

Draft of October 23, 2006

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[REG-115403-05]

RIN 1545-BF95

Section 181 - Deduction for Film and Television Production Costs

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to deductions for the cost of producing film and television productions under section 181. These temporary regulations reflect changes to the law made by the American Jobs Creation Act of 2004 and the Gulf Opportunity Zone Act of 2005, and affect taxpayers that produce films and television productions within the United States. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section in this issue of the **Federal Register**.

DATES: Effective Date: These regulations are effective **[INSERT DATE OF PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

Applicability Dates: For dates of applicability, see §1.181-6T.

FOR FURTHER INFORMATION CONTACT: Bernard P. Harvey, (202) 622-3110 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These temporary regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collections of information contained in these regulations have been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545-XXXX. Responses to these collections of information are required to obtain a tax benefit.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

For further information concerning these collections of information, and where to submit comments on the collections of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble of the cross-referencing notice of proposed rulemaking published in the Proposed Rules section in this issue of the **Federal Register**.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains amendments to 26 CFR part 1 to provide regulations under section 181 of the Internal Revenue Code of 1986 (Code). Section 181 was added to the Code by section 244 of the American Jobs Creation Act of 2004, Pub. L. No. 108-357 (118 Stat. 1418) (Oct. 22, 2004), and was modified by section 403(e) of the Gulf Opportunity Zone Act of 2005, Pub. L. No. 109-135 (119 Stat. 2577) (Dec. 21, 2005).

Explanation of Provisions

For several years, independent filmmakers and television producers have moved production activities from the United States to other countries. Frequently, this has been motivated by credits and incentives offered by foreign governments to attract the economic benefits gained by hosting these productions. Congress enacted section 181 to make domestic production more attractive to these taxpayers.

Section 181 permits the owner of a qualified film or television production to elect to deduct production costs in the year the costs are paid or incurred in lieu of capitalizing the costs and recovering them through depreciation allowances if the aggregate costs do not exceed \$15 million for each qualifying production (\$20 million if a significant amount of the production costs are incurred in certain designated areas) (the “production cost limit”). A film or television production qualifies for the section 181 deduction if 75 percent of the total compensation of the production is compensation for services performed in the United States by actors, directors, producers, and other relevant production personnel (the “75 percent test”).

Allowance of deduction

The deduction under section 181 is allowed for the cost of producing qualifying films and television productions for which principal photography begins after October 22, 2004, and before January 1, 2009. Production costs incurred before or after this period may be deducted so long as principal photography commences during the period.

Section 181 refers only to “the taxpayer” with respect to who makes the election and takes the deduction. The temporary regulations provide that only the owner of a qualified production may elect to deduct production costs under section 181. Under the regulations, the owner of the film or television production is deemed to be the person or persons otherwise required to capitalize production costs into the basis of the film or television production under section 263A (or the person or persons that would be required to be capitalize production costs if subject to section 263A).

The production costs that must be taken into account (for both the amount of the deduction and for the dollar limitation on production costs) are the amounts that, absent section 181, are required to be capitalized under section 263A (or the amounts that would be required to be capitalized if the taxpayer was subject to section 263A).

Although a film’s budget might be evidence that the production costs will not exceed the production cost limit, the budget is not the same as production costs for purposes of section 181. All costs eligible to be deducted under section 181 are subject to the production cost dollar limitation of section 181(a)(2). Under the temporary regulations, distribution costs are specifically excluded from the definition of production costs under section 181, consistent with the exclusion of distribution costs under section 263A.

Section 181 does not require the production to be placed in service in order for the producer to begin deducting capital costs incurred in production, and there is no requirement that the production ever be placed in service or completed. However, the temporary regulations require that, at the time the deduction is claimed, a taxpayer must have a reasonable basis for believing that the production will be a qualified production and must have a reasonable basis for believing that the cost of the production will not exceed the production cost limit. For instance, a taxpayer that has developed a shooting script, has a well-documented budget, and has obtained financing on the basis of these facts is in a good position to determine whether it has a reasonable basis to claim the deduction.

The temporary regulations treat the cost of acquiring a production as a production cost. This rule is premised upon the understanding that under section 1245, the seller would recapture upon the sale of the production any section 181 deduction it had claimed. In the case of a sale between related parties, the purchaser must treat the greater of the acquisition cost or the seller's production cost as the purchaser's production cost for purposes of the production cost limitation, notwithstanding that the purchaser's deduction under section 181 is based on the purchaser's actual acquisition cost. We request comments on this issue.

In the film industry, once a prospective producer has determined the estimated budget for a production, it usually must obtain financing from a bank or other lender to cover at least part of the cost of production. The producer may incur up-front costs in obtaining such financing. The producer's pre-sale agreements with distributors may be used as collateral for this financing. Generally, the financier will be repaid directly by

these distributors upon delivery of the finished production. In addition, the financier will usually require that the producer obtain a completion guarantee (often referred to as a completion bond) as a condition of the loan. The completion guarantee is a guarantee that, if the production costs exceed the budgeted costs or the loan proceeds are mishandled, the film will still be completed and/or the financier will be made whole. A completion guarantee can be satisfied in a number of ways. For example, the guarantor may loan funds to the producer to finish the production, may finish the production itself (although this is rare), or may reimburse the financier for the amount loaned to the producer (plus interest and other charges). Generally, the producer must pay an up-front amount in order to obtain a completion guarantee.

The temporary regulations provide that the costs of obtaining financing, including premium costs for completion guarantees, are production costs that are subject to the production cost limit and are deductible under section 181. In addition, if the completion guarantor loans additional funds to the producer and the funds are expended by the producer to complete the production, or if the completion guarantor incurs additional production costs on its own behalf, the additional funds are production costs under section 181. Participations and residuals (P&R) are defined in section 167(g)(7)(B), as costs with respect to an item of property described in section 167(g)(6), the amount of which by contract varies with the amount of income earned in connection with the property. In the context of film and television production, participations are payments to actors, directors, and other talent based on a contractually-defined measure of future income from the production. Residuals are payments made under collective-bargaining agreements to directors' and actors' guilds based upon non-theatrical sales, under

terms that differ between video, free television, and pay television sales. Participations are generally paid by the producer but may be assumed by a third-party distributor. On the other hand, residuals are generally paid by a distributor out of its gross receipts from the production. Industry accounting generally treats participation payments made by distributors as a reduction in the producer's profit rather than a cost of production, and generally treats residual payments made by distributors as a distribution cost.

Various comments were received with respect to the treatment of P&R under section 181. Some comments suggested that taxpayers be permitted to elect to deduct participation payments (rather than capitalizing those payments into the basis of the production) under the income forecast method rather than section 181. Other comments suggested that Congress, by specifically excluding P&R costs paid or incurred by the taxpayer from the definition of "qualified compensation" in section 181(d)(3), intended these costs to be excluded from the production cost limit in section 181(a)(2). Comments received also suggested that P&R costs excluded from the production cost limit should nonetheless be deductible production costs under section 181. In addition, various comments expressed concern that including P&R costs in the calculation of the production cost limit could require unexpectedly successful productions to be retroactively disqualified from section 181.

The temporary regulations provide that P&R costs are considered production costs for purposes of section 181. The IRS and Treasury Department believe that the statute requires P&R costs to be included in the production cost limitation. For example, the statute specifically provides that participations and residuals are excluded from the definition of compensation for purposes of determining whether the film or television

production was a qualified film as defined in section 181(d)(1). This explicit exclusion is not found in the production cost limit of section 181(a)(2) or elsewhere in section 181.

In addition, the IRS and Treasury are concerned that if P&R costs were excluded from the definition of production costs under section 181, section 181(b) could cause them to be nondeductible under any provision of the Internal Revenue Code.

Specifically, section 181(b) states that no depreciation or amortization deduction other than the deduction provided under section 181 is allowed for the basis of a qualified film or television production for which an election has been made. Therefore, if P&R costs were excluded from the definition of production costs under section 181, a taxpayer wishing to expense P&R costs under the holding of Associated Patentees may be barred from doing so under section 181(b), as the holding in that case is explicit that a deduction under Associated Patentees is a depreciation deduction of basis.

Additionally, the IRS and Treasury are concerned that a blanket exclusion of participations from the definition of production costs would allow taxpayers to manipulate the total cost of a production (and avoid the production cost limitation) by structuring compensation as participation payments. Commentators argued that this potential abuse could be mitigated with an anti-abuse rule that treats only those participations that are disguised non-contingent or guaranteed payments, where the talent incurs minimal risk of non-payment (for example, participations with a payment priority over distribution cost repayment and/or production financing cost repayment) as production costs subject to the production cost limitation, but does not treat other participation costs as production costs.

The IRS and Treasury Department considered excluding from the amount to be taken into consideration under section 181 any residuals (payments to actors' or directors' guilds based on gross income from exploitation in secondary markets) that are paid by the distributor or other third party, under the theory that these payments are costs of exploiting the finished production. However, the same argument could be advanced for participations contingent on income, notwithstanding that most participations are taken in lieu of compensation for services (normally a production cost). In addition, a payment of residuals by a third party is still made on the producer's behalf, and the producer remains the party with ultimate liability for the payment. Thus, the temporary regulations provide that P&R costs are production costs that are deductible under section 181 and are included in the production cost limit.

Section 181(a)(2)(B) provides a higher production cost limitation for a qualified film or television production "the aggregate cost of which is significantly incurred" in a designated area. Designated areas include areas eligible for designation as low-income communities or certain distressed counties and isolated areas. However, neither the statute nor its legislative history provides a definition for "significantly incurred," nor do they explain how the standard should be applied. However, Congress' stated intent in enacting section 181 was to encourage economic activity in these designated areas. Accordingly, the temporary regulations provide two different tests for establishing when production costs have been significantly incurred in a designated area. One test is based upon production costs while the other is based upon days of production. Under the first of these tests, the temporary regulations establish a 20 percent threshold for the "significantly incurred" standard (similar to the rules of §1.199-3(f)(3)). This test

compares costs incurred in first-unit principal photography that takes place in a designated area to all costs incurred for first-unit principal photography. First-unit principal photography typically films the primary actors, whereas second-unit principal photography typically films shots that establish location or context (exteriors of buildings, crowds, cars passing, etc.). Costs of principal photography include, for example, compensation to actors, directors and other production personnel, location costs, camera rental and insurance, and catering. This 20 percent test is based upon costs incurred in first-unit principal photography and ignores all other production costs such as preproduction, editing, and postproduction costs for purposes of the "significantly incurred" requirement. These other production costs often greatly exceed principal photography costs, and must be incurred where adequate production facilities exist (and it is likely that few such facilities are available in the designated areas). The IRS and Treasury Department believe that if all production costs were taken into consideration in determining whether the 20 percent "significantly incurred" threshold had been met, very few films would qualify for the additional production cost limitation, even if a substantial amount of principal photography occurred in a designated area. However, we request comments regarding whether the exclusion of preproduction, editing, and postproduction costs will unfairly impact taxpayers.

Comments were received requesting that consideration be given to developing a "significantly incurred" test based upon the number of days of principal photography. The temporary regulations adopt this suggestion and provide, as an alternative to the 20 percent cost-based test, a "significantly incurred" test based upon the total number of days of principal photography. Under this test, if at least 50 percent of the total days of

principal photography take place in a designated area, the production will be deemed to have satisfied the "substantially incurred" requirement of section 181(a)(2)(B). This 50 percent test may provide a simpler computation than the 20 percent cost-based test referenced above, and avoids issues such as the allocation of salaries to specific days of principal photography.

A taxpayer intending to utilize the \$20 million deduction limit under section 181(a)(2)(B) for a production must maintain records adequate to demonstrate that it has a reasonable basis under the "significantly incurred" standard to support claiming the additional deduction.

Election

The Conference Report underlying section 181 provides that, until the Secretary publishes specific guidance, taxpayers may make a valid election under section 181 by claiming the deduction on the taxpayer's return for the year that production costs are first incurred. The IRS published the section 181 election requirements in Notice 2006-47 (2006-20 IRB 892, May 15, 2006). The Notice also includes transition rules for taxpayers that incurred costs during the period prior to October 22, 2004 (the enactment of section 181) for productions that qualify under section 181 (that is, productions for which principal photography began on or after October 22, 2004). The temporary regulations provide the same election requirements and transition rules, along with a requirement that the taxpayer have a reasonable basis for claiming the deduction and a requirement that electing taxpayers identify any other owners of the production.

Many films do not have a single owner (or are owned by a passthrough entity with more than one owner). The temporary regulations provide that if the production is

owned by a partnership, the election is made at the partnership level. In the case of a joint venture or other cost sharing arrangement that is not a partnership, the election by one taxpayer is binding on all owners. Moreover, the section 181(a)(2) cost limit applies to the aggregate production cost of the production as whole, notwithstanding the fact that production costs may be incurred by more than one owner.

The temporary regulations provide that a taxpayer that claims a deduction under section 181 without complying with the election requirements nonetheless will be deemed to have made a proper election under section 181, and will be subject to the other rules and restrictions in these regulations.

Section 181(c)(2) provides that an election under section 181 may not be revoked without the consent of the Secretary. However, the election is effectively revoked if the production costs exceed the production cost limit or if the production otherwise fails to be a qualified production. In recognition of the concerns expressed by commentators over the inclusion of P&R costs in the definition of production costs under section 181, and the fact that the requirements of section 181 may ultimately not be met, notwithstanding a prior reasonable basis for believing otherwise, the temporary regulations permit taxpayers to revoke a section 181 election by filing a statement with the return for the taxable year in which the revocation is effective identifying the production for which the election is revoked. The return for that taxable year must also report compliance with the recapture provisions discussed in Special Rules, below.

Qualified film or television production (definitions)

Both the Senate report and the Conference report underlying section 181 state that "the provision defines a qualified film or television production as any production of a

motion picture (whether released theatrically or directly to video cassette or any other format); miniseries; scripted, dramatic television episode; or movie of the week" that satisfies the 75 percent test. The definition provided in the Senate report and the Conference report would exclude programs that do not fall within these delineated categories, such as reality programming, documentaries, sports programs, news programs, variety shows, game shows, live performances, interview and talk shows, commercials and "infomercials," religious/inspirational programming, educational programming, exercise shows, training videos, and others. Comments were received noting that it appeared from the legislative history that Congress only intended for the provision to apply only to a motion picture, miniseries, scripted dramatic television episode, or movie of the week. Notwithstanding the legislative history, section 181(d) itself defines a qualified film or videotape as "property described in section 168(f)(3)" that satisfies the 75 percent test. Section 168(f)(3) property is "any film or video tape." Accordingly, the temporary regulations adopt the broader statutory definition provided in section 168(f)(3) and specifically define a film or television production under section 181 to include all "film or video tape production the production cost of which is subject to capitalization under section 263A."

Once a film or television production is completed and ready for release or broadcast, the taxpayer may face additional costs to prepare the production for foreign distribution, rebroadcast (for example, editing a theatrical film for television), or release to the home video market. In order to be consistent with the approach taken under the income forecast method, these costs are not treated as costs of producing the film or television

production for purposes of the production cost limit under section 181(a)(2), and no deduction may be taken under section 181 for such costs.

Section 181(d)(1) compares qualified compensation to total compensation in applying the 75 percent test. Although qualified compensation is defined by section 181(d)(3)(A) as compensation for services performed in the United States by actors, directors, producers, and other relevant production personnel, the 75 percent test compares this amount to the "total compensation of the production." In order to be consistent with the definition provided for in section 181(d)(3)(A), the temporary regulations define "total compensation of the production" as the total amount of compensation paid for services performed anywhere by actors, directors, producers, and other relevant production personnel in the production of the film or television production. In addition, the temporary regulations specifically provide that the terms compensation and qualified compensation include compensation paid to persons who are not directly employed by the producer.

The term "qualified compensation" is defined as compensation for services by various participants performed "in the United States." The definition of "United States" in section 7701(a)(9) includes the 50 states and the District of Columbia. Although the goal of section 181 is to encourage economic activity within the United States as defined in section 7701(a)(9), the use of a standard based upon principal photography requires the use of a slightly broader definition that takes into account that the physical act of principal photography may take place on land, at sea, or in the air. Consequently, the temporary regulations provide that a service is performed in the United States for purposes of the 75 percent test if the principal photography to which the service relates

occurs within the fifty states, the District of Columbia, the territorial waters of the United States, or the airspace or space above the United States and its territorial waters.

There are some services related to a production that may physically take place at a variety of places outside the control and knowledge of the producer (for example, training, rehearsal, and pre- and post-production). However, the producer has direct or indirect control and knowledge of the shooting location of principal photography with which these other services are associated. Therefore, the IRS and Treasury Department believe that as a general rule the 75 percent test should be based upon the locations where principal photography occurs.

In this regard, the temporary regulations provide a special rule for animated productions. Although these productions may have a "principal photography" analogue, the production process is completely different and the majority of the work of the "talent" is performed independent of the actual frame photography. Computer-generated animation is not photographed at all. Hand-drawn animated films involve the creation of a storyboard (sketches of the story action) by the principal artists. Once the storyboards are approved, individual frames showing important moments in the action called "keyframes" are created by the principal artists, after which the frames in between these frames (the "in-betweens") are produced by apprentice animators. These in-betweens are frequently outsourced overseas. Background art is created separately. The animation frames are transferred to plastic cels with a copier or, in some cases, are hand painted on the cels (or both). The cels are then photographed against the background art. Voice acting, music, and Foley (sound effects) are recorded independently. All of these elements are then combined into the finished film.

The production process for computer animation is similar, except that the principal artists work directly with computer programmers to create keyframe images in the animation software. In-between work is less likely to be outsourced, as the computer can generate most in-between frames from the keyframes themselves. Background art can be created within the computer program or scanned in from physical artwork. Post-production is generally done completely in the digital realm, and the final product is output to disc.

The temporary regulations apply the 75 percent test to animated productions based upon the production locations for (at least) the keyframe animation, the in-between animation, the animation photography, and the recording of the voice acting performances instead of the location where principal photography takes place. A separate rule is provided for productions that combine animation and live action, taking into account the production locations for the animation functions in addition to the location of principal photography.

Special rules

The version of the legislation that became section 181 (as originally passed by the Senate) provided that any production costs in excess of \$15 million would be depreciated using the straight-line method over a three-year period. [add cite to Senate bill number]. This provision was removed in conference and replaced with the limitation that the provision does not apply to productions with an aggregate cost above \$15 million. Section 181 is silent as to what should happen if a film appears to qualify in the year the election is first made, but fails to qualify thereafter (for example, when the total cost exceeds \$15 million, or when the film no longer meets the 75 percent test).

The temporary regulations provide a recapture provision that requires the recapture of any previously deducted section 181 costs in the year the election is voluntarily revoked or the property fails to qualify. For property already placed in service, the taxpayer must include in income the difference between the aggregate amount claimed under section 181 and the depreciation that would have been allowable with respect to the production in the same years. For a production not yet placed in service, the taxpayer must include in income the aggregate amount claimed under section 181. The structure of the recapture provision is intended in part to alleviate concerns that including P&R in the definition of production costs under section 181 would cause taxpayers to completely forgo the benefits of section 181. Under the temporary regulations, a taxpayer with a reasonable belief that it is producing a qualified production will be permitted to elect to currently deduct costs under section 181 with the understanding that a recapture may be required in a later year if circumstances or expectations change.

Prior to the technical correction enacted in the Gulf Opportunity Zone Act of 2005, a taxpayer could potentially incur production costs, deduct the production cost under section 181 against ordinary income, then sell the film after holding it for one year and report the proceeds (including the gain attributable to the basis reduction from the section 181 deduction) as a long-term capital gain, effectively converting ordinary income to capital gain. This potential "tax flip," existed because, as originally enacted, the statute did not specify that the deduction under section 181 is a deduction for depreciation or amortization, or state that it is subject to recapture under section 1245. The technical correction specifically treats a deduction under section 181 as a deduction

for depreciation or amortization that is subject to recapture under section 1245, and the temporary regulations follow this rule.

Effective Date

The temporary regulations apply to qualified film and television productions with respect to which principal photography commenced on or after [Insert the date that these temporary regulations are published in the **Federal Register**].

Effect on Other Documents

Notice 2006-20 (2006-20 I.R.B. 892) is modified by deleting section B.2. in the INTERIM PROVISIONS of Notice 2006-20.

Rev. Proc. 2002-9 (2002-1 C.B. 327) is modified and amplified to include the automatic changes in methods of accounting in §1.181-2T(d)(2) and (e)(1) in the APPENDIX of Rev. Proc. 2002-9.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), please refer to the Special Analyses section of the preamble to the cross-reference notice of proposed rulemaking published in the Proposed Rules section in this issue of the **Federal Register**. Pursuant to section 7805(f) of the Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Bernard P. Harvey, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Sections 1.181-0T through 1.181-6T are added to read as follows:

§1.181-0T Table of contents (temporary).

This section lists the major captions contained in §1.181-1T through §1.181-6T.

§1.181-1T Deduction for qualified film and television production costs (temporary).

- (a) Deduction.
 - (1) In general.
 - (2) Owner.
 - (3) Production costs.
- (b) Limitation on amount of production cost and amount of deduction.
 - (1) In general.
 - (2) Additional dollar limitation amount.
 - (i) In general.
 - (ii) Significantly incurred.
 - (iii) Animated films and television productions.

- (iv) QFTPs incorporating both live action and animation.
- (c) Reasonable basis.
- (d) No other depreciation or amortization deduction allowed.

§1.181-2T Election (temporary).

- (a) Time and manner of making election.
- (b) Special rules.
- (c) Information required.
 - (1) Initial election.
 - (2) Subsequent taxable years.
- (d) Revocation of election.
 - (1) In general.
 - (2) Consent granted.
- (e) Transition rules.
 - (1) Costs first paid or incurred prior to October 23, 2004.
 - (2) Returns filed after June 14, 2006, and before **[INSERT DATE THAT IS 30 DAYS AFTER THE PUBLICATION DATE OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.
 - (3) Information required.

§1.181-3T Qualified film or television production (temporary).

- (a) In general.
- (b) Production.
 - (1) In general.
 - (2) Special rules for television productions.
 - (3) Exceptions.
 - (i) Certain sexually explicit productions.
 - (ii) Subsequent release or broadcast.
 - (c) Production compensation.
 - (d) Qualified compensation.
 - (e) Other definitions.

§1.181-4T Special rules (temporary).

- (a) Recapture.
 - (1) Applicability.
 - (2) Amount of recapture.
- (b) Recapture under section 1245.

§1.181-5T Examples (temporary).

§1.181-6T Effective date (temporary).

- (a) In general.
- (b) Application of regulation project REG-115403-05 to pre-effective date productions.

(c) Special rules for returns filed for prior taxable years.

§1.181-1T Deduction for qualified film and television production costs (temporary).

(a) Deduction--(1) In general. The owner of any qualified film or television production (QFTP) (as defined in paragraph (a) of §1.181-3T) may elect to treat all production costs (as defined in paragraph (a)(3) of this section) of the QFTP that are paid or incurred by the owner as an expense that is not chargeable to capital account and that is deductible by the owner in the taxable year in which the costs are paid or incurred. This section provides rules for determining who is the owner of a QFTP, the costs to be taken into account in calculating the deduction, and the maximum production costs that may be incurred for a production for which an election is made under section 181 of the Internal Revenue Code (Code). Section 1.181-2T provides rules for making the election under section 181. Section 1.181-3T provides definitions and rules concerning QFTPs. Section 1.181-4T provides special rules, including rules for recapture of the deduction and rules for multiple owners. Section 1.181-5T provides examples of the application of §§1.181-1T, 1.181-2T, 1.181-3T, and 1.181-4T, while §1.181-6T provides the effective date of §§1.181-1T, 1.181-2T, 1.181-3T, 1.181-4T, and 1.181-5T.

(2) Owner. For purposes of this section and §§1.181-2T, 1.181-3T, 1.181-4T, 1.181-5T, and 1.181-6T, the owner of a QFTP is any taxpayer that is required under section 263A to capitalize costs paid or incurred in the production of the QFTP into the cost basis of the QFTP, or that would be required to do so if section 263A applied to that taxpayer. A taxpayer that receives only a limited license or right to exploit a QFTP

or an interest or profit participation in a QFTP as compensation for services generally is not an owner of the QFTP for purposes of section 181.

(3) Production costs. (i) Except as provided in paragraph (a)(3)(iv) of this section, the term production costs means all costs paid or incurred by the owner in the production or acquisition of the QFTP that are required, absent the provisions of section 181, to be capitalized under section 263A, or that would be required to be capitalized if section 263A applied to the owner. Production costs specifically include, but are not limited to, participations and residuals, compensation paid for services, compensation paid for property rights, non-compensation costs, and costs paid or incurred in connection with obtaining financing for the QFTP (for example, premiums paid or incurred to obtain a completion bond for the QFTP).

(ii) The term production costs does not include costs paid or incurred to distribute or exploit a QFTP (including advertising and print costs).

(iii) A taxpayer seeking to deduct the cost of acquiring a production (and subsequent production costs) should obtain detailed records concerning the production from the seller in order to demonstrate the eligibility of the production under section 181. The acquired production must have been a QFTP in the hands of the seller, and must continue to be a QFTP in the hands of the taxpayer, in order for the cost of acquiring the production (and subsequent costs) to be deductible by the taxpayer.

(iv) If a QFTP (or any right or interest in a QFTP) is acquired from any person bearing a relationship to the taxpayer described in section 267(b) or section 707(b)(1), and the costs paid or incurred to acquire the QFTP are less than the seller's cost to produce the QFTP, the purchaser must treat the seller's entire cost of production as a

production cost of the acquired QFTP for purposes of the production cost limitation imposed under paragraphs (b)(1) and (b)(2) of section 181. Notwithstanding this paragraph (a)(3)(iv), the taxpayer must use the acquisition cost of the QFTP (plus any further production costs incurred by the taxpayer) as its basis for calculating the deduction under section 181.

(v) The provisions of this paragraph (a) apply notwithstanding the provisions of section 167(g)(7)(D).

(b) Limitation on amount of production cost and amount of deduction--(1) In general. Except as provided under paragraph (b)(2) of this section, the deduction permitted under section 181 does not apply in the case of any QFTP, the production costs of which exceed \$15,000,000. In the case of a QFTP with more than one owner, the production costs to be taken into account by each owner in applying this dollar limit are the aggregate of the production costs paid or incurred by all current owners.

(2) Additional dollar limitation amount--(i) In general. This section is applied by substituting \$20,000,000 for \$15,000,000 in the case of any QFTP the aggregate production costs of which are significantly incurred in an area eligible for designation as--

(A) a low income community under section 45D, or

(B) a distressed county or isolated area of distress by the Delta Regional Authority established under 7 U.S.C section 2009aa-1.

(ii) Significantly incurred--The aggregate production cost of a QFTP is significantly incurred within one or more areas specified in paragraph (b)(2)(i) of this section if --

(A) at least 20 percent of the total production cost incurred in connection with first-unit principal photography for the production is incurred in connection with first-unit principal photography that takes place in such areas; or

(B) at least 50 percent of the total number of days of first-unit principal photography for the production consists of days during which first-unit principal photography takes place in such areas.

(iii) Animated films and television productions. For purposes of an animated film or television production, the aggregate production cost of the QFTP is significantly incurred within one or more areas specified in paragraph (b)(2)(i) of this section if--

(A) at least 20 percent of the total production cost incurred in connection with keyframe animation, in-between animation, animation photography, and the recording of voice acting performances for the QFTP is incurred in connection with such activities that take place in such areas; or

(B) at least 50 percent of the total number of days during which first unit principal photography, keyframe animation, in-between animation, animation photography, and the recording of voice acting performances for the QFTP consists of days during which such activities take place in such areas.

(iv) QFTPs incorporating both live action and animation. For purposes of a QFTP incorporating both live action and animation, the aggregate production cost of the QFTP is significantly incurred within one or more areas specified in paragraph (b)(2)(i) of this section if--

(A) at least 20 percent of the total production cost incurred in connection with first-unit principal photography, keyframe animation, in-between animation, animation photography, and the recording of voice acting performances for the QFTP is incurred in connection with such activities that take place in such areas; or

(B) at least 50 percent of the total number of days during which keyframe animation, in-between animation, animation photography, and the recording of voice acting performances for the QFTP consists of days during which such activities take place in such areas.

(C) An taxpayer intending to utilize the additional dollar limitation amount under paragraph (b)(2)(i) of this section must maintain records adequate to demonstrate qualification under this paragraph (b)(2)(ii).

(c) Reasonable basis. An owner may make an election under section 181 only if, in the taxable year of the election, the owner reasonably expects (based on all of the facts and circumstances) that both--

(i) the production (as defined in paragraph (b) of §1.181-3T), will be a QFTP; and

(ii) the aggregate production costs paid or incurred by all owners with respect to the QFTP will, at no time, exceed the applicable dollar amount set forth under paragraph (b) of this section.

(d) No other depreciation or amortization deduction allowed. (1) Except as provided in paragraph (d)(2) of this section, if an owner makes an election to deduct film or television production costs under section 181 with respect to a QFTP, then, unless paragraph (a) of §1.181-4T applies to the production, no deduction for depreciation or amortization may be taken for any production cost under any provision of the Internal

Revenue Code other than section 181. In addition, an owner that has, in a previous taxable year, deducted any production cost of a production under a provision of the Code other than section 181 is ineligible to make an election with respect to that production under section 181.

(2) An owner may make an election under section 181 despite prior deductions claimed for amortization of the cost of acquiring or developing screenplays, scripts, story outlines, motion picture production rights to books and plays, and other similar properties for purposes of potential future development or production of a QFTP under any provision of the Code if such costs were incurred prior to the decision to produce the film or television production (for further guidance, see Rev. Proc. 2004-36 (2004-1 C.B. 1063) and §601.601(d)(2)(ii)(b) of this chapter).

§1.181-2T Election (temporary).

(a) Time and manner of making election. Except as provided in paragraph (e) of this section, a taxpayer electing to deduct production costs of a QFTP under section 181 must do so by following the procedures of paragraph (c)(1) of this section. Except as provided in paragraph (e) of this section, the election must be made by the due date (including extensions) for filing the taxpayer's Federal income tax return for the taxable year in which production costs are first paid or incurred. See §301.9100-2 for a six-month extension of this period in certain circumstances.

(b) Special rules. The election under section 181 is made separately for each QFTP produced by the owner. In the case of a production owned by a partnership or other entity, the election must be made by the entity. In all other cases, except as provided below, the election may be made by any owner of the production. If co-owners

of a QFTP have differing taxable years, the election must be made by the owner with the taxable year that is the first to close following the date that production costs are first paid or incurred by any owner. The election must be made by the due date (including extensions) applicable to the owner with the taxable year that is the first to close following the date that production costs are first paid or incurred by any owner for its Federal income tax return for the taxable year in which costs of the production are first paid or incurred. The election by (or the failure to elect by) the owner described in the previous sentence applies to all interests in the production. See Example (3) of §1.181-5T.

(c) Information required--(1) Initial election. For each QFTP to which the election applies, the owner must attach a statement to the return stating that the taxpayer is making an election under section 181 and providing--

(i) the name (or other unique identifying designation) of the production;

(ii) the date production costs were first paid or incurred (either by the owner, or by a co-owner) with respect to the production;

(iii) the amount of production costs paid or incurred by the owner with respect to the production during the taxable year (and, in the case of a production with multiple owners, the aggregate amount of production costs paid or incurred by all owners with respect to the production during the taxable year);

(iv) the aggregate amount of qualified compensation (as defined in paragraph (d) of §1.181-3T) paid or incurred by all owners with respect to the production during the taxable year;

(v) the aggregate amount of compensation (as defined in paragraph (c) of §1.181-3T) paid or incurred by all owners with respect to the production during the taxable year;

(vi) if the owner expects that the total production costs of the production will be significantly paid or incurred in (or, if applicable, if a significant portion of the total number of days of principal photography will occur in) one or more of the areas specified in paragraph (b)(2)(i) of §1.181-1T, the identity of the area or areas, the amount of production costs paid or incurred (or the number of days of principal photography engaged in) by all owners for the applicable activities described in paragraph (b)(2)(ii) of §1.181-1T that take place within such areas, and the total amount of production costs paid or incurred (or the total number of days of principal photography engaged in) by all owners for such activities (whether or not they take place in such areas), for the taxable year;

(vii) if more than one taxpayer is entitled to claim a deduction under section 181 with respect to the QFTP, a list of the names and Taxpayer Identification Numbers of all such taxpayers; and

(viii) a declaration that the owner reasonably expects (based on all of the facts and circumstances at the time the election was filed) both that the production will be a QFTP, and that the aggregate production costs of the QFTP paid or incurred by all owners will not, at any time, exceed the applicable dollar amount set forth under paragraph (b) of §1.181-1T.

(2) Subsequent taxable years. If the owner pays or incurs additional production costs of the production in any taxable year subsequent to the taxable year in which

costs of the production are first paid or incurred, the owner must attach a statement to its Federal income tax return for that subsequent taxable year providing--

(i) the name (or other unique identifying designation) of the production;

(ii) the date the production costs were first paid or incurred;

(iii) the amount of production costs paid or incurred by the owner with respect to the production during the taxable year (and, in the case of a production with multiple owners, the aggregate amount of production costs paid or incurred by all owners with respect to the production during the taxable year), and the aggregate amount of production costs paid or incurred by all owners with respect to the production in all taxable years;

(iv) the amount of qualified compensation paid or incurred by the owner with respect to the production during the taxable year (and, in the case of a production with multiple owners, the aggregate amount of qualified compensation paid or incurred by all owners with respect to the production during the taxable year), and the aggregate amount of qualified compensation paid or incurred by all owners with respect to the production in all prior taxable years;

(v) the aggregate amount of compensation paid or incurred by all owners with respect to the production during the taxable year, and the aggregate amount of compensation paid or incurred by all owners with respect to the production in all prior taxable years;

(vi) if the owner expects that the total production costs of the production will be significantly paid or incurred in (or, if applicable, if a significant portion of the total number of days of principal photography will occur in) one or more of the areas

specified in paragraph (b)(2)(i) of §1.181-1T, the identity of the area or areas, the amount of production costs paid or incurred (or the number of days of principal photography engaged in) by all owners for the applicable activities described in paragraph (b)(2)(ii) of §1.181-1T that take place within such areas, and the total amount of production costs paid or incurred (or the number of days of principal photography engaged in) by all owners for such activities (whether or not they take place in such areas), for the taxable year; and

(vii) if more than one taxpayer is entitled to claim a deduction under section 181 with respect to the QFTP, a list of the names and Taxpayer Identification Numbers of all such taxpayers; and

(viii) a declaration that the owner continues to reasonably expect (based on all of the facts and circumstances at the time the election was filed) both that the production will be a QFTP, and that the aggregate production costs of the QFTP paid or incurred by all owners will not, at any time, exceed the applicable dollar amount set forth under paragraph (b) of §1.181-1T.

(d) Revocation of election--(1) In general. An election made under this section may not be revoked without the consent of the Secretary.

(2) Consent granted. The Secretary's consent to revoke an election under this section with respect to a particular production will be granted if the owner--

(i) files a Federal income tax return in which the owner complies with the recapture provisions of paragraph (a) of §1.181-4T to recapture the amount described in paragraph (a)(2) of §1.181-4T; and

(ii) attaches a statement to the owner's return clearly indicating the name (or other unique identifying designation) of the production and the name and Taxpayer Identification Number of each owner of the production, and stating that the election under section 181 with respect to that production is being revoked pursuant to §1.181-2T(d)(2).

(e) Transition rules--(1) Costs first paid or incurred prior to October 23, 2004. If a taxpayer begins principal photography of a QFTP after October 22, 2004, but first paid or incurred costs of the production before October 23, 2004, the taxpayer is entitled to make an election under this section with respect to those costs. If, before June 15, 2006, the taxpayer filed its federal tax return for the taxable year in which the costs of the production were first paid or incurred, and if the taxpayer wants to make a section 181 election for that taxable year, the taxpayer may make the election either by: (a) filing an amended federal tax return for the taxable year in which the costs of the production were first paid or incurred, and for all subsequent affected taxable year(s), on or before November 15, 2006, provided that all of these years are open under the period of limitations for assessment under section 6501(a); or (b) filing a Form 3115, "Application For Change in Accounting Method", for the first or second taxable year ending on or after December 31, 2005, in accordance with the administrative procedures issued under §1.446-1(e)(3)(ii) for obtaining the Commissioner's automatic consent to a change in accounting method (for further guidance, for example, see Rev. Proc. 2002-9, 2002-1 C.B. 327, and §601.601(d)(2)(ii)(b) of this chapter). This change in method of accounting results in a section 481 adjustment. Further, any limitations on obtaining the automatic consent of the Commissioner do not apply to a taxpayer

seeking to change its method of accounting under this paragraph (e)(1). Moreover, the taxpayer must include on line 1a of the Form 3115 the designated automatic accounting method change number "100".

(2) Returns filed after June 14, 2006, and before [INSERT DATE THAT IS 30 DAYS AFTER THE PUBLICATION DATE OF THIS DOCUMENT IN THE FEDERAL REGISTER]. If, after June 14, 2006, and before [INSERT DATE THAT IS 30 DAYS AFTER THE PUBLICATION DATE OF THIS DOCUMENT IN THE FEDERAL REGISTER], the owner of a film or television producer filed its original Federal income tax return for a taxable year ending after October 22, 2004, without making an election under section 181 for the costs of a QFTP first paid or incurred after October 22, 2004, and if the taxpayer wants to make an election under section 181 for the costs of a QFTP first paid or incurred during that taxable year, the taxpayer must make the election within the time provided by paragraph (a) of this section and in the manner provided in paragraph (c)(1) of this section, except that the election statement attached to the return must include the information required in paragraphs (c)(1)(i) through (vi) of this section.

(3) Information required. If, in accordance with paragraph (e)(1) of this section, the taxpayer is making an election for a prior taxable year by filing amended federal tax return(s), the statement and information required by paragraph (c) of this section (except for the information required in paragraph (c)(1)(vii) or (c)(2)(ix) of this section), as applicable, must be attached to each amended return. If, in accordance with paragraph (e)(1) of this section, the taxpayer is making a section 181 election for a prior taxable year by filing a Form 3115 for the first or second taxable year ending on or after December 31, 2005, the statement and information required by paragraph (c) of this

section(except for the information required in paragraph (c)(1)(vii) or (c)(2)(ix) of this section), as applicable, must be attached to the Form 3115. For purposes of the preceding sentence, the amount of the cost or compensation paid or incurred for the production must only include the amount paid or incurred in taxable years prior to the year of change (for further guidance on year of change, see section 5.02 of Rev. Proc. 2002-9 and §601.601(d)(2)(ii)(b) of this chapter).

§1.181-3T Qualified film or television production (temporary).

(a) In general. The term qualified film or television production (QFTP) means any production (as defined in paragraph (b) of this section) if not less than 75 percent of the total amount of compensation (as defined in paragraph (c) of this section) paid with respect to the production is qualified compensation (as defined in paragraph (d) of this section).

(b) Production--(1) In general. Except as provided in paragraph (b)(3) of this section, for purposes of this section and §§1.181-1T, 1.181-2T, 1.181-4T, 1.181-5T, and 1.181-6T, a film or television production (or production) means any film or video (including digital video) production the production cost of which is subject to capitalization under section 263A, or that would be would be subject to capitalization if section 263A applied to the owner of the production.

(2) Special rule for television productions. Each episode of a television series is a separate production to which the rules, limitations, and election requirements of this section and §§1.181-1T, 1.181-2T, 1.181-4T, 1.181-5T, and 1.181-6T apply. A taxpayer may elect to deduct costs under section 181 only for the first 44 episodes of a television

series (including pilot episodes). A television series may include more than one season of programming.

(3) Exceptions--(i) Certain sexually explicit productions. A production does not include property with respect to which records are required to be maintained under 18 U.S.C. 2257. Section 2257 of Title 18 requires maintenance of certain records with respect to any book, magazine, periodical, film, videotape, or other matter that—

(A) Contains one or more visual depictions made after November 1, 1990, of active sexually explicit conduct; and

(B) is produced in whole or in part with materials that have been mailed or shipped in interstate or foreign commerce, or is shipped or transported or is intended for shipment or transportation in interstate or foreign commerce.

(ii) Subsequent release or broadcast. A production does not include a new release or new broadcast of an existing film or video after the initial release or initial broadcast of the film or video (for instance, the preparation of a DVD release of a theatrically-released film, or the preparation of an edited version of a film for television broadcast). Costs paid or incurred to prepare a new release or a new broadcast of an existing film or video, therefore, are not taken into account for purposes of paragraph (b) of §1.181-1T, and may not be deducted under paragraph (a) of §1.181-1T.

(c) Production compensation. The term production compensation means, for purposes of this section and §§1.181-1T, 1.181-2T, 1.181-4T, 1.181-5T, and 1.181-6T, all payments (whether or not by the owner) for services performed by actors (as defined in paragraph (e) of this section), directors, producers, and other relevant production personnel (as defined in paragraph (e) of this section) with respect to the production.

Production compensation includes all direct and indirect compensation costs required to be capitalized under section 263A for film producers under §1.263A-1(e)(2) and (3).

Production compensation is not limited to W-2 wages and includes compensation paid to independent contractors. However, solely for purposes of paragraph (a) of this section, the term production compensation does not include participations and residuals (as defined in section 167(g)(7)(B)). See paragraph (a)(3) of §1.181-1T for additional rules concerning participations and residuals.

(d) Qualified compensation. The term qualified compensation means, for purposes of this section and §§1.181-1T, 1.181-2T, 1.181-4T, 1.181-5T, and 1.181-6T, the total amount of compensation (as defined in paragraph (c) of this section) paid for services performed in the United States (as defined in paragraph (e) of this section) by actors, directors, producers, and other relevant production personnel with respect to the production. A service is performed in the United States for purposes of this paragraph if the principal photography to which the compensated service relates occurs within the United States and the person performing the service is physically present in the United States. For purposes of an animated film or animated television production, the location where production activities such as keyframe animation, in-between animation, animation photography, and the recording of voice acting performances are performed is considered in lieu of the location of principal photography. For purposes of a QFTP incorporating both live action and animation, the location where production activities such as keyframe animation, in-between animation, animation photography, and the recording of voice acting performances for the QFTP is considered in addition to the location of principal photography.

(e) Other definitions. The following definitions apply for purposes of this section and §§1.181-1T, 1.181-2T, 1.181-4T, 1.181-5T, and 1.181-6T. The term actors includes players, newscasters, or any other persons performing in a production. The term production personnel includes, for example, writers, choreographers and composers providing services during the production of the film, casting agents, camera operators, set designers, lighting technicians, make-up artists, and others whose activities are directly related to producing the production. The term United States includes the 50 states, the District of Columbia, the airspace or space over the United States, the territorial waters of the United States, and the seabed and subsoil of those submarine areas that are adjacent to the territorial waters of the United States and over which the United States has exclusive rights, in accordance with international law, with respect to the exploration and exploitation of natural resources. The term United States does not include possessions and territories of the United States (or the airspace or space over these areas).

§1.181-4T Special rules (temporary).

(a) Recapture--(1) Applicability. The rules of this paragraph (a) apply notwithstanding whether a taxpayer has satisfied the requirements of paragraph (d) of §1.181-2T. A taxpayer that, with respect to a production, claimed a deduction for production costs in the taxable year such costs were paid or incurred in an amount in excess of the amount that would be allowable as a deduction for that year in the absence of section 181 must recapture any excess deductions with respect to the production in the first taxable year in which either--

(i) the production ceases to be a QFTP as defined in §1.181-3T;

(ii) the aggregate production costs of the production exceed the applicable dollar limitation amount under paragraph (b) of §1.181-1T; or

(iii) the taxpayer revokes the election pursuant to paragraph (d) of §1.181-2T.

(2) Amount of recapture. A taxpayer subject to recapture under this §1.181-4T must, in the taxable year in which recapture is triggered, include in the taxpayer's gross income and add to the taxpayer's adjusted basis in the property--

(i) for a production that is placed in service in a taxable year prior to the taxable year in which recapture is triggered, the difference between the aggregate amount claimed as a deduction under section 181 with respect to the production in all such prior taxable years and the aggregate depreciation deductions that would have been allowable with respect to the property for such prior taxable years (or that the taxpayer could have elected to deduct in the taxable year that the property was placed in service) with respect to the production under the taxpayer's method of accounting; or

(ii) for a production that has not been placed in service, the aggregate amount claimed as a deduction under section 181 with respect to the production in all such prior taxable years.

(b) Recapture under section 1245. For purposes of recapture under section 1245, any deduction allowed under this provision is treated as a deduction allowable for amortization.

§1.181-5T Examples (temporary).

The following examples illustrate the application of §§1.181-1T, 1.181-2T, 1.181-3T, and 1.181-4T:

Example (1). X, a corporation using a calendar taxable year, is a producer of films. X intends to produce film ABC, and will be the only owner (within the meaning of

paragraph (a)(2) of §1.181-1T) of film ABC. X incurs production costs in Year 1, but does not commence principal photography for film ABC until Year 2. X reasonably expects, based on all of the facts and circumstances, that film ABC will be a QFTP, and that at no time will the production costs of film ABC exceed the applicable dollar limit of paragraph (b) of §1.181-1T. Provided that X satisfies all other requirements of §§1.181-1T, 1.181-2T, 1.181-3T, 1.181-4T, and 1.181-6T, X may deduct the production costs for film ABC that X incurred in Year 1.

Example (2). The facts are the same as in Example (1). In Year 2, X begins, but does not complete, principal photography for film ABC. Most of the scenes that X films in Year 2 are shot outside the United States and, as of December 31, Year 2, less than 75 percent of the total compensation paid with respect to film ABC is qualified compensation. Nevertheless, X still reasonably expects, based on all of the facts and circumstances, that film ABC will be a QFTP, and that at no time will the production costs of film ABC exceed the applicable dollar limit of paragraph (b) of §1.181-1T. Provided that X satisfies all other requirements of §§1.181-1T, 1.181-2T, 1.181-3T, 1.181-4T, and 1.181-6T, X may deduct the production costs for film ABC that X incurred in Year 2.

Example (3). The facts are the same as in Example (2). In Year 3, X continues, but does not complete, production of film ABC. Due to changes in the expected cost of producing film ABC, X no longer expects film ABC to qualify under section 181. X files a statement with its return for Year 3 identifying the film and stating its intent to revoke its election under section 181, and includes in income in Year 3 the deductions claimed in Year 1 and in Year 2 as provided for in §1.181-4T. X has successfully revoked its election pursuant to §1.181-2T(d).

Example (4). The facts are the same as in Example (2). In Year 3, X completes production of film ABC at a cost of \$14.5 million and places it into service. ABC is an unexpected success in Year 3 and Year 4. In Year 5, participation payments drive the total cost of producing film ABC above \$15 million. X includes in income in Year 5 as recapture under §1.181-4T(a) the entire deductions claimed in Year 1 and Year 2 (before the property was placed in service) and the difference between the deductions claimed in Year 3 and Year 4, and the deductions that it would have claimed under a method that would have been allowable for the film in Year 3 (the year the film was placed in service). Because X calculated the recapture amount by comparing actual deductions to deductions under the income forecast method, X must use this method to calculate deductions for film ABC for Year 5 and in subsequent taxable years. _

Example (5). Taxpayer A and Taxpayer B enter into an agreement to co-produce a film. Both Taxpayer A and Taxpayer B are considered an owner of the production for purposes of §1.181-1T(a)(2). Production costs are first incurred on March 1 of Year 1. Taxpayer A reports its Federal income tax on the basis of a fiscal year ending September 30, and Taxpayer B reports its Federal income tax on a calendar-year basis. Because Taxpayer A's taxable year that includes March 1 of Year 1 ends earlier than Taxpayer B's taxable year that includes March 1 of Year 1, the deadline for filing the

election under §1.181-2T is Taxpayer A's due date (including extensions) for filing its Federal income tax return for the year the election is to be effective.

§1.181-6T Effective date (temporary).

(a) In general. (i) Section 181 applies to productions commencing after October 22, 2004, and shall not apply to productions commencing after December 31, 2008. Except as provided in paragraphs (b) and (c) of this section, §§1.181-1T through 1.181-5T apply to productions, the first day of principal photography for which occurs on or after **[INSERT DATE ON WHICH THESE TEMPORARY REGULATIONS ARE PUBLISHED IN THE FEDERAL REGISTER]**, and before January 1, 2009.

(ii) The applicability of §§1.181-1T through 1.181-5T expires on **[INSERT DATE THAT IS 3 YEARS FROM THE PUBLICATION DATE OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

(b) Application of regulation project REG-115403-05 to pre-effective date productions. A taxpayer may apply §§1.181-1T through 1.181-5T to productions, the first day of principal photography for which occurs after October 22, 2004, and before **[INSERT DATE ON WHICH THESE TEMPORARY REGULATIONS ARE PUBLISHED IN THE FEDERAL REGISTER]**, provided that the taxpayer applies all provisions in §§1.181-1T through 1.181-5T to the productions.

(c) Special rules for returns filed for prior taxable years. If before **[INSERT DATE THAT IS 30 DAYS AFTER THE PUBLICATION DATE OF THIS DOCUMENT IN THE FEDERAL REGISTER]**, an owner of a film or television production began principal photography of the QFTP after October 22, 2004, and filed its original Federal income tax return for the year such costs were first paid or incurred without making an election under section 181 for the costs of a QFTP, and if the taxpayer wants to make an

election under section 181 for such taxable year, see paragraph (e) of §1.181-2T for the time and manner of making the election.

PART 602 -- OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. In §602.101, paragraph (b) is amended by adding the following entry in numerical order to the table to read as follows:

§602.101 OMB control numbers.

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(b) * * *

CFR part or section where identified and described	Current OMB Control No.
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1.181-1T and 1.181-2T.....	1545-XXXX
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Deputy Commissioner for Services and Enforcement.

Approved:

Acting Deputy Assistant Secretary of the Treasury (Tax Policy).