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A Tax Shelter for the Film Industry: To Invest or Not to Invest?

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Abstract. This teaching case focuses on tax shelters for audiovisual works. Since its inception in 2003, the Belgian tax shelter system has undergone substantial reforms to make the system more ethical and reduce risks for investors. The necessity to reform the system was in part highlighted by a fraud that affected over 1,200 investors. Students take on the role of a business owner contemplating an investment in the Belgian tax shelter. The case challenges students to discuss the ethics of tax shelters, identify risks for investors and make an investment decision.

Keywords: tax ethics, tax shelters, film financing.

Data sources: All information included in this case was derived from publicly available sources as listed in the reference list. Appendix A was created based on ChatGPT, because the protagonist in the case is using ChatGPT to find background information about the historical evolution of the tax shelter legislation. All other pages of the case are written by the authors based on the references included in the reference list. Names in the case file are fictitious names.

1. Introduction

John Smith is the Chief Executive Officer (CEO) of a successful chain of grocery stores in Belgium and a shareholder in the business along with four additional investors. John is the founder and the only owner involved in managing the business. The business has experienced rapid growth in recent years and managing the costs of the business, including the tax cost, is crucial for the continued success of the grocery stores.

The other four shareholders are merely investors, providing capital to support the expansion of the business. With no special interest in the grocery business, the investors are primarily interested in the return on their invested capital and

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they prioritize tax efficiency. Under the conditions of their investments, the investors will maintain their investment in John's business if they receive a 6% return on investment annually. If the business operations fail to produce the required return, John could lose their investment. He values their ongoing backing and views them as financial partners in building the business.

At the end of the current year, John faces a challenge generated by the success of the business. As a consequence of John's attention to revenue generation and cost management, the business generated €1,000,000 in profit over its expected budgeted earnings. Initially, John began dreaming of ways to use the profits of his hard work - A new inventory system to improve the data available to support his management decision-making process? A webmaster to enhance the online presence of the grocery stores? A trip to a conference for grocery management held in Navarino Bay on the Greek coast? After rousing himself from his daydreams, John considered the immediate situation. The business has a marginal income tax rate of 50%, meaning for every additional Euro of profit, the business pays 50 cents in tax, and for every additional Euro of expense, the business saves 50 cents in tax. At the end of the current year, the business faces an additional tax cost of €500,000 (€1,000,000 * .50 tax rate).

John's initial speculation about the many uses of these unplanned profits was moderated by the realization that half of the profit would be shared with the government. While John is eager to diminish the impact of taxes relative to the windfall profit, he is not interested in options that are legally questionable. Successfully minimizing the tax cost could provide the funding for other lucrative priorities within John's business plan to help him more comfortably meet the required rate of return necessary to keep his investors. However, if the tax planning strategy fails, then not only will it harm the cash position of the business, but John could disappoint or lose his investors.

To eliminate, or at least minimize, this increased tax cost, John sought out tax planning advice from an investment advisor. The advisor suggested a tax shelter as a means of reducing John's tax cost. Tax shelters are created by governments to reward certain behaviors of taxpayers and support causes identified as beneficial to the community/country. The shelters typically shield some portion of income from tax obligation. A common example is the interest earned through holding municipal bonds. Bond purchasers lend money to the government and as a reward, the interest earned on this investment is tax exempt (i.e., sheltered). Tax shelters are also created to benefit particular industries or companies that are viewed as advantageous to the region. In the US, (the state of Texas, in particular), investment in the oil industry is encouraged with tax deductible expenses associated with oil wells. Investors in smaller oil companies can also exclude 15% of the oil well income from their tax base. The economic theory that supports tax shelters for investments suggests that inducements make sense in cases in which the market alone fails to support adequate sector investment. The tax incentive leads to increased use of a productive area that is currently underemployed. The