Loan-Out Corporations in the Entertainment Industry

by Practical Law Media & Entertainment

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A Practice Note discussing the loan-out (loan out or loanout) corporations or companies that talent, such as writers, directors, producers, actors, and musicians, in the television, streaming, film, digital, and music industries create and use. This Note covers loan-out corporation advantages and disadvantages. It also addresses loan-out corporation formation and structure and how talent and musicians use loan-out corporations to contract with third parties engaging their services.

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When producing an entertainment project, such as a TV or streaming series or theatrical motion picture, studios and production companies need talent, such as writers, producers, directors, and actors. Similarly, record labels need musicians. In these cases, companies typically use engagement agreements to engage talent or musicians as independent contractors instead of hiring them as employees. This Practice Note refers to talent and musicians as artists.

Instead of entering into engagement agreements directly with companies, many artists create loan-out corporations that contract with companies for their services. The companies engage the artist through the loan-out corporation and pay the loan-out corporation for the artist's services. In most cases, the artist is the sole owner and employee of the loan-out corporation.

This Note discusses the advantages and disadvantages of using loan-out corporations. It also addresses considerations for forming loan-out corporations and various agreements the loan-out corporation enters with third parties contracting for the artist's services.

Advantages and Disadvantages

Artists primarily forms loan-out corporations to:

- Secure tax benefits (see Tax Benefits).
- Limit their liability (see Limited Liability).

If a court deems the loan-out corporation the artist's alter ego and pierces the corporate veil, the artist will lose these benefits. This rarely happens. For more about the alter ego theory and piercing the corporate veil, see Practice Note, Piercing the Corporate Veil.

In addition, setting up a loan-out corporation can be costly and creates additional responsibilities for the artist and their management (see Costs and Additional Responsibilities).

Tax Benefits

The main benefits of forming a loan-out corporation are artist's ability to take advantage of:

- Lower tax rates.
- Tax deferral options.
- Additional deductions.

Depending on the artist's income, the corporate tax rate could be significantly lower than the applicable individual tax rate. However, the artist must weigh any tax savings against factors such as the cost of forming and maintaining a loan-out corporation (see Costs and Additional Responsibilities).

While both individuals and corporations pay taxes annually, individuals pay taxes on a calendar year basis and corporations on a fiscal year basis. Because a corporation chooses its fiscal year start and end dates, a strategically selected fiscal year can defer taxation of a substantial portion of taxable income. For example, if the artist expects to receive significant compensation starting on a particular date, such as the anticipated start date of principal photography of a feature film, an artist creating a new loan-out corporation can establish a fiscal year starting on that date.

Both loan-out corporations and artists engaged directly by companies as independent contractors can deduct business expenses from taxable income. However, as a loan-out corporation's owner, the artist can benefit from additional deductions available only to corporations. For example, depending on the corporate form selected, the loan-out corporation may be entitled to deduct certain employee benefits, such as insurance premiums the loan-out corporation pays for the artist. The loan-out corporation also can more readily deduct business losses than the artist could when filing tax returns in the artist's individual capacity. Also, corporate business deductions may be less likely to trigger an IRS audit than individual business deductions.

Limited Liability

In addition to the tax benefits, loan-out corporations may help artists limit their liability, therefore protecting their assets. This is particularly valuable for high net-worth artists with more assets at risk.

Because the loan-out corporation is a legal entity separate from the artist, typically only the loan-out corporation's assets are available to satisfy any loan-out corporation liabilities. These liabilities could include, for example, judgments against the loan-out corporation if it breaches any agreements it enters, including:

- Loan and credit card agreements.
- Office, rehearsal space, and equipment rental agreements.
- Employment agreements with any employees, such as personal assistants.
- Engagement agreements with any independent contractors. For example, a writer's loan-out corporation may engage a researcher for a given project.
- Car leases and rental agreements.
- Engagement agreements (see Engaging the Artist Through the Loan-Out Corporation).

The widespread use of inducement letters and paragraphs in the entertainment industry, however, greatly limits artists' protection from liability for engagement agreement breach. For more about inducement letters and paragraphs, see Inducement Letters.

Costs and Additional Responsibilities

The costs to create and maintain a loan-out corporation could outweigh the benefits. The typical rule of thumb is that loan-out corporation costs outweigh benefits if the artist earns less than US $100,000 annually. Typical costs include:

- State corporate fees. For example, most California corporations must pay a US $800 minimum annual franchise fee (A.B. 778).
- Fees for reserving and registering a corporate name (see, for example, Cal. Gov. Code § 12186 (a), (b)). For more about corporate name reservation, see Availability and Reservation.
- Fees for filing corporate documents, such as corporate charters and annual reports (see, for example, Cal. Gov. Code § 12186 (c), (g), (p)).
- Legal fees for counsel engaged to create and maintain the loan-out corporation.

Setting up a loan-out corporation requires additional work and ongoing responsibilities. Typically, an attorney engaged by the artist or artist's management undertakes these responsibilities, which include:

- Selecting a state of incorporation and corporate form and name (see Pre-Incorporation Considerations).

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