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April 8, 2004

Mr. E--- J. M---
---, ---, ---, --- & ---, LLP
XXXX --- Street, Suite XXXX
---o, California XXXXX

Re: M--- of A---

Dear Mr. Miethke:

This responds to your December 23, 2003, letter to Mr. Ramon J. Hirsig, then Deputy Director, Sales and Use Tax Department of the Board of Equalization. You wrote on behalf of your client, the M--- of A--- (M---). I will separately address the three topics on which you sought an opinion. Preliminarily, I note that because your letter did not identify a specific entity that performs any of the services described in your letter, my responses herein cannot serve as a basis for relief under Revenue and Taxation Code section 6596.

Format Changes

You wrote:

“The United States and some parts of the world utilize an ‘NTSC’ format for its videotapes. Other parts of the world utilize other formats, such as ‘PAL’ or ‘SECAM.’ When programming (usually television programming) is sent overseas, it is sent in the converted format, but not in a ‘ready to air’ condition. Overseas, foreign-language credits are added, a foreign-language soundtrack or subtitles may be added and commercial ‘blacks’ are ‘relaxed’ to the appropriate length.”

You asked us for an opinion that conversion of tapes from the NTSC format to other formats constitutes “qualified production services,” within the meaning of subdivision (b)(2) of Regulation 1529. That subdivision explains:

“(2) QUALIFIED PRODUCTION SERVICES. ‘Qualified production services’ are any fabrication performed by any person in any capacity (including, but not

limited to, an employee, agent, or independent contractor) on film, tape, or other audiovisual embodiment in connection with the production of all or any part of any qualified motion picture. Qualified production services include, but are not limited to, photography; sound or music recording; creation of special effects or animation on film, tape or other audiovisual embodiment, including animation drawings, inkings, paintings, tracings and celluloid 'cels'; technological modification, including colorizing; adaptation; alteration; computer graphics, including transfers of computer graphics on computer-generated media; sound dubbing or sound mixing; sound or music or effect transferring; film or tape editing or cutting; developing or processing of negatives or positives; timing; coding or encoding; creation of opticals, titles, main or end credits; captioning; and medium transfers (e.g., film to tape, tape to tape).

“The term includes any such fabrication whether performed on the qualified motion picture before or after the release date. The term does not include work to manufacture release prints.

“Qualified production services include processing performed on a qualified motion picture, except for processing to produce release prints. Processing includes film developing and processing; film to tape transfers; and sound transferring, rerecording, dubbing, and mixing.”

It is my understanding from your letter that in a typical transaction, a studio will retain a firm to convert a qualified motion picture from an NTSC format to other formats. To complete the work, the firm purchases raw film or tape stock, uses its machinery to transfer the qualified motion picture onto the raw film or tape, and then sells the resulting product to the studio. If that effort constitutes qualified production services (and assuming the original product is a qualified motion picture), then the charges for converting it to the new format are not taxable, and the company doing the work is the consumer of the raw film or tape stock. (Reg. 1529(a).)

As set forth above, the manufacturing and processing of release prints does not constitute qualified production services. (Reg. 1529(b)(2).) Subdivision (b)(3)(A) of Regulation 1529 explains the consequences arising from sales of release print:

“(3) RELEASE PRINTS.

“(A) The manufacturing of release prints is not the performance of qualified production services. The application of sales tax to sales of release prints is the same as the application of tax to other sales of tangible personal property; that is, the sale of a release print to a person for exhibition or broadcast is a retail sale subject to sales tax. The sale of a release print for resale is not subject to tax. See subdivision (d)(11)(A) for a list of film and tape products which are release prints.”

Therefore, if the company converts a qualified motion picture from an NTCS format into multiple broadcast quality copies (release prints) in a different format, the charges will be taxable, absent some exemption or exclusion. Where the studio provides a master of a qualified motion picture and requests that it be converted into a single master in another format, and additional post-production is required prior to manufacturing of release prints from the newly-formatted master (such as the addition of foreign-language credits and soundtrack), such services constitute qualified production services. In these cases, the charges of the firm performing the conversion would be nontaxable.

Electronic Press Kits:

You next asked about the tax treatment of charges for sales of electronic press kits (“EPK”). An EPK is either a video tape or a DVD, prepared for movie studios to be distributed to local television stations prior to the release of a new movie. The studio sends a master of the EPK to the duplicating facility, which fabricates several hundred tape or DVD copies of the EPK for the studio. You have explained that an EPK has several interviews with the star or co-stars, as well as various clips of the movies. An EPK also has gaps or blank time slots between each interview and movie clip, so that local television stations can impose its film reviewers on the tape, and edit and customize the tape or DVD for its needs.

You believe that the preparation of the duplicate EPKs on tape or DVD constitutes qualified production services, so that the charges of the duplicating facility to the studio will be exempt pursuant to subdivision (a) of Regulation 1529. You have represented that certain conditions exist which support your contention, namely that further sound editing and color correction are needed before the tape or DVD can be broadcast, and that the buyers will certify to the duplicating facility that the tapes are not of broadcast quality, and are not used for exhibition or broadcast until the further editing and corrections have been accomplished. Under those circumstances, I agree that the preparation of duplicate EPKs constitutes qualified production services, and the charges therefore would be exempt. However, if an audit revealed that the duplicated copies were actually of broadcast quality and were used for exhibition or broadcast without further editing, the exemption would not apply.

I see that Annotation 375.0783 (1/21/97) is inconsistent with the opinion expressed herein. I will have it removed from the Business Taxes Law Guide.

Screeners

On this subject you wrote:

“ ‘Screeners’ are promotional or marketing copies of motion pictures that are distributed to video stores, critics, industry executives, etc. for personal use. Routinely, screeners are ‘burned in’ with an anti-piracy warning, making them unsuitable for broadcast or exhibition.”

You have asked us for an opinion that preparation of screeners by a duplicating facility constitutes qualified production services, thereby exempting its charges under subdivision (a) of Regulation 1529. As discussed above, if the screeners constitute release prints, as defined in subdivision (d)(11) of Regulation 1529, then the work to produce the screeners does not constitute qualified production services. (Reg. 1529 (b)(2).) I also note that subdivision (d)(11)(A) of Regulation 1529 identifies a "Screening Copy (Complete)" as "A print used for marketing, goodwill or other promotional purposes," and states that such a screener is a release print.

However, screeners are only release prints if they are suitable for exhibition or broadcast. (Reg. 1529(d)(11)(A).) It is my opinion that if the screeners include anti-piracy overlays that are overtly visible during viewing, they are not suitable for exhibition or broadcast, and thus do not constitute release prints. Charges for such screeners are therefore exempt, and the duplicating facility is the consumer of the materials it purchases to produce the screeners. (Reg. 1529 (a).) However, screeners that do not include overtly visible anti-piracy protection and are suitable for exhibition or broadcast do constitute release prints, and the charges of the duplicating facility for such screeners will be subject to tax.

I hope this letter sufficiently addresses your questions. If you need further assistance, please write again.

Sincerely,

Jeffrey H. Graybill
Senior Tax Counsel

JHG/ds

cc: Culver City District Administrator (AS)
Van Nuys District Administrator (AC)
Mr. Ramon J. Hirsig (MIC: 43)