



State of California
Franchise Tax Board

Legal Division MS A260
PO Box 1720
Rancho Cordova, CA 95741-1720

tel: (916) 845-3306 fax: (916) 845-3648
ftb.ca.gov

chair John Chiang | member Jerome E. Horton | member Ana J. Matosantos

06.14.13

CHIEF COUNSEL RULING 2013-01

Dear M*. *****:

You requested a Chief Counsel with respect to the operation of California Code of Regulations, title 18, section 25137-8.2 pertaining to ***** Corporation and Affiliates.

FACTS

***** is a motion picture entertainment company. One of its activities involves taking existing film properties and ***** (****) the films. The *** process transforms two-dimensional and three-dimensional films so that they may be displayed in an ***** theater. In a typical *** arrangement, a film studio contracts with ***** to produce the *** film, and in return ***** is entitled to a share, ** to ** percent, of the *** film's box office receipts from display in all theaters using the ***** display system.

The *** process is a multi-step process that is analogous to conventional film production. ***** digitally encodes the 35mm version of a film for showing in ***** theaters. The digitally encoded film is then analyzed for flaws and general trends such as lighting and color. Unique customized algorithms are developed for each film that expand and create color pixels in the conversion of the film for display in an ***** theater. The pixels are applied via a computer-automated process. The majority of this work is performed outside of California. Quality control is conducted by a subsidiary located in California and necessary adjustments are made.

The *** process employs both manual and automated processes involving a number of individuals including editors, coordinators, accountants, sound technicians and digital artists.

Distribution is accomplished in several ways. The finished *** film on ***** negative film stock is shipped to another company, where it is compiled into an ***** Digital Cinema package for exhibition in ***** theaters, or it is drop-shipped to theaters for exhibition.

ISSUE

For purposes of the *** process is ***** a "producer" such that the revenue derived from the *** process constitutes gross receipts from "films in release to theaters" so that such receipts will be assigned to the numerator of the sales factor pursuant to title 18, California Code of Regulations ("Regulation") section 25137-8.2(c)(3)(A)(i)?

HOLDING

For purposes of the *** process ***** is a "producer" such that the revenue derived from the *** process constitutes gross receipts from "films in release to theaters," so that such receipts should be assigned to the numerator of the sales factor pursuant to Regulation section 25137-8.2(c)(3)(A)(i).

DISCUSSION

Regulation section 25137-8.2(b)(5) defines a producer as "a business entity that develops and creates motion picture, television, or web-based content."

The activities that ***** engages in creating *** films out of existing 35mm film properties are all those of a nature traditionally performed by a producer of motion pictures. ***** edits and enhances films for exhibition in movie theaters. ***** converts existing films via a computer-automated process by expanding and creating color pixels so that the film may be displayed in an ***** theater. It employs a number of individuals in capacities identical to those employed by producers of traditional motion picture films. Those capacities include those of, editors, digital artists, sound technicians, color technicians, production accountants, and coordinators. Products are reviewed to ensure quality control. ***** develops and creates a "new" film product. ***** is a producer within the meaning of regulation section 25137-8.2(b)(5).

Because ***** is a producer as defined in regulation section 25137-8.2(b)(5), the receipts it receives from the distribution of the films that it produces should be assigned pursuant to Regulation section 25137-8.2(c)(3)(A)(i).

Please be advised that the tax consequences expressed in this Chief Counsel Ruling are applicable only to the named taxpayer and are based upon and limited to the facts you have submitted. In the event of a change in relevant legislation, or judicial or administrative case law, a change in federal interpretation of federal law in cases where our opinion is based upon such an interpretation, or a change in the material facts or circumstances relating to your request upon which this opinion is based, this opinion may no longer be applicable. It is your responsibility to be aware of these changes, should they occur.

This letter is a legal ruling by the Franchise Tax Board's Chief Counsel within the meaning of paragraph (1) of subdivision (a) of section 21012 of the Revenue and Taxation Code.

Please attach a copy of this letter and your request to the appropriate return(s) (if any) when filed or in response to any notices or inquiries which might be issued.

Very truly yours,

Benjamin F. Miller
Counsel, Multistate Tax Affairs