

By PwC Deutschland | 04. Oktober 2022

Transfer of economic ownership in case of licensing of film distribution rights

According to the Supreme Tax Court the principles developed for leasing agreements regarding the attribution of economic ownership cannot be applied fully and without reservations to the transfer of the use of film rights.

Background

A film production company (plaintiff) concluded a film distribution agreement in December 2006 whereby the exploitation rights of the film XY were transferred from the plaintiff (as owner, licensor) to F, who had its seat in the Netherlands, as licensee.

Since the realization of this film project failed, the plaintiff decided to produce another film as substitute. The existing contracts were adjusted for this purpose. The plaintiff was also the sole and exclusive owner of all rights regarding this film. On the same day, the plaintiff granted F the comprehensive, sole, exclusive, and irrevocable exploitation rights to this film in an amended film distribution agreement for a period of 42 years. In return, F had to make to the plaintiff fixed payments and variable participation royalties. With respect to the eventual expiration of the contract, the film distribution agreement contains various optional provisions: The film distribution agreement could be extended by both parties, otherwise F had the option to acquire ownership of the film rights. The plaintiff had a put option himself but only in the event of dissolution, liquidation, insolvency, or in the case of contractual disruptions or breaches. If the contract term is not extended as planned and F were not to exercise the purchase option, the plaintiff could request from F an interest-free loan. If this latter option were to be exercised, the plaintiff must undertake to "market or otherwise exploit the film in order to repay the amount of the loan to the distributor".

The tax office took the view that according to the structure and implementation of the film distribution agreement economic ownership of the film rights were transferred to F. However, the Tax Court of Cologne upheld the claim of the plaintiff.

Decision

The Supreme Tax Court rejected the appeal of the tax office as unfounded and confirmed the ruling of the Cologne tax court whereby the film distribution agreement concluded between the plaintiff and the licensee did not result in a transfer of beneficial ownership of these film rights to the licensee. The principles developed for leasing agreements regarding the attribution of economic ownership cannot uniformly be applied also to the transfer of use of film rights. This is because a sufficiently reliable assessment of the development of the value of film rights at the time of the conclusion of the distribution agreement is generally not possible.

Where a person other than the owner exercises effective control over an asset in such a way that he can, as a rule, economically exclude the owner's power of disposal over the asset during the normal period of its useful life, the asset shall be attributable to this person, Sec. 39(2) No. 1 Fiscal Code. Thus, the Supreme Tax Court went on to add that economic ownership can be transferred to the beneficial owner only in exceptional cases, e.g., where the owner under civil law is economically excluded from the substance and income of the film rights throughout their expected useful life. This is not the case, however, if – as in the case at hand - the owner under civil law continues to participate in increases in the value of the film rights during the entire term of the agreement by means of performance-based payments.

Ultimately, the Supreme Tax Court also agreed with the Cologne tax court who held that the unusually long

term of the film distribution agreement alone does not result in a transfer of economic ownership. A worthlessness of the film rights resulting from the expiry of the contractual term cannot be expected in view of the normal useful life of 50 years and given a contractual term in the case of dispute of 42 years.

Source

Supreme Tax Court decision of 14 April 2022 (IV R 32/19), published on 4 August 2022.

Schlagwörter

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