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MASTER RECORDINGS: HOW DOES THE CALIFORNIA SALES TAX APPLY?

*By Edward G. Samaha**

INTRODUCTION

California sales tax law provides that a tax is imposed upon the final sale, lease, storage, use, or consumption of tangible personal property.¹ As early as 1939, the California State Board of Equalization (hereinafter referred to as the "Board") ruled that master recordings² and finished records³ furnished by a processor to producer are tangible personal property subject to tax.⁴ In the early 1970's the Board began assessing deficiency notices for back payments of sales taxes on recording companies for the royalties received from their sales of master recordings.⁵

These deficiency assessments were contested by the recording industry,⁶ and in 1976, legislation was introduced and ultimately enacted which exempted from sales tax the copyrightable, artistic, or intangible elements of master recordings.⁷ However, this law did not specifically

* Member, Third Year Class.

1. Assembly Revenue and Taxation Committee, Memorandum on AB 2871, p. 3, (1982). See Appendix, *infra*.

2. Master recordings are the medium upon which sound is recorded. The recording process is as follows: Microphones convert sound waves into electrical signals, which are then processed through the magnetic tape recorder. The magnetic tape recorder converts electrical signals into magnetic ones and imprints those signals as patterns on a recording tape. The tape consists of a plastic backing coated with metallic particles (feric oxide, chromium dioxide, or other metallic oxides) which react to electrical signals. The recording head on the tape recorder, functioning like a small electromagnet, aligns these particles into magnetic patterns that reflect the sound being recorded. Rapport, *How to Make and Sell Your Own Record*, 70, 72-73 (1979).

3. Master recordings are used to produce finished records or tapes. The record making process is as follows: After the master tape is cut, the disc mastering takes place. Disc mastering or disc cutting is the process of transforming the music on the master tape into grooves on an aluminum disc coated with lacquer. The master tape is played through a disc mastering console and converted by a lathe into the mechanical motion of a stylus. This stylus cuts the actual grooves, which physically represent the music on the master tape. Next, there is a three step process that transforms the lacquer into a permanent plate. Finally, from this plate, the records are pressed. Rapport, *supra*, at 59-61.

4. *Id.*

5. *Id.*

6. *Id.*

7. Actually, the appropriate law, California Revenue and Taxation Code § 6362.5, was

exempt the production of "fabrication" elements required to make master recordings.⁸ Again, the recording industry contested the deficiency assessments; this time on those that were assessed on fabrication costs.⁹ In response to the industry pressure, the legislature, in 1982, enacted an amendment which exempts fabrication costs from sales tax.

This comment will examine three distinct phases of California sales tax law on master recordings: pre-1976 law, post-1976 but pre-1982 amendment, and post-1982 amendment. Each phase will be analyzed, as to what portion, if any, of a master recording sale the Board was or is able to subject to sales tax.¹⁰

PRE-1976 LAW

Before 1976 there was no specific sales tax exemption for master recordings. Therefore, one looked to the California Revenue and Taxation Code to determine if a master recording transaction was subject to sales tax.

California imposed then, and still imposes a tax upon "the privilege of selling tangible personal property at retail."¹¹ Tangible personal property is "personal property which may be seen, weighed, measured, felt, or touched, or which is in any other manner perceptible to the senses."¹² A retail sale is "a sale for any purpose other than resale in the regular course of business in the form of tangible personal property."¹³ The legislature has delegated to the Board the duty of enforcing the sales tax and has authorized the Board to adopt regulations for effectively discharging its duty.¹⁴

The questions that these statutes raise when applying them to master recordings are, first, is a master recording tangible personal property; and second, if so, then is the sale of a master recording a retail sale.

Is a Master Tape Tangible Personal Property?

Since all transfers of property include both tangible and intangible elements, the taxability of a particular sale depends upon the "true ob-

enacted in September of 1975. However, for ease of discussion, it will be referred to as "1976" law.

8. Assembly Memorandum, *supra*, at note 1.

9. *Id.*

10. California Assembly Bill No. 2871, Chapter 951 (9-10-82).

11. Cal. Rev. & Tax. Code § 6051 (Deering 1975).

12. Cal. Rev. & Tax. Code § 6016 (Deering 1975).

13. Cal. Rev. & Tax. Code § 6007 (Deering 1975).

14. Cal. Rev. & Tax. Code § 7051 (Deering 1975).

ject of the transaction.”¹⁵ This principle is embodied in the Board’s regulation 1501 which states: “[I]s the real object sought by the buyer the service per se or the property produced by the services. If the true object of the contract is the service per se, the transaction is not subject to tax even though some tangible personal property is transferred.”¹⁶

When attempting to assess master recordings, the Board argues that the “true object of the transaction” is to obtain the master recordings (the property produced by the service) and not to obtain the service per se.¹⁷ This position would impose a tax upon the full amount received for the master recordings because tangible personal property valued in part for its intangible content may be taxed on its total worth.¹⁸ This tax consequence is embodied in 1501:

When a transaction is regarded as a sale of tangible personal property, tax applies to the gross receipts from the furnishing thereof without any deduction on account of the work, labor, skill, thought, time spent, or other expense of producing the property.¹⁹

Regulation 1501 goes on to give examples of what the Board believes are good illustrations of how the “true object of the transaction” is determined:

Persons engaged in the business of rendering services are consumers, not retailers, of tangible personal property which they use incidentally in rendering the service . . . Thus, the transfer to a publisher of an original manuscript by the author thereof for the purpose of publication is not subject to taxation. The author is the consumer of the paper on which he has recorded the text of his creation. However, the tax would apply to the sale of mere copies of an author’s works or the sale of manuscripts written by other authors where the manuscript itself is of particular value as an item of tangible personal property and the purchaser’s primary interest is in the

15. *Simplicity Pattern Co. v. State Board of Equalization*, 27 Cal. 3d 900, 907, 167 Cal. Rptr. 366, 370 (1980).

16. Cal. Admin. Code, tit. 18, R. 1501 (1972).

17. While an administrative agency’s interpretation of its own regulations deserves great weight, the ultimate resolution of such legal questions rests with the courts—i.e. it is within the scope of judicial review to determine whether the Board has followed legislative intent and whether the Board has interpreted its own relevant regulations properly. *Simplicity Pattern Co.*, at 905, 167 Cal. Rptr. at 368, (citing *Carmona v. Division of Industry Safety*, 13 Cal. 3d 303, 310, 118 Cal. Rptr. 473, 476 (1975)).

18. *Simplicity Pattern Co.*, at 906, 167 Cal. Rptr. at 369.

19. Cal. Admin. Code, tit. 18, R. 1501 (1972).

physical property. Tax would also apply to the sale of artistic expressions in the form of paintings and sculptures even though the work of art may express an original idea since the purchaser desires the tangible object itself: that is since the true object of the contract is the work of art in its physical form.²⁰

The California Supreme Court in *Simplicity Pattern Co. v. State Board of Equalization*,²¹ applied 1501 to a case in which the applicability of sales tax to master recordings was disputed. The court held that the plaintiff's master recordings were tangible personal property sold at retail and therefore subject to tax.

In *Simplicity Pattern Co.*, the plaintiff (Simplicity Pattern Co.) produced and marketed audio-visual educational materials used to train nurses. The product was a package comprised of a film strip, phonograph record, and instructor's guide. In 1971, Simplicity sold its assets and included in those assets were master recordings. The Board determined that the transfer of those assets was a retail sale subject to sales tax. The plaintiff sued, arguing that the sale of the master recordings was not taxable as it was not a sale of tangible personal property. The court disagreed.

In comparing a master recording to the manuscript example in 1501, the court held that a master recording is analogous to a printing plate (tangible property)²² while a manuscript furnishes only verbal guidance to the editors and typesetters (a service). A manuscript was distinguished from the master recording sales in that a manuscript is used solely for its intellectual content, while a master recording, though having intellectual content, is also physically useful in making the finished product.²³

This rationale, however, appears to draw a fictional distinction in two ways. First, in either situation, a sale of a manuscript or a master recording, one buys the creator's thought or effort so it can be copied and made into a final product (a tangible item—i.e., a book or record). The only difference between a manuscript and a master recording lies in the means by which the thought or creative effort is transmitted: A master recording transmits by way of sound waves, a manuscript transmits by way of printed words. This difference is not substantial, how-

20. *Id.*

21. *Simplicity Pattern Co.*, *supra* note 15.

22. *Simplicity Pattern Co.* at 909, 167 Cal. Rptr. at 371.

23. *Id.* at 912, Cal. Rptr. at 373.

ever, as the purpose of both the sound wave and printed word is to transmit a creative effort.

Second, a manuscript is purchased for the total creation or service, not each printed word. It is only when these words are gathered into a thought do they have meaning and worth. This principle applies equally well to master recordings. Each recorded sound wave has little or no value, but when gathered into a full recording, it has meaning and worth. Therefore, just because a master recording gives the added benefit of being more efficient—it is involved with the actual physical recording process (see footnote three)—does not mean that the true object of the transaction is no longer the attainment of the creator's services.

Is the Sale of a Master Recording a Retail Sale?

Assuming, for argument's sake, that master recordings are tangible personal property, the recordings must still be sold in a retail transaction before they are subject to sales tax as California only imposes a sales tax upon "the privilege of selling tangible personal property at retail."²⁴

California Revenue and Taxation Code § 6007 provides that "a 'retail sale' or 'sale at retail' means a sale for any purpose other than resale in the regular course of business . . ." ²⁵ A master recording buyer can argue that the master recording is really a goods in process or stock in trade, i.e. inventory. Therefore, the transfer of a master recording would be for the purpose of resale.

However, the California Supreme Court in *Simplicity Pattern Co.* disagreed with this contention and concluded that sales tax law does not treat all properties consumed, disposed of, or made obsolete in the business of operating cycle as goods held for resale, even if Generally Accepted Accounting Principles may call for their treatment as inventory.²⁶ That court found that the Board's Regulation 1525 properly interprets how § 6007 relates to the sale of master recordings.²⁷ Regulation 1525 provides:

- (a) Tax applies to the sale of tangible personal property to persons who purchase it for the purpose of use in manufacturing producing or processing tangible personal property and not for the purpose of physically incorpo-

24. Cal. Rev. & Tax Code § 6051, *supra* note 11.

25. Cal. Rev. & Tax Code § 6007, *supra* note 13.

26. *Simplicity Pattern Co.*, at 913, 167 Cal. Rptr., at 373-374.

27. *Id.*, 167 Cal. Rptr. at 374.

rating it into the manufactured article to be sold. Examples of such property are machinery, tools, furniture, office equipment, and chemicals used as catalysts or otherwise to produce a chemical or physical reaction such as the production of heat or the removal of impurities.

- (b) Tax does not apply to sales of tangible personal property to persons who purchase it for the purpose of incorporating it into the manufactured article to be sold, as, for example, any raw material becoming an ingredient or component part of the manufactured article."²⁸

In applying 1525, the court in *Simplicity Pattern Co.* concluded that a buyer's primary purpose in buying a master recording is to use it in manufacturing the final product (i.e., it functions as a printing plate) rather than to incorporate it into the final product. Thus, such a sale is not for resale and it does not escape tax.²⁹ The following appears to be the court's analysis of the situation: The master recording is needed directly to make the record pressing plate. These plates are used to press and manufacture records, but do not become physically incorporated into the final playing disc.³⁰ This situation falls within the spirit and purpose of Regulation 1525 as the Board drafted that Regulation to emphasize that physical incorporation into the sold property is required before an exemption from sales tax is allowed.

Conclusion on Pre-1976 Law

Once the court in *Simplicity Pattern Co.* decided that master recordings are tangible personal property, it was easy for the court to conclude that a master recording's sale is at retail and subject to tax.³¹

28. Cal. Admin. Code, tit. 18 R. 1525 (1974).

29. *Simplicity Pattern Co.*, at 914, 167 Cal. Rptr. at 374.

30. See generally, Rapport, *How to Make and Sell Your Own Record*, *supra* note 2 (for a more detailed explanation of the process).

31. Since it is possible that a sales tax return was not filed by the record producers and engineers, California Revenue and Taxation Code § 6487 provides for liability up to eight years. The pertinent parts read as follows:

For taxpayers filing returns on other than an annual basis, except in the case of fraud intent to evade this part or authorized rules and regulations, or failure to make a return, every notice of a deficiency determination shall be mailed within three years after the last day of the calendar month following the quarterly period for which the amount is proposed to be determined within three years after the return is filed, whichever period expires the later. In the case of failure to make a return, every notice of determination shall be mailed within eight years after the last day of the calendar month following the quarterly period for which the amount is proposed to be determined.

Although the court's holding that a master recording is tangible personal property is subject to criticism (discussed *supra*), the decision is not likely to be overruled as the 1976 law was not retroactive and the court was well aware of legislative sentiment that the sale of master recordings should not be taxed.³²

POST-1976 LAW, BUT PRE-1982 AMENDMENT

The legislature attempted to end the pre-1976 master recording taxable or non-taxable controversy by enacting § 6362.5 of the California Revenue and Taxation Code. The pertinent parts of § 6362.5 state:

- (a) There are exempted from the taxes imposed by this part the gross receipts from the sale or lease of, . . . master tapes or master records embodying sound, except amounts subject to the taxes imposed by other provisions of this part paid by a customer in connection with the customer's production of master tapes or master records to a recording studio for the tangible elements of such master records or master tapes.
- (b) For purposes of this section: . . . (2) "Amounts paid for the furnishing of the tangible elements" shall not include any amounts paid for the copyrightable, artistic or intangible elements of such master tapes or master records, whether designated as royalties or otherwise.³³

Although the section was enacted too late for pre-enactment sales (6362.5 does not have a provision that is retroactive to pre-1976 sales), it appeared that under § 6362.5 at least post-enactment buyers and sellers of master recordings could transact business without worrying about the imposition of sales tax.

However, this situation did not become a reality. Subsequent to the enactment of 6362.5 the Board took the position that the full

For taxpayers filing returns on an annual basis, except in the case of fraud, intent to evade this part or authorized rules and regulations or failure to make a return, every notice of a deficiency determination shall be mailed within three years after the last day of the calendar month following the one year period for which the amount is proposed to be determined or within three years after the return is filed, whichever period expires the later. In the case of failure to make a return, every notice of determination shall be mailed within eight years after the last day of the calendar month following the one year period for which the amount is proposed to be determined . . .

Cal. Rev. & Tax code § 6487 (Deering Supp. 1982).

32. *Simplicity Pattern Co.*, was decided in 1980—a few years after the passage of the 1976 law. Yet, the underlying transaction took place prior to 1976, and it was therefore governed by pre-1976 law.

33. Cal. Rev. & Tax. Code § 6362.5 (Deering Supp. 1982).

amount charged by a recording engineer to create a master recording is subject to tax.³⁴ This amount included all of the charges for the finished product, without deduction for the cost of travel, hotel rooms, materials or equipment used and other associated expenses.³⁵

The Board based its argument on California Revenue and Taxation Code § 6006. Under § 6006:

'Sale' means and includes: . . . (b) The producing, fabricating, processing, printing, or imprinting of tangible personal property for a consideration for consumers who furnish either directly or indirectly the materials used in the producing, fabricating, processing, printing, or imprinting³⁶

In administering § 6006, the Board did limit sales tax liability to transactions where the production studios or production engineers made master recordings for artists who intended to use the master recording themselves, i.e., where the production of the master was the final retail sale.³⁷ In situations where the master recording was to be resold immediately to a record company, the master recording's production was not subject to sales tax as that sale was not the final, retail sale.³⁸ Therefore, the Board's position was that its pre-1976 arguments that master recordings are tangible personal property and that their sale is at retail would still have limited applicability in the situation where the artist would keep the master for his own use.³⁹

To support its position, the Board pointed to evidence of legislative intent which the Board said was consistent with its stand. One item was a Senate Revenue and Taxation Committee Bill Analysis of the 1976 legislation. There the Committee stated that the bill includes in the amounts subject to tax "charges for the use of the studio's recording facilities and technical personnel."⁴⁰

Another item of supposed legislative intent was that the 1976 bill, as it left the Senate, contained the following language:

[T]he tangible elements of such master records or master tapes, include charges for the use of the studio's recording facilities and technical personnel in connection with the cus-

34. Assembly Revenue and Taxation Committee Memorandum, *supra*, note 1, at 4.

35. *Id.*

36. Cal. Rev. & Tax. Code § 6006 (Deering Supp. 1982).

37. Assembly Revenue and Taxation Committee Memorandum, *supra*, note 1, at 3.

38. *Id.*

39. *Id.* at 4.

40. *Id.* at 5.

tomers' production of such master tapes or master records
⁴¹

These items, however, do not accurately reflect legislative intent as the 1976 bill was amended in the Assembly. This amendment allowed for the passage of the bill and created a version of § 6362.5 which stood until the 1982 amendment. The amendment deleted the language of the bill which provided that charges for the use of the studio's recording facilities and technical personnel would remain taxable.⁴² The Assembly stated that the purpose of the amendment was "to avoid the possibility of the Board taxing personal services"⁴³

Therefore, contrary to supporting the Board's position of taxing fabrication charges in limited situations, the above legislative action of changing the wording of the bill "suggests that the possibility that tax might be assessed on the charges of recording engineers was foreseen, and the language limiting the tax base to charges for 'tangible elements' was intended to prevent tax being levied on fabrication charges."⁴⁴

POST 1982 AMENDMENT

To clarify the intent of § 6362.5, and to keep the Board from assessing tax on fabrication charges, the Legislature amended § 6362.5, making the amendment retroactive to 1976.⁴⁵ The germane provisions of § 6362.5, including the amended parts (in italics below) which were made into law on September 10, 1982, now read as follows:

SECTION 1. Section 6362.5 of the Revenue and Taxation Code is amended to read:

6362.5(a) There are exempted from the taxes imposed by this part the gross receipts from the sale of, . . . master tapes or master records embodying sound, except amounts subject to the taxes imposed by other provisions of this part paid by a customer in connection with the customer's production of master tapes or master records to a recording studio for the tangible elements of such master records or master tapes.

(b) For purposes of this section: . . . (2) "Amounts paid for the furnishing of the tangible elements" shall not include any amounts paid for the copyrightable, artistic or intangible elements paid for the copyrightable, artistic or intangible ele-

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

45. California Assembly Bill No. 2871, Chapter 951 (9-10-82).

ments of such master records, whether designated as royalties or otherwise including, but not limited to, services rendered in producing, fabricating, processing, or imprinting tangible personal property or any other services or production expenses in connection therewith

Section 2. The legislature finds and declares that Section 1 of this act is declaratory of, and not a change in, existing law. It is the intent of the legislature in enacting this Act to clarify the existing law and to affect all applicable pending proceedings⁴⁶

CONCLUSION

In light of the strong language of § 6362.5, there is no doubt that the Board will drop its position of taxing fabrication costs of post-1976 master recording sales.⁴⁷ The Board continues to have the option to complete enforcing any pre-1976 master recording sale.⁴⁸

46. *Id.*

47. In fact, according to SBE member Richard Nevins:

Persons who have paid sales or use taxes to the Board on the sale or purchase of master tapes or records measured by an amount in excess of the sale price of the unprocessed recording media may file a claim for refund with the Board.

\$1 Mil. Refund Due Record Producers in Wake of AB2871, Hollywood Reporter October 28, 1981, at 1-3, Col.1. The California Entertainment Organization, the lobbyist who led the campaign to amend § 6362.5, estimates that as much as a million dollars will be refunded. *Id.* at 3.

48. See Cal. Rev. & Tax. Code § 6487, *supra* note 31.

APPENDIX

ASSEMBLY REVENUE AND TAXATION COMMITTEE

ASSEMBLYMAN WADIE P. DEDDEH, CHAIRMAN

DATE:

AB2871 (MOORE), AS AMENDED APRIL 12, 1982

SUBJECT: Sales and Use Tax: Clarification of Exemption for Master
Tapes and Records.

FISCAL EFFECT: (Fiscal Committee: Yes)

Unknown state and local effect.*If* the bill is truly a clarification of existing law, and this view (the industry's view) is or would have been upheld by the courts, the bill would have no *fiscal effect*.*If* the bill exempts sales which are now taxable under present law, and this view (BOE's view) is or would have been upheld by the courts, the bill would result in an *unknown revenue loss*.

DIGEST (WHAT THE BILL DOES):

Under current law, there is an exemption from the sales tax for master tapes or master records embodying sound. The exemption *covers* "amounts paid for the copyrightable, artistic or intangible elements of such master tapes or master records, whether designated as royalties or otherwise."

The exemption *does not cover* "amounts subject to the taxes imposed by other (sales tax) provisions . . . paid by a customer in connection with a customer's production of master tapes or master records to a recording studio for the *tangible elements* of such master records or master tapes" (emphasis added).

This bill further specifies that the master tapes and master records exemption *does cover* "*services rendered* in producing, fabricating, processing, or imprinting tangible personal property or *any other services or production expenses* in connection therewith . . ." (emphasis added).

The bill provides that this language is declaratory of and not a change in existing law, and that the act is intended to clarify present law and affect all pending proceedings.

STAFF COMMENTARY

a. Purpose of the Bill

The bill apparently is intended to resolve a dispute now under way between the State Board of Equalization and a number of independent recording engineers and producers over recording industry's sales tax liability for master tapes and records.

BOE is attempting to collect back taxes plus penalties and interest from certain producers for the portion of the sales prices of the master tape or record that represents the "fabrication" costs. The affected recording industry representatives believe this is a new interpretation which is not consistent with the actual coverage of the law. The bill is intended to clarify that the sales tax does not apply to those fabrication expenses associated with master tape and record production, and thereby to resolve the pending disputes in favor of the industry.

b. Background of the Master Tapes and Records Exemption

Master tapes and records are the original media upon which sound is recorded. These masters are used to produce finished records or tapes for ultimate sale to the public. The masters are also often used by the artists themselves for mixing with other recordings, or for other uses.

A basic principle of the sales and tax law is that the tax is imposed on the *final* sale, lease, storage, use or consumption of *tangible personal property*. As early as 1939, BOE ruled that "masters", "mothers", "stampers" and finished records furnished by a processor to a producer are tangible personal property subject to tax.

In 1954, BOE held that *royalties* connected with master recordings were *included* in the price subject to taxation. In about 1970 the Board began to levy deficiency assessments for back payments of sales taxes on the royalties received by recording companies from the sale of master recordings.

These deficiency assessments were contested by the industry, and legislation was introduced and ultimately enacted which exempted the copyrightable, artistic or intangible elements of master tapes and records (SB 512, Robbins, Chapter 1116 of 1976). This is the language of current law described above in the Digest. This change was effective January 1, 1976 and did not affect *pre-1976* tax liabilities on royalties (which are still being appealed and litigated today).

The language enacted in 1976 (quoted above in the Digest) *does not exempt* amounts paid by a customer to a recording studio for the "tangible elements" of the master tapes or records being produced. This is the provision upon which the Board today is basing its attempt to collect additional taxes for the "fabrication costs" of master tapes or records, which is being vigorously disputed by the industry.

c. *BOE's Arguments For Collecting Tax on Master Record "Fabrication" Cost*

The disputes at issue here are limited to sales tax liabilities where a production studio or production engineer makes a master tape for an artist who intends to use the master himself, that is, where the sale of that master tape is the final or retail sale. (In cases where the master tape is to be resold immediately to a record company, the *production* of the master is not subject to tax because that is not the final, retail sale.)

BOE's arguments for subjecting the production of the master tape to tax are:

- * A fundamental principle of the sales tax law is that "fabrication" costs are subject to tax. Section 6066 R&TC includes in the definition of a "sale" (against which tax must be charged):
 - "(b) The producing, fabrication, processing, printing, or imprinting of tangible personal property for a consideration for consumers who furnish either directly or indirectly the materials used in the producing, fabricating, processing, printing, or imprinting."
- * Therefore, the Board believes that the *full amount* that a recording engineer or sound engineer charges the artist to create the master tape is subject to tax. This includes all the charges for the finished product, *without deductions* for the cost of travel, hotel rooms, materials or equipment used, and so on. BOE uses the analogy of a tailor, who must charge tax on the whole finished item of apparel, without deductions for the costs of thread, needles, fabric, sewing machine, or services of a designer or seamstress.
- * The work of the recording engineer in producing the master tape is *not a service*. BOE concludes this by using the "true object of the contract" test. In the case of master tape production, the customer's "true object" is the tape itself (a piece of tangible personal property) rather than the engineer's service. This is analogous to many other situations where service, or the creativity of the fabricator, is provided but is *incidental* to the acquisition of the tangible property. For example, such creativity and labor go into the production of a mold used in a manufacturing process or an artist's

painting. But tax is charged on the *entire price*, because the "true object" of the sale is the mold or the painting, not the "service" of the craftsman.

- * BOE also points out that the law with respect to master tapes and records has been enforced in this manner for many years, with the large studios complying in including the costs of contract engineers in the tax base. It has been only relatively recently with the growth of the independent sound engineer industry that disputes have developed.
- * BOE staff have pointed to a Senate Revenue and Taxation Committee bill analysis of the 1976 legislation as evidence of legislative intent in this regard. The analysis says that the bill *includes* in the amounts subject to tax "charges for the use of the studio's recording facilities and technical personnel."

However, this analysis was prepared *before* the bill was amended to modify this language. See Comment e below.

d. Industry's Arguments For Excluding Fabrication Costs

Recording industry representatives argue that the law provides that only costs of the *tangible elements* of the master records or tapes—that is, the tape itself—is subject to tax. They argue that the activities of recording engineers are *services*, not fabrication. They also contend that the collection of the back and future taxes assessed by BOE will put the industry in this state in jeopardy, and cause the price of records to increase.

e. Evidence on 1976 Legislative Intent

The 1976 bill which enacted the master tapes and records exemption, *as it left the Senate*, excluded from the exemption, "amounts paid to a recording studio by a customer for the furnishing of the tangible elements of such master records or master tapes, including *charges for the use of the studio's recording facilities and technical personnel*, in connection with the customer's production of such master tapes or master records" (emphasis added).

However, the bill was amended to the language ultimately enacted in the Assembly, as a result of correspondence with staff of the Assembly Revenue and Taxation Committee. The purpose of the Assembly amendment was "to avoid the possibility of the Board taxing personal services . . ." The Assembly amendment deleted the language of the

bill which would have provided that charges for the use of the studio's recording facilities and technical personnel would remain taxable, and inserted the language appearing on the books today (see Digest).

This suggests that the possibility that tax might be assessed on the charges of the recording engineers was foreseen, and the language limiting the tax base to charges for "tangible elements" was intended to prevent tax being levied on fabrication charges.

f. Technical Language Clean-up Needed

Current law contains an unintended mismatch of language. The wording in subdivision (b)(2) does not exactly match the term being defined in subdivision (a). This should be cleaned up.

