committee Chairman R. Dole (R.-Kan.) and House Ways and Means Committee Chairman Rep. D. Rostenkowski (D.-Ill.), appear to have rejected the extension of the Ninth Circuit's reasoning on film and sound recording master tangibility for ITC purposes, governed generally by Internal Revenue Code sections 38 through 48, to tangibility for purposes of depreciation. Depreciation is governed generally by sections 167 and 168 of the Internal Revenue Code.

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23. *Disney III*, 549 F.2d at 281.

24. *Id.* at 580.

25. *Id.* at 581.

26. *Id.*

27. *Disney III*, 75-2 U.S. Tax Cas. (CCH) ¶ 9824 at 88,634.

28. *See infra* note 56, Tax Reform Act of 1984, note 67, Technical Corrections Bill of 1985, and accompanying text.

In Internal Revenue Code subsections 167(b)(1) through (b)(4),[29] the Congress has set forth the three most common depreciation computation methods: straight line, declining balance and sum of the years-digits. Under the straight line method, the simplest, an asset with a 10-year life loses 1/10 of that value each year: in year two it is worth 9/10, in year three 8/10 and so on. This regular decline in value would appear graphically as a "straight" line.[30]

The other two methods "accelerate" the deductions, in that they provide larger deductions than straight line in the early years.[31] Here the film or sound recording producer benefits because the higher early depreciation deduction enables it to retain more of the income the property is

29. I.R.C. § 167(b)(1)-(4) (1982). For text of statute *see supra* note 6.

30. In present practice, with straight line depreciation the residual salvage value is usually subtracted before the fractions are computed. Treas. Reg. § 1.167(a)-1, T.D. 6500, 25 Fed. Reg. 11,402, 11,532-33 (1960); *modified,* T.D. 6712, 1964-1 C.B. 106, 108, T.D. 7203, 1972-2 C.B. 12, 30.

Section 201(b)(3) of H.R. 3838, the "Tax Reform Bill of 1985," provides that for tangible assets placed in service after December 31, 1985, salvage value will be treated as zero. H.R. 3838, 131 CONG. REC. H12589 (daily ed. December 17, 1985).

31.

TABLE 1. Effective depreciation rates as a percentage of initial basis in a 5-year time frame. No adjustment for salvage value.

YEAR	Straight-line	200% DB	SYD	150% DB	5yr ACRS	3yr ACRS
1	20%	40	33	30	15	25
2	20	24	27	11	22	38
3	20	14	20	9	21	37
4	20	9	13	8	21	
5	20	5	6	7	21	
total	100	90	100	64	100	100

TABLE 2. Effective depreciation rates as a percentage of initial basis in a 10-year time frame. [Adjustment for 10% salvage value]

YEAR	Straight-line	200% DB	SYD	150% DB	5yr ACRS	3yr ACRS
1	10%[9]	20	18	15	15	25
2	10 [9]	16	16	13	22	38
3	10 [9]	13	15	11	21	37
4	10 [9]	10	13	9	21	
5	10 [9]	8	11	8	21	
6	10 [9]	7	9	7		
7	10 [9]	5	7	6		
8	10 [9]	4	6	5		
9	10 [9]	3	4	4		
10	10 [9]	1	2	3		
total	100%	100*	100	81	100	100

*Actual sum is 101, due to rounding.

Notes to Tables 1 and 2. SYD stands for "sum of the years-digits." DB stands for "declining balance."

100% DB would yield the same result as straight line. Any percentage between 100%

producing at an earlier time than it could with the straight line method. But these three methods share a common difficulty: the production company must estimate the asset's useful life in advance. Furthermore, these three formulas yield an annual deduction fixed in advance, while the actual revenues can vary widely from year to year.

The Internal Revenue Service ("IRS") addressed this problem in a 1960 Revenue Ruling on television films.[32] The solution was subsequently applied to motion picture films and sound recordings.[33] The IRS observed that since the income actually produced from year to year determines the usefulness of a film or tape in the taxpayer's business, a more accurate depreciation method would follow the income flow and not a hypothetical useful life.[34]

The proposed solution was the "income forecast" method, where the production company estimates the total income the film or sound recording will produce. This amount becomes the denominator in a fraction whose numerator is the current year's income. This fraction times the total cost of the production masters equals the current year's depreci-

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and 200% can be selected by the taxpayer. I.R.C. § 167(b)(2), T.D. 6500, 25 Fed. Reg. 11,402, 11,537-38 (1960), *modified,* T.D. 6712, 1964-1 C.B. 106, 109.

Computation formulas are set forth in Treas. Reg. § 1.167(b)-1 through 1.167(b)-3, T.D. 6500, 25 Fed. Reg. 11,402, 11,536-41 (1960), *modified*, T.D. 6712, 1964-1 C.B. 106, 109.

The 3-year and 5-year ACRS recovery property depreciation schedules are essentially equivalent to 3- and 5-year straight line, with a slight discount in year 1 to compensate for the very generous statutory equivalent to a 3-year or 5-year useful life. I.R.C. § 168(b)(1) (1982).

Chirelstein explains that

> the newer, "accelerated" methods concentrated larger deductions in the earlier years of the asset's life and thus effected a speedier return of the greater part of the taxpayer's cost. Generally, as compared with the straight-line approach, the accelerated methods permitted deduction of about one-half the cost of an asset during the first third of its useful life, and about two-thirds of the cost over the first half of that life.

M. CHIRELSTEIN, FEDERAL INCOME TAXATION ¶ 6.07 p. 133 (3d ed. 1982) ["CHIRELSTEIN"]. A business person should buy a machine when the "present value of the expected after-tax revenues generated by the machine excee[d], or [fall] short of, the required investment . . . ." CHIRELSTEIN at 133.

32. Rev. Rul. 60-358, 1960-2 C.B. 68.

33. Rev. Rul. 64-273, 1964-2 C.B. 62 (motion picture film); Rev. Rul. 79-285, 1979-2 C.B. 91, 92 (sound recording).

34. The Treasury noted that the income distortion on tax returns was:

> caused by a strikingly uneven flow of income, earned by groups of [television] programs within the series, resulting from contract restrictions, methods of distribution and audience appeal of the programs. If the film series is a success, additional income will be forthcoming from reruns over a period of years, depending upon its popularity; whereas, unsuccessful film series may produce little or no income after the initial exhibition.

Rev. Rul. 60-358, 1960-2 C.B. 68 (1960).

ation deduction.[35] In years where contract restrictions, distribution methods and audience appeal produce a small amount of income the depreciation deduction is proportionally small. The IRS concluded that the income forecast formula provides an "acceptable method," but did not go so far as to require its use.[36] This was fortunate, since it is cumbersome in practice[37] and the denominator, "total income," only disguises the forecasting problem.

While the income forecast method admittedly provides a better match[38] between current income and the current depreciation deduction, it does not furnish a genuine solution to the problem of prognostication.

35.

TABLE 3. Income forecast depreciation method. Total income over life of film estimated at $1,000; initial fixed production costs of $100.

Year	Annual Income	Annual Income as a % of Est. Total Inc.	Depreciation Deduction as a % of Initial Cost Basis
1	$ 300	30%	30%
2	150	15	15
3	200	20	20
4	200	20	20
5	150	15	15
Total	$1,000	100%	100%

Year 1 depreciation deduction = 30% × $100 = $30.
Year 4 depreciation deduction = 20% × $100 = $20.
Computation formula is set forth at Rev. Rul. 60-358, 1960-2 C.B. 68, 69.

36. Rev. Rul. 60-358, 1960-2 C.B. 68, 69.

Section 109(c)(1) of the Technical Corrections Bill of 1985, H.R. 1800 and S. 814, narrows film depreciation options to a choice between the income forecast and straight line methods, by foreclosing selection of any of the tangible property accelerated methods set forth in § 167(b). Section 109(c)(1) provides:

> Except with respect to property placed in service by the taxpayer on or before March 28, 1985, subsection (c) of section 167 (relating to limitations on use of certain methods and rates) is amended by adding at the end thereof the following new sentence: "For purposes of the preceding sentence, any motion picture film, video tape, or sound recording shall be treated as intangible property."

131 CONG. REC. H1636, S3693 (daily ed. March 28, 1985).

37. *See infra* notes 41-43 and accompanying text.

38. The income forecast method is consistent with the popular Haig-Simons definition of income as "all accretions to an individual's net worth during the relevant accounting period." On the Haig-Simons comprehensive tax base theory, *see generally* Cooper, *The Taming of the Shrewd: Identifying and Controlling Income Tax Avoidance,* 85 COLUM. L. REV. 657, 659. But ACRS for films can be justified under the three-part Surrey-Kennedy tax equity test. For an application of the Surrey-Kennedy criteria to the motion picture industry, especially small production companies, *see generally* Note, *The Tax Reform Act of 1976 and Tax Incentives for Motion Picture Investment: Throwing the Baby Out with the Bathwater,* 58 S. CAL. L. REV. 839 (1985) ["*Tax Incentives*"]. Testifying in support of the generous tax provisions in the Tax Reform Act of 1976, Senator Edward Kennedy (D.-Mass.) suggested a three-part test first proposed by Professor Surrey of Harvard:

> 1. Are there sufficient policy reasons to justify federal expenditures in this area, whether through tax expenditures or direct subsidies?

Instead, the difficult task of estimating "useful life" has been exchanged for the arguably equal challenge of estimating "total income." The estimator's challenge is economically determined: this "total income" must be earned by the product over the period in which it remains "useful," i.e. producing income at a rate fast enough to overtake its own maintenance costs. The sum of annual incomes over the useful period constitutes "total income." In this sense the terms "useful life" and "total income" are equivalent. For example, entertainment industry products must promise a revenue stream that will justify the cost of striking new release prints, i.e. new prints will be struck until that cost is more than the anticipated revenue.

The challenge is also practical: a film or sound recording's audience appeal is ultimately beyond the control of any producer, and audience demand determines the useful life of the film or recording and the total income realized over that time. Even when a company designs its product around themes believed to have a broad and continued appeal, for example a family film or a Christmas album, there is no guarantee the product will succeed on initial release or in the future.[39]

With the income forecast method, if the creative work does not perform up to expectations, the anticipated depreciation deduction from its initial fixed production costs will have to stretch over a longer period. But if the film or sound recording does better than expected, the IRS can argue that the taxpayer has been "able to depreciate more rapidly than it should have [by] underestimating its income forecast (the denominator)."[40] This actually happened to Walt Disney Productions.[41] By adopting the income forecast method the production company can avoid a dispute with the IRS about useful life, but now it faces the double risk of low income *and* a low depreciation deduction if the product performs

2. If there is a need for federal expenditures, can it be done most effectively and efficiently through direct subsidies or through tax expenditures?
3. If tax expenditures are the best method, is the particular form of expenditure the fairest and most efficient distribution of the tax subsidy?

Tax Incentives at 843. Because these criteria equate tax break expenditures and direct budget expenditures, "[t]hey force legislatures to ask whether . . . the government should be supporting the activity in question and . . . whether the proposed method of support is effective . . . ." *Tax Incentives* at 843.

39. Only one out of ten films is successful; two break even and the other seven lose money. *Tax Incentives, supra* note 38 at 846. "Films are financed and shot twelve to eighteen months before they are released, in which time popular tastes may change." *Id.* at 860.

40. *Disney II,* 1975-2 U.S. Tax Cas. (CCH) ¶ 9824 at 88,635.

41. *Id.* The IRS sought an adjustment to depreciation deductions previously allowed to Walt Disney Productions on three 1970 master film negatives (*see supra* note 8) to include unanticipated income from "world-wide television release, initial world-wide theatrical release and possible theatrical re-release." *Id.*

poorly, or the threat of tax deficiency if it does well. Since under the income forecast method the "estimated income . . . should be based on the conditions known to exist at the end of the period for which the return is made,"[42] the taxpayer practically guarantees himself the need for an annual review and possible recalculation before filing each tax return. The guarantee is almost ironclad. Absent the Commissioner of Internal Revenue's explicit consent to a change, the production company's election of the income forecast method for a particular film property is binding for depreciation calculations in all subsequent years.[43]

The elusive nature of any future year's precise depreciation deduction also poses a problem of tax equity. Once useful life has been disguised as total income, an otherwise knowledgeable taxpaying citizen (or legislator) cannot easily evaluate the relative generosity of the film or sound recording producer's depreciation tax benefit. Income forecast formula results do not lend themselves to tabular comparison with fixed percentages.[44] This is a drawback, since perceived fairness is at the threshold of the tax equity issue.[45]

In 1981 the Congress appeared to offer the taxpayer some relief from the problems of estimating useful life and total income, and defending these estimates from IRS challenge. The mechanism was new Code section 168,[46] which set forth an "Accelerated Cost Recovery System" ("ACRS") where eligible "recovery property" could be depreciated at rates even more favorable than those available under section 167(b). Here the acceleration was accomplished "by substituting sharply abbreviated depreciation schedules for the 'useful life' limitation that ha[d] governed the depreciation allowance in the past."[47] The taxpayer was allowed to deduct approximately twenty percent per year in the case of five-year recovery property,[48] which included motion picture films and

42. Rev. Rul. 60-358, 1960-2 C.B. 68, 69.

43. *See, e.g.,* Riester v. Comm'r, 49 T.C.M. 1985-46 (CCH) 621, 623 (initial election of income forecast method by motion picture limited partnership was binding in future years).

44. Compare Tables 1 and 2 with Table 3, *supra* notes 31 and 35.

45. Congressman Siljander (R.-Mich.) remarked,

> [T]he American people want . . . a simple, fair tax system that requires everyone to pay their fair share of taxes. The elite, through sophisticated tax lawyers and tax loopholes can avoid paying taxes which leaves the massive burden on the middle-income American.

130 CONG. REC. H2601 (daily ed. April 11, 1984).

46. I.R.C. § 168 (1982). Section 168(a) states that "[t]here shall be allowed as a deduction for any taxable year the amount determined under this section with respect to recovery property." The applicable percentages for the 3-year and 5-year classes of recovery property are set forth *supra* at note 31, Tables 1 and 2.

47. CHIRELSTEIN, *supra* note 31 at ¶ 6.08 p. 139.

48. *See supra* note 31, Table 1.

video tapes.[49] Now the production company could lock in an approximation to five-year straight line depreciation in advance, without reference to salvage value and without the burden of showing a proximate relationship between this five-year period and the possibly longer service life of the asset. Moreover, there was no need for annual recalculation of the depreciation deduction depending on the fortuities of that year's income.

While ACRS could be criticized, as could earlier class life systems, on the grounds that the abbreviated useful lives were fictional,[50] the principle of fixed life has utility: the interested taxpayer or legislator had no trouble comparing tax benefits because each type of property was to be depreciated over a period determined in advance. The ACRS system was extended to every major American industry.[51]

But ACRS was very costly in terms of foregone tax revenue, so much so that in the Tax Reform Act of 1984 Congress yielded to pressure from the Treasury Department[52] and certain of its own tax committee members.[53] In its newfound zeal to reduce the budget deficit, to rein

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49. I.R.C. § 168(c)(2)(B) (1982).This subsection states that "[t]he term '5-year property' means recovery property which is section 1245 class property and which is not 3-year property, 10-year property, or 15-year public utility property." Since films were never assigned a class life they are not 3-year or 10-year property. Pursuant to § 1245, films are "personal property . . . of a character subject to the allowance for depreciation provided in section 167." I.R.C. § 1245(a)(3)(A) (1982).

50. The *Disney I* trial court observed that "[d]epreciation and its use as a 'tax shelter' has a sufficient history to make one thing clear—that depreciation—as permitted by the tax laws—really has no true relationship to the life of the item depreciated—either useful or otherwise." *Disney I,* 327 F. Supp. at 191.

51. *Id.*; I.R.C. § 168(e)(1)-(4) (1982). The limitations were drafted narrowly, mainly to exclude property in which the taxpayer had an interest before January 1, 1981 from application of the rapid ACRS depreciation method.

52. The House Ways and Means Committee held hearings on the Treasury Department's proposed tax shelter and other tax reform provisions on February 22 and 28, 1984. H.R. REP. NO. 432, 98th Cong., 2d Sess. —, 1025 n.1, *reprinted in* 1984(3) U.S. CODE CONG. & AD. NEWS 697, 711 n.1.

53. Representative Dan Rostenkowski (D.-Ill.), Chairman of the House Ways and Means Committee, noted three tax reform goals: first, "repair" of certain Code sections to reflect higher interest and inflation rates, and reduction of tax incentives that had proven ineffectual or too expensive for the results achieved; second, the need to raise sufficient revenue, and in an equitable manner; and third, "to demonstrate to the Nation that Congress is willing and able to confront such problems." The Chairman characterized the 1984 tax reform act as "a start—a downpayment." 130 CONG. REC. H7085, (daily ed. June 27, 1984), *reprinted in* 1984(3) U.S. CODE CONG. & AD. NEWS 2140-41.

On the same day, Senator Robert Dole (R.-Kan.), Chairman of the Senate Finance Committee, characterized the thrust of the legislation as "deficit reduction." "Eighty percent of the tax package is closing loopholes." The Senator echoed President Reagan's concern, as expressed in a letter dated June 27, 1984 (reprinted in the Record), that the Act contain "meas-

in tax shelters,[54] and to close tax loopholes in the interest of a more favorable public image for our tax system,[55] Congress acted on legislation proposed by Senator R. Dole, Chairman of the Senate Finance Committee, to foreclose any further application of the ACRS system to motion picture and videotape production costs.[56] The proposed new Code subsection 168(e)(5) consisted of a brief declarative sentence: "[t]he term 'recovery property' shall not include any motion picture film or video tape."[57]

Seven days after Senator Dole proposed this new subsection 168(e)(5), Senator Pete Wilson (R.-Cal.) protested from the Senate floor that "without any public notice to impacted tax payers and no discussion of the provision in the [Senate Finance] committee, the Finance Committee has retroactively repealed ACRS for motion pictures. No adequate transitional rule is provided."[58] The Senator complained that "[n]othing generally available to taxpayers, including the committee press release announcing its decisions, gave any indication that movies would lose the right to claim ACRS. The result became known only when the statutory language became available."[59]

Noting that his proposed floor amendment for a transitional rule for films placed in service in 1984 had been "cleared with the majority, the

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ures to close tax loopholes of questionable fairness." 130 CONG. REC. S8373 (daily ed. June 27, 1984), *reprinted in* 1984(3) U.S. CODE CONG. & AD. NEWS 2140-41.

54. *See* STAFF OF JOINT COMM. ON TAXATION, 98TH CONG., 2D SESS., PROPOSALS RELATING TO TAX SHELTERS AND OTHER TAX-MOTIVATED TRANSACTIONS, SCHEDULED FOR HEARINGS BEFORE THE COMM. ON WAYS AND MEANS ON FEBRUARY 22 AND 28, 1984 (Joint Comm. Print 1984) ["TAX SHELTERS"]. The staff noted that with respect to factors influencing the supply of tax shelters, it was the combination of ITC, ACRS and debt financing, not one of these alone, that caused the value of an investment's deductions to exceed the present value of its pre-tax income. Tax deductions that greatly exceed pre-tax income encourage asset users to lease from partnerships, where the owners (often limited partners) are better able to use the tax write-offs and credits. TAX SHELTERS at 10.

The staff also noted that the growth of tax shelters may have had an adverse impact on tax system efficiency, since shelter activity "has significantly reduced the tax base over time, which has contributed both to higher deficits and the need for higher tax rates." TAX SHELTERS at 13. *See also, Abusive Tax Shelters: Hearing Before the Subcomm. on Oversight of the Comm. on Ways and Means, House of Representatives*, 97th Cong., 2d Sess. (1982).

See Tax Incentives, supra note 38 at 860, 867 for a discussion of how to control film tax shelter abuse without impairing desirable production and employment incentives. Two common outside investor (tax shelter) financing methods are "negative pickup" and "service partnership." Most abuses occurred with the negative pickup method. *Tax Incentives* at 860.

55. TAX SHELTERS, *supra* note 54, at 13.

56. Dole (and Long) Floor Amendment No. 2902, § 173, to H.R. 2163, 130 CONG. REC. S3921-4070 (daily ed. April 5, 1984). *See* S3923, 3975.

57. 130 CONG. REC. S3975 (daily ed. April 5, 1984).

58. 130 CONG. REC. S4543 (daily ed. April 12, 1984).

59. *Id.*

minority, and the Treasury," Senator Wilson was able to persuade the Senate to agree to it.[60] This amendment appeared in substantially the same form in the bill subsequently approved by the House of Representatives, and then signed into law by President Reagan on July 19, 1984.[61] But this concession was small consolation—among users of long-term investment capital, film production companies were in effect singled out by the Ninety-eighth Congress for the harsh treatment entailed by outright abolition (rather than modification) of a favorable tax provision. This was unfortunate, since the Senate Finance Committee estimated that abolishing ACRS for films would "increase budget receipts by less than $10 million annually."[62]

In introducing his transitional rule, Senator Wilson observed that in abolishing ACRS for motion pictures, the Finance Committee had "summarily repeal[ed] the Ninth Circuit *Disney* case."[63] The Finance Com-

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60. *Id.* The purpose of the transitional rule was to protect from the Tax Reform Act's retroactive effect any film producer who had elected five-year ACRS treatment for a film placed in service prior to the end of 1984 if he expended more than 20% of the production costs before March 16, 1984.

61. Tax Reform Act of 1984, Div. A of the Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 113(c)(2)(A), 98 Stat. 494, 635-38. CALENDARS OF THE UNITED STATES HOUSE OF REPRESENTATIVES AND HISTORY OF LEGIS. 10-29, 98th Cong., 2d Sess. (daily ed. July 23, 1984).

62. COMMITTEE ON FINANCE, UNITED STATES SENATE, DEFICIT REDUCTION ACT OF 1984, EXPLANATION OF PROVISIONS APPROVED BY THE COMMITTEE ON MARCH 21, 1984, S. PRT. 169, 98th Cong., 2d Sess. 468 (Comm. Print 1984) ["FINANCE COMMITTEE REPORT"].

The Joint Committee on Taxation did not characterize the application of ACRS to films as a tax shelter abuse, but only as a technical misunderstanding to be corrected in the 1984 tax reform legislation:

> Under E[conomic] R[ecovery] T[ax] A[ct of 1981, Pub. L. No. 97-34], personal property of a character subject to the allowance for depreciation which is placed in service by a taxpayer after December 31, 1980, generally qualifies as recovery property, eligible for depreciation under ACRS. Most personal property qualifying as recovery property can be depreciated, on an accelerated basis, over 3 or 5 years.
>
> However, under section 168(c)(2), recovery property includes only tangible property. Furthermore, under section 168(e), recovery property, for depreciation purposes, generally does not include tangible depreciable property which the taxpayer elects to depreciate under the unit-of-production method, the income forecast method, or any other method of depreciation not expressed in a term of years.
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> . . . .
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> The language of prior law was unclear as to whether films (including video tapes) were generally to be treated as tangible personal property. While it was held that negatives of feature films qualified as tangible personal property for regular investment credit purposes (see, e.g., *Walt Disney Productions v. United States*, 480 F.2d 66 (9th Cir. 1973), cert. denied, 415 U.S. 934 (1974), Treas. Reg. § 1.48-1(f) is to the contrary.

JOINT COMMITTEE ON TAXATION, GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE DEFICIT REDUCTION ACT OF 1984, JT. COMM. PRINT 41, 98th Cong., 2d Sess. 336-37 (1984).

63. 130 CONG. REC. S4543 (daily ed. April 12, 1984).

mittee Report accompanying proposed section 168(e)(5) noted that the Ninth Circuit held in 1973 that negatives of feature films qualified as tangible personal property in *Walt Disney Productions v. United States* [*Disney I*], and that the Supreme Court had denied certiorari in 1974, even though the relevant Treasury Regulation [1.48-1(f)] stated that motion picture or television film or video tapes were intangible.[64]

Senator Wilson's remark from the floor about Congress's summary repeal of *Disney III* through new Code section 168(e)(5)[65] was not strictly accurate for two reasons. First, the *Disney* cases only addressed the issue of tangibility with respect to the ITC, not with respect to allowable depreciation methods. The Congress has analogized from one to the other. Second, new Code subsection 168(e)(5) itself does not address tangibility or ITC. While it does deny the five-year recovery property status as set forth in section 168 to film master negatives, the new subsection says nothing about the applicability to motion pictures of the accelerated, declining balance or sum of the years' digits depreciation methods available for tangible property under subsection 167(b).[66] As enacted, the Tax Reform Act of 1984 leaves section 167(c) accelerated methods open to films and sound recordings.

Nevertheless, Senator Wilson's remark was prophetic in light of legislative developments during in the First Session of the Ninety-ninth Congress. In March 1985 Rep. D. Rostenkowski, Chairman of the House Ways and Means Committee, and former Senate Finance Committee Chairman Senator R. Dole introduced the companion bills H.R. 1800 and S. 814, the "Technical Corrections Bill of 1984."[67] In identical language, the bills amend Internal Revenue Code section 167(c) by adding at the end the following new sentence: ". . . any motion picture film, video tape, or sound recording shall be treated as intangible property."[68] The accompanying Joint Committee on Taxation report explains that "[t]hus, accelerated depreciation methods available under section 167(c) only with respect to tangible property [i.e. declining balance, sum of the years-digits and comparable methods] are not available.

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64. FINANCE COMMITTEE REPORT, *supra* note 62, at 467.

For the Senator, tangibility with respect to ITC was most likely the equivalent to tangibility for depreciation purposes. Rationally one could expect them to be treated in parallel fashion. One could also hope for this from the viewpoint of tax simplicity.

65. New subsection 168(e)(5) states that "[t]he term 'recovery property' shall not include any motion picture film or video tape." I.R.C. § 168(e)(5) (West Supp. 1986).

66. I.R.C. § 167(b) (1982).

67. 131 CONG. REC. H1630 (daily ed. March 28, 1985); 131 CONG. REC. S3687 (daily ed. March 28, 1985).

68. The amending language is found in § 107(c) of both bills. *See supra* note 4.

However, the income forecast method or similar methods of depreciation are available."[69] Where the owner or owners of a sound recording have failed to elect the three-year recovery property treatment under section 48(r), they likewise will find accelerated tangible depreciation options foreclosed.

It would appear that the Congress, or at least the two influential tax committee members, are moving toward endorsement of the Treasury's consistently held position, articulated first in Treasury Regulations section 1.48-1(f)[70], and then in the *Disney* cases[71] and the *EMI* case[72]. Film and sound recording masters are intangible property, rather than tangible "machines" producing a copyrighted product. The persistent Treasury may finally obtain through Congress what the federal courts, in eleven years of litigation against the entertainment industry, denied it as a matter of legal principle.

Paradoxically, in the 1984 Tax Reform Act the Congress, once again acting on provisions supplied by the Senate Finance Committee,[73] granted the sound recording industry a depreciation option quite similar to the one just denied the film industry. The taxpayer was given the option to elect the ITC and a three-year ACRS recovery period in which to depreciate the sound recording master tape through new Code subsection 48(r).[74]

Senators Wilson and Cranston suggested a floor amendment[75] to the proposed new subsection 48(r), to include certain contingent costs, residuals and royalties that the Finance Committee had excluded from ITC and three-year recovery property treatment.[76] When Senator H. Metzenbaum (D.-Ohio) opposed this amendment,[77] Senator Cranston pointed out that under the existing 1984 Tax Reform Bill language, rec-

69. JOINT COMMITTEE ON TAXATION, DESCRIPTION OF THE TECHNICAL CORRECTIONS ACT OF 1985 (H.R. 1800 AND S. 814), JT. COMM. PRINT 7, 99th Cong., 2d Sess. 27 (1985).

70. *See supra* note 12 and accompanying text.

71. *Disney I, Disney II* and *Disney III.*

72. EMI North America Holdings v. United States, 675 F.2d 1068 (9th Cir. 1982).

73. *See supra* note 46 and accompanying text.

74. One might have expected the sound recording recovery property provision to appear somewhere in § 168, which sets forth the ACRS system, or even in § 280(c), which defines sound recordings, instead of § 48, which deals almost exclusively with the ITC. The Joint Committee, however, took pains to state that since "sound recordings do not qualify as recovery property unless an election is made under section 48(r)(1) (relating to treating a sound recording as 3-year property). Thus, their costs cannot be recovered under ACRS." JOINT COMMITTEE ON TAXATION, DESCRIPTION OF THE TECHNICAL CORRECTIONS ACT OF 1985 (H.R. 1800 AND S. 814), JT. COMM. PRINT 7, 99th Cong., 2d Sess. 27 (1985).

75. Amendment No. 2986. 130 CONG. REC. S4491 (daily ed. April 12, 1984).

76. *Id.* at S4491.

77. *Id.* at S4492.

ord companies that specialize in developing new talent by recording as yet unrecognized artists were at a disadvantage. This type of company customarily makes a modest "trial effort" with a new artist, and will only issue a "considerably greater release" after some promising initial acceptance. He warned that "if our amendment is not adopted, smaller companies will be at a disadvantage as against those who are now famous and who have no difficulty with new recordings."[78]

Senator Cranston stated that:

> [allowing these contingent costs for the rerelease would] even the playing field for the record industry, permit[ting] the smaller firms to compete effectively against the giants. [The proposed amendment would] keep the door open [for the] many, many musicians in my State of California who work day and night for the opportunity for recognition.[79]

The Congress agreed with Wilson and Cranston; the substantial equivalent of their floor amendment was passed into law with the rest of the 1984 Tax Reform Act.[80]

Ironically, the appeals Cranston made on behalf of small recording producers and hardworking performers apply equally well to independent motion picture production, as a recent Note has documented.[81]

In a 1982 case, *EMI North America Holdings v. United States,* the Ninth Circuit had extended, without elaboration, the tangibility rationale developed in the *Disney* film cases to sound recordings.[82] There the court applied the "long-established"[83] *Disney* precedents to EMI's dispute with the IRS over ITC for capital expenditures incurred in producing master sound recording tapes. Without further discussion, in *EMI* the court held that "[b]ecause master prints of movies and master sound tapes are functionally identical, no principled distinction can be drawn between the authorities cited[84] and the present controversy."[85]

The absence of a principled distinction that could have justified the grant of three-year recovery property status to sound recording masters

78. *Id.* at S4491.

79. *Id.* at S4492 (statement of Sen. Cranston).

80. It now appears as I.R.C. § 48(r)(6)(C) (West Supp. 1986).

81. *Tax Incentives,* supra note 38.

82. EMI North America Holdings v. United States, 675 F.2d 1068 (9th Cir. 1982).

83. 675 F.2d at 1069.

84. The court cited *Bing Crosby, Disney III, Disney I,* and *Texas Instruments. Id.*

85. The Congress acted consistently with this court's perspective when it exempted *both* films and sound recordings from the rules for predominant use outside the United States (§ 48(a)(2)) and for amounts at risk (§§ 48(c)(8)-(9), 465) in the Tax Reform Act of 1984. Pub. L. No. 98-369, §§ 113(a)(3) (films) and 113(b)(3) (sound recordings), 98 Stat. 494, 635-38.

and the simultaneous denial of five-year recovery property status to film masters was not raised on the Senate floor or in the committee prints. As a result, the Tax Reform Act of 1984 left the entertainment industry with an uneasy, unarticulated compromise. Now motion pictures and videotapes could only be depreciated under section 167 and not 168, but the accelerated methods set forth in section 167(b) were still available (hence the "tin Oscar").[86] Nevertheless, sound recordings were now guaranteed the very favorable three-year depreciation schedule by new subsection 48(r) (hence the "bronze Grammy").[87]

How long this compromise lasts currently depends on the Ninety-ninth Congress's feeling about film industry provisions set forth in the companion House and Senate bills H.R. 1800 and S. 814[88], the "Technical Corrections Bill of 1984." Will this Congress, mindful that the film industry has lost five-year ACRS in the Ninety-eighth's Tax Reform Act of 1984, now preclude use of the accelerated forms of depreciation available under section 167(b)?[89] The sound recording industry would face this same loss of all accelerated depreciation methods whenever the three-year recovery property election is not made.[90]

The 'Tax Reform Act of 1985," pending bill H.R. 3838,[91] would scale back the depreciation benefits available under ACRS uniformly across major industries. Nevertheless, passage of the "Technical Corrections Bill" would force the entertainment industry, unlike any other major American industry, into an unwholesome choice between the modest straight line depreciation benefits available under section 167(a), and the inherently problematic income forecast method available under section 167(b).

Consequently, all film and recording production companies would experience a loss of financial planning flexibility and would lose ground relative to other American industries in competing for investment capital. Within the film industry, the problem of concentration of production in the hands of a few major studios, an antitrust problem the government has addressed since the late 1930s, would be exacerbated.[92]

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86. *Supra* note 1.

87. *Supra* note 2.

88. *See supra* notes 4, 67 and accompanying text.

89. *See supra* note 6.

90. *See supra* note 67 and accompanying text.

91. H.R. 3838, § 201, 131 CONG. REC. H12597 (daily ed. December 17, 1985).

92. United States v. Paramount Pictures, 334 U.S. 131 (1947). In 1947, after two decades of litigation the Supreme Court affirmed a consent decree between the Justice Department and the major studios. The decree required that they divest themselves of their theaters, while allowing them to retain their production and distribution operations. It was hoped that this

The "Tax Reform Bill of 1985," H.R. 3838, also contains provisions abolishing the ITC in its entirety.[93] If the 1985 Tax Reform Bill and the Technical Corrections Bill become law, the Treasury's victory over the motion picture and sound recording industries, especially the small production companies, will have been made complete in one legislative session.

*Raymond L. Towne**

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divestiture would lead to new entrants into the production field. *Tax Incentives, supra* note 38 at 847.

Since the 1976 Act, "independent production has declined fifty-eight percent while major studio production has remained relatively stable." *Id.* See Table at 864. Now that independent film producers have lost five-year ACRS in the 1984 Act and stand to lose more in pending 1986 legislation, the same antitrust conditions which the government sought to remedy in 1947 may exist again by 1987.

93. H.R. 3838, § 211, 131 CONG. REC. H12597 (daily ed. December 17, 1985).

In December 1985 Rep. J. Duncan (R.-Tenn.) proposed H.R. 3879, an "amendment in the nature of a substitute" for H.R. 3838. 131 CONG. REC. H12736. This "Republican substitute," 131 CONG. REC. H12801, for the Ways and Means bill H.R. 3838 sponsored by chairman Rostenkowski, was soundly defeated, H12824, immediately before the House passed H.R 3838 on a voice vote, H12826. Perhaps H.R. 3879 would have fared better had Rep. Duncan garnered film and sound recording industry support for his attempt to preserve the ITC for "qualified domestically produced . . . tangible property which . . . is manufacturing [or] production . . . machinery or equipment," H12752.

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