**DEALMAKERS ELITE** N.Y.

# Trump Tax Cut Roils the Rules

Entertainment companies and individuals should brace themselves for the new law's unintended consequences **Story by BRAD COHEN | Illustrations by CHRIS GASH**

THE LEGISLATION KNOWN as the Tax Cut and Jobs Act, along with its accompanying proposed Treasury Regulations, has already had a significant impact on the entertainment industry. While not every effect is known, several unintended consequences are immediately apparent.

**SEXUAL HARASSMENT: THE TRIFECTA FROM HELL**

The Tax Act re-victimizes individuals who have suffered sexual harassment. First, it prevents companies settling sexual harassment claims from deducting the cost of settlements if they are subject to a nondisclosure agreement. Anecdotal evidence suggests that companies will continue to include nondisclosure clauses in their settlement agreements, likely leading them to settle claims for less — i.e., the lost deduction may end up coming out of victims' pockets.

Second, victims of sexual harassment can no longer deduct their legal expenses in non-physical contact sexual harassment disputes, because of the elimination of miscellaneous itemized deductions. This new limitation will significantly reduce the amount victims will ultimately receive on an after-tax basis.

Finally, state and local taxes, including property taxes, are now only deductible up to $10,000. So, victims will likely have to pay the full amount of federal AND state income taxes due on the entire settlement, with no federal income tax relief for state income taxes paid.

As an illustration, assume a company would have previously been willing to settle a non-

physical contact sexual harassment dispute with a California resident for $1.2 million. Now the company may only be willing settle for $1 million because it cannot deduct the settlement amount from its federal income taxes.

It is common in these cases for attorneys to charge a 40% contingency fee. On a million-dollar award, the victim will pay the attorney $400,000, with $600,000 left before taxes. Since the victim's legal fees are non-deductible, the victim will pay taxes on the entire $1 million, not just the $600,000. Furthermore, since state and local taxes are no longer deductible (above $10,000), the victim's combined tax rate could be approximately 50% (37% federal and 13.3% California) on the entire $1 million.

So, after paying the attorney $400,000 in fees and federal and state governments $500,000 in taxes, the victim will end up with a mere $100,000 out of what might have been a $1.2 million settlement. Ouch.

### SPAGO NO, CRAFT SERVICES YES

Prior to the Tax Act, taxpayers could generally deduct 50% of the cost of meals and entertainment spent on existing or potential clients. Under the Tax Act, no entertainment expenses are deductible and meals may, under certain circumstances, be considered entertainment expenses.

Thus, it is unclear to what extent expenses for meals with potential or existing clients will be deductible. Until the IRS or Treasury issues further guidance on whether these meals are still eligible for the 50% deduction, taxpayers are advised to ensure that they have a reasonable expectation of deriving income or other business from the meeting, that business is actually conducted at the meal, the meals are furnished at a restaurant (rather than an entertainment venue, such as a sporting event), and that such meals are not lavish or extravagant. The IRS may still issue guidance denying the deductibility of such expenses.

Other types of meal expenses may still be partially or fully deductible. For example, office holiday parties and meals provided in-house for the convenience of the employer, such as craft services on set, are still (wholly or partially) deductible.

### 20% DEDUCTION FOR PASS-THROUGHS: HERE COME THE ROBOTS

Firing employees may produce a greater deduction. The new Section 199A provides pass-through entities — such as limited liability corporations, Sub Chapter S corporations, partnerships and sole proprietorships — with a 20% deduction for their qualified business income. To accommodate businesses with little or no wages, such as real estate companies, the drafters of the Tax Act added an alternative test that produced a maximum deduction for companies if they had sufficient basis in assets in the company.

This may have unintentionally created an incentive for companies to increase their qualified business income by firing employees and purchasing tangible assets, i.e., robots to perform the work employees could have performed, to increase the allowable pass-through deduction.

The definition of "performing artist" excludes many from deduction benefits. Not all taxpayers are eligible for the pass-through deduction. Specifically, the section excludes income above certain threshold levels for specified service trades or businesses, such as the performing arts. Historically, the term performing arts referred to individuals in front of the camera — actors, musicians, etc. — in contrast with behind the camera — directors, producers, etc. Proposed Treasury regulations have inappropriately broadened the definition to include directors and similar job functions. As a result of this expansion, and contrary to the historical definition of performing arts, directors — and people in comparable positions — may have their pass-through deductions reduced or eliminated.

### LOAN-OUTS ARE IN

With the elimination of the miscellaneous itemized deductions for unreimbursed business expenses, many people are going to lose the ability to deduct various expenses including fees for accountants, lawyers, personal managers, business managers, agents and the like. Many of these deductions can be achieved at the corporate level. For this reason, loan-out corporations, which can hire artists as employees in order to protect their assets, are going to be more important than ever.

Who are the overall winners and losers of this new legislation? Winners include large corporations and their shareholders, including studios and networks, the ultra-wealthy, individuals and business entities whose income is largely derived from capital or capital expenditures, and residents of red states.

Losers include people who earn their income through the provision of services, particularly in specified service trades or businesses, middle and working classes, and residents of blue states. It remains to be seen whether the Tax Cuts and Jobs Act will, in fact, end up creating any new jobs or increased wages.

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## CENTURY OF PROGRESS, BUT STILL FAR TO GO

On Aug. 26, the country celebrated Women's Equality Day, the anniversary of the adoption of the 19th Amendment to the Constitution in 1920, which in effect prohibited the states and the federal government from denying women the right to vote.

And over the 98 years since that date, enormous progress toward gender equality in business, government and society has been made, but full parity has yet to be achieved.

Statisticians agree that today more women than men graduate from college and that just as many women as men enter the workforce. Yet in the U.S. there's still a significant gender wage gap, which widens for minorities, and which contributes to a continuing feeling of disenfranchisement among women.

This year's Dealmakers Elite New York includes a number of prominent women, but the list is still overwhelming male. *Variety* has taken a proactive stance toward parity. For example, panels at *Variety*'s conferences and summits must include at least one female participant. The conferences have improved as a result.

As we continue to create lists like this one, we will strive to be as inclusive as possible and move closer to the goal of gender parity on all *Variety* Impact, 10 to Watch, and Elite lists.

*— Peter Caranicas*