

CLIENT ALERT

California EDD Notice Regarding Loanout Companies – Much Ado About Nothing or a Seismic Shift?

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As many of you are aware, The International Alliance of Theatrical Stage Employees (“IATSE”) and the payroll service Cast & Crew recently sent out notices indicating that the California Employment Development Department (the “EDD”) is taking action to disregard loanout companies, which could have the effect of treating loanout shareholders as studio employees and rendering all compensatory payments made to such employee as W-2 wages subject to tax withholding. For decades, federal and state tax authorities have blessed loanout companies and studios routinely have accepted such business structures. Loanout companies provide certain non-tax benefits (such as possible limited liability treatment in certain situations) and multiple tax benefits, including the ability to deduct business expenses (including professional fees such as fees paid to agents, managers, entertainment lawyers, business managers, etc.) and to fund qualified pension plans. Without a loanout in place, none of the business expenses would be deductible because, under the 2017 Tax Cut and Jobs Act, all employee business expenses are currently disallowed, which would dramatically increase the overall tax burden on our talent clients.

There has been public outcry against the EDD’s position due to the seismic consequences that would be caused by the disallowance of loanout companies. Studios would experience a significant increase in their payroll tax burdens and talent would face dramatically higher taxes as noted above, all at a time when the industry is recovering from the strike-related production shutdown while also facing other strong headwinds. In response, the EDD issued the following statement today, which appears to be an effort to mollify industry concerns:

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“We understand the great importance of California’s film and television industry and are proud of our work to support California’s employers and industries. We have received various inquiries highlighting questions about loanout corporations’ ability to operate in California. As we have previously stated, EDD is not taking action to ban [loanout companies] in California”.

See <https://edd.ca.gov/en/about-edd/news-releases-and-announcements/edd-issues-statement-on-loanout-corporations/>.

We have been advised by at least one other major payroll service that they have NOT received a letter from the EDD similar to what was sent to Cast & Crew, and that it is business as usual for them.

The EDD’s statement has helped to reduce the blood pressure of the industry and calm already frayed nerves, and will hopefully enable everyone to resume the prior practice of using and relying on loanout companies for all of the intended benefits. However, there is still some uncertainty about what efforts, if any, the EDD intends to take to challenge what they might perceive as loanout abuses, or why the EDD issued the notice in the first place.

Given the uncertainty, we recommend vigilance on this important topic. If you receive a notice from the EDD or a payroll service which purports to disregard your client’s loanout company, the loanout must file a petition in response to the notice within 30 days of the date on the notice to qualify as a timely appeal. Not all loanouts are created equal, and it is very possible that your client’s loanout company may survive any such scrutiny but your client must exercise its administrative rights in the unfortunate event that you receive such a notice.

Willkie is tracking developments in this area and is in touch with many of the key constituents. Please let us know if you receive any loanout disallowance notices, if you hear of any further developments, or if we can otherwise be of assistance.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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