

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-02(50)S
Sales Tax
September 27, 2002

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S010112A

On January 12, 2001, the Department of Taxation and Finance received a Petition for Advisory Opinion from Deloitte & Touche LLP, Two World Financial Center, New York, NY 10281. Petitioner, Deloitte & Touche LLP, provided additional information pertaining to the Petition on September 6, 2001.

The issue raised by Petitioner is whether purchases by its client, XYZ, Inc., of equipment, tools, materials, supplies, and services used in the creation of master recordings of movies/videotapes, television series, and musical CDs qualify for exemption from sales and compensating use tax under the production exemption provided by Section 1115(a)(12) of the Tax Law or as purchases for resale under Section 1101(b)(4) of the Tax Law.

Petitioner submitted the following facts as the basis for this Advisory Opinion.

XYZ, Inc., a New York based corporation, is a United States (“US”) producer and sales agent. XYZ, Inc. has been granted exclusive rights to produce and market its clients’ trademark products in the US, including movies and videotapes, television series, and musical compact discs (“CDs”). In most instances, XYZ, Inc. does not obtain title to its clients’ products. However, XYZ, Inc. is currently producing a US marketable television series in which XYZ, Inc. holds title.

The original format received by XYZ, Inc. from its client is not marketable in the US. XYZ, Inc. creates a master recording (“US Recording”) from the original foreign format. XYZ, Inc. incurs all expenses associated with the production of the master recording. For movies and videotapes XYZ, Inc. is reimbursed by its clients for one half of the expenses incurred.

XYZ, Inc. will ultimately license the US Recordings to unrelated third parties (“US Distributors”) for mass production and distribution, such as theater presentations and videotape sales. The license is for a specified period of time, e.g., 10 years. The US Distributor will have the exclusive right to market, distribute, subdistribute, and otherwise exploit the US Recording, and advertising materials, excerpts, and clips therefrom. Generally, the US Distributor is also granted the right to make the necessary alterations required to make the US Recording suitable for exhibition. At the expiration of the term, all rights will revert to XYZ, Inc.

XYZ, Inc. receives from the US Distributors a fixed license fee plus royalties. The fixed license fee is charged to the US Distributors for the license to use the newly created US Recording. The fee is always a fixed amount. However, the amount may vary from contract to contract. XYZ, Inc. accounts for the fixed fee as a royalty advance. However, XYZ, Inc. is entitled to the fixed fee regardless of whether any royalties accrue.

XYZ, Inc.'s production process for movies, videotapes, and television series includes translation, voice and sound mixing, dubbing, and film editing. The production process for creating master CDs includes the selecting, dubbing, editing, and mixing of existing musical compositions into a marketable arrangement. Dubbing includes the translation of the musical compositions into both English and foreign languages.

Expenses incurred by XYZ, Inc. in the production of US recordings include, but are not limited to, rental of studio time, technician wages, and purchases of production equipment, tools, parts, and supplies. Production equipment includes various recorders, equalizers, compressors, and monitoring systems for movies, videotapes, and CDs, and specialized computers, software, dubbing equipment, and monitoring systems for television series. All of the expenses incurred by XYZ, Inc. are predominantly used in the production of the US Recordings.

Applicable Law and Regulations

Section 1101(b) of the Tax Law provides, in part:

When used in this article for the purposes of the taxes imposed by subdivisions (a), (b), (c) and (d) of section eleven hundred five and by section eleven hundred ten, the following terms shall mean:

* * *

(4) Retail sale. (i) A sale of tangible personal property to any person for any purpose, other than (A) for resale as such or as a physical component part of tangible personal property. . . .

(5) Sale, selling or purchase. Any transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume (including, with respect to computer software, merely the right to reproduce), conditional or otherwise, in any manner or by any means whatsoever for a consideration, or any agreement therefor, including the rendering of any service, taxable under this article, for a consideration or any agreement therefor.

Section 1105 of the Tax Law provides, in relevant part:

. . . there is hereby imposed and there shall be paid a tax of four percent upon:

(a) The receipts from every retail sale of tangible personal property, except as otherwise provided in this article.

* * *

(c) The receipts from every sale, except for resale, of the following services:

* * *

(2) Producing, fabricating, processing, printing or imprinting tangible personal property, performed for a person who directly or indirectly furnishes the tangible personal property, not purchased by him for resale, upon which services are performed.

(3) Installing tangible personal property . . . or maintaining, servicing or repairing tangible personal property . . . not held for sale in the regular course of business, whether or not the services are performed directly . . . or by any other means, and whether or not any tangible personal property is transferred in conjunction therewith. . . .

Section 1105-B of the Tax Law provides, in part:

(a) Receipts from the retail sales of parts with a useful life of one year or less, tools and supplies for use or consumption directly and predominantly in the production of tangible personal property . . . for sale by manufacturing, processing, generating, assembling, refining, mining or extracting shall be exempt from the tax imposed by subdivision (a) of section eleven hundred five of this article.

Section 1115 of the Tax Law provides, in part:

(a) Receipts from the following shall be exempt from the tax on retail sales imposed under subdivision (a) of section eleven hundred five and the compensating use tax imposed under section eleven hundred ten:

* * *

(12) Machinery or equipment for use or consumption directly and predominantly in the production of tangible personal property . . . for sale, by manufacturing, processing, generating, assembling, refining, mining or extracting, but not including parts with a useful life of one year or less or tools or supplies used in connection with such machinery or equipment. . . .

Section 1132(c)(1) of the Tax Law provides, in part:

For the purpose of the proper administration of this article and to prevent evasion of the tax hereby imposed, it shall be presumed that all receipts for property or services of any type mentioned in subdivisions (a), (b), (c) and (d) of section eleven hundred five . . . are subject to tax until the contrary is established, and the burden of proving that any receipt . . . is not taxable hereunder shall be upon the person required to collect tax or the customer. Except as provided in subdivision (h) or (k) of this section, unless (i) a vendor, not later than ninety days after delivery of the property or the rendition of the service, shall have taken from the purchaser a resale or exemption certificate in such form as the commissioner may prescribe, signed by the purchaser and setting forth the purchaser's name and address and, except as otherwise provided by regulation of the commissioner, the number of the purchaser's certificate of authority, together with such other information as the commissioner may require, to the effect that the property or service was purchased for resale or for some use by reason of which the sale is exempt from tax under the provisions of section eleven hundred fifteen . . . the sale shall be deemed a taxable sale at retail. . . .

Section 526.6(c) of the Sales and Use Tax Regulations provides, in part:

Resale exclusion. (1) Where a person, in the course of his business operations, purchases tangible personal property or services which he intends to sell, either in the form in which purchased, or as a component part of other property or services, the property or services which he has purchased will be considered as purchased for resale, and therefore not subject to tax until he has transferred the property to his customer.

Section 526.7 of the Sales and Use Tax Regulations provides, in part:

(a) *Definition.* (1) The words *sale*, *selling* or *purchase* mean any transaction in which there is a transfer of title or possession, or both, of tangible personal property for a consideration.

(2) Among the transactions included in the words *sale*, *selling* or *purchase* are exchanges, barters, rentals, leases or licenses to use or consume tangible personal property.

(c) *Rentals, leases, licenses to use.* (1) The terms *rental*, *lease* and *license to use* refer to all transactions in which there is a transfer for a consideration of possession of tangible personal property without a transfer of title to the property. Whether a transaction is a "sale" or a "rental, lease or license to use" shall be determined in accordance with the provisions of the agreement. . . .

* * *

(e)(4) *Transfer of possession* with respect to a rental, lease or license to use, means that one of the following attributes of property ownership has been transferred:

- (i) custody or possession of the tangible personal property, actual or constructive;
- (ii) the right to custody or possession of the tangible personal property;
- (iii) the right to use, or control or direct the use of, tangible personal property.

Opinion

The trademark products of XYZ, Inc.'s clients include foreign movies and videotapes, television series, and musical CDs. XYZ, Inc. produces and markets its clients' products in the United States by creating master recordings (US Recordings) of the products through the processes of translation, voice and sound mixing, dubbing, and editing. The US Recordings are ultimately licensed by XYZ, Inc. to unrelated third parties (US Distributors) for mass production and distribution in the US. For the license, XYZ, Inc. receives from the US Distributors a fixed fee.

The creation of feature films, television films, commercials, and similar film and video productions is considered a manufacturing activity that results in the production of tangible personal property. Therefore, a person engaged in the production of a film for sale is afforded all of the exemptions which are available to manufacturers. See A Guide to Sales Tax for the Film Industry, Publication 28, p.1, (8/99). A license agreement provided in connection with the transfer of tangible personal property constitutes a sale as defined in Section 1101(b)(5) of the Tax Law. Accordingly, XYZ, Inc.'s creation of US Recordings licensed to distributors for a fixed fee results in the production of tangible personal property for sale and XYZ, Inc. is entitled to all of the exemptions available to manufacturers. See A Guide to Sales Tax for the Film Industry, *supra*, p. 2.

Machinery or equipment, as well as parts, tools and supplies, used or consumed directly and predominantly (more than 50%) in the production of XYZ, Inc.'s US Recordings may be purchased or leased exempt from all sales and use taxes under Sections 1115(a)(12) and 1105-B of the Tax Law. The manufacturing exemption for film and music producers extends through the post production activities of selecting, editing, dubbing, and mixing. See A Guide to Sales Tax for the Film Industry, *supra*, pp. 5, 18. Accordingly, XYZ, Inc.'s purchases of production equipment (recorders, equalizers, compressors, monitoring systems, specialized computers, software, and dubbing equipment), tools, parts, and supplies that are used predominantly in these manufacturing activities, as well as in the translation process, are exempt from sales and compensating use tax (see Frankford/Wayne Mastering Labs, Inc., Adv Op Comm T&F, September 25, 1987, TSB-A-87(24)C; A Guide to Sales Tax for the Film Industry, *supra*). XYZ, Inc. must furnish a properly completed

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Form ST-121, *Exempt Use Certificate*, to its suppliers within 90 days of the date of sale to exempt such qualifying purchases. See Section 1132(c) of the Tax Law.

The renting of a studio typically includes the use of equipment along with the services of a technician. When XYZ., Inc. has the right either to direct the activities of the technician, or to supply a technician of its own, possession of the equipment is deemed to have been transferred to XYZ, Inc. This makes the rental charge for the equipment subject to tax pursuant to Section 1105(a) and 1101(b)(5) of the Tax Law, unless the equipment qualifies for exemption under Section 1115(a)(12) of the Tax Law as described above. In any case, the portions of the rental charge allocable to the technician's wages and rent for the room space itself are not taxable, provided the charges are reasonable and separately stated on the invoice and the wages reflect prevailing wage rates. See Salomon & Leitgeb CPA's, LLP, Adv Op Comm T&F, July 23, 1997, TSB-A-97(44)S.

Materials, e.g., the original tape, and services on these materials, e.g., negative splicing, that will become a component of the US Recordings, come within the resale exclusion from sales tax inasmuch as the materials are resold by XYZ, Inc. to the US Distributors. See A Guide to Sales Tax for the Film Industry, *supra*, p. 16, 17. Such materials and services may be purchased exempt from tax provided XYZ, Inc. issues a properly completed Form ST-120, *Resale Certificate*, to its supplier no later than 90 days after delivery of the property or service. See Section 1132(c) of the Tax Law. It is noted that for purposes of usual industry practice, the activities of editing and dubbing by an editing house result in the creation and sale of tangible personal property rather than the providing of a service on the property of the producer as described in Section 1105(c)(2) of the Tax Law. Therefore, XYZ, Inc. may purchase such property as production equipment exempt from tax. See A Guide to Sales Tax for the Film Industry, *supra*, pp. 16 - 21.

DATED: September 27, 2002

/s/
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NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.