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OUT FROM SAFE HARBOR: THE ODYSSEY OF THE MOTION PICTURE PRODUCER'S "SPECIAL EMPLOYEE"

*Raymond L. Towne**

As Ulysses found some time ago, a good crew is hard to keep together; you can be devoured . . . and just when you thought it was safe to go in the water.

I. INTRODUCTION

One way for a state government to obtain the revenue it needs to operate is through the sales tax. In California, the assessment and collection of this tax is accomplished through the State Board of Equalization. In return for the privilege of doing business in the state, the retail seller is liable for payment of the tax; the tax is figured as a percentage of the gross sales receipts. In practice, the seller usually passes the sales tax through to the buyer as an extra charge added to the price of goods sold. Thus the extra wait at the checkout counter, while the clerk looks at the little white card to figure the extra charge for sales tax.

The use tax is imposed to protect retailers within the state. It is imposed on the person who purchases goods out of state for use in the state. If this tax were not imposed, purchasers would have an incentive to buy goods out of state simply to avoid the sales tax; the state would lose revenues and retailers would suffer a decrease in sales volume.

In the motion picture industry, those who sell raw film stock, magnetic tape, costumes, sets and the other tangible items needed to create the final product are retailers, who collect the sales tax; the producer is the consumer, who pays it. This seems clear; conceptually we are still at the hardware store or sporting goods outlet. But the state uses the concept of "fabrication labor" to considerably broaden the reach of the sales tax; under this theory, a "sale" also occurs when materials provided by the manufacturer are fabricated into an intermediate stage or the finished product.

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Because "fabrication labor" includes most of the production and post-production work on film or videotape, such as photography, processing, sound effects and editing, these services are considered "sales" and those who provide them are retailers, obligated to collect the sales tax. The producer would like to use his or her own employees to avoid having to pay a sales tax, but increasingly finds that these fabrication skills are not available in-house. Hence the twin dilemma: the production company cannot get work, and the producer cannot get affordable skilled help. The sales tax, originally designed to raise revenue, becomes a major business disincentive.

Responding to this dilemma, in 1974 the Board of Equalization created the concept of "special employee." Production and post-production companies enjoying a "long-term" relationship with a producer could take advantage of this new classification to avoid the mutual sales tax burden. Those that could not, remained subject to the disincentive; it is here that our story begins.

II. FROM 1933 TO 1987 WITH REGULATION 1529

In late 1987¹ the Board of Equalization for the State of California² extensively amended its Regulation 1529,³ which governs the application

1. The Hon. Ernest J. Dronenburg, Jr., Vice-Chairman of the California State Board of Equalization, worked throughout 1987 "with a coalition of industry members and the California Film Commission" to make the Board of Equalization Regulation 1529 "more equitable, understandable and easy to administer." Letter from Ernest J. Dronenburg, Jr. to Members of the Motion Picture Industry (Sept. 10, 1987) [hereinafter Dronenburg Letter].

2. The Board of Equalization "shall enforce the provisions of this part [the sales and use taxes] and may prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of this part. The board may prescribe the extent to which any ruling or regulation shall be applied without retroactive effect." CAL. REV. & TAX CODE § 7051 (West 1987).

3. At the hearing in Los Angeles on October 21, 1987, the Board voted 5-0 to adopt the Regulation 1529 amendments. Letter from Lisa Rawlins, Director of the California Film Commission and Steve McCoy, President of FilmCore/AICE West to Industry Professionals (Oct. 26, 1987). The hearing had been noticed in the usual manner. Cal. Admin. Notice Reg. 87, No. 36-Z (mistakenly numbered 34-Z; pub. date Sept. 4, 1987). The Board formally adopted the amendments on Nov. 18, 1987. Telephone conversation with Gary Lambert, Senior Tax Auditor (Mar. 22, 1988). The Office of Administrative Law approval was filed with the Secretary of State on Dec. 29, 1987. Telephone conversation with Janice Masterton, Assistant to the Executive Secretary of the Board. Effective Jan. 1, 1988. Cal. Regulatory Code Supp. 88, No. 2 (pub. Jan. 9, 1988). CAL. CODE OF REGULATIONS tit. 18, § 1529.

Please note that effective January 1, 1988, the California Administrative Code "shall be known as the California Code of Regulations." CAL. GOV'T CODE § 11344(a) (West Supp. 1988).

Regulatory amendments were formerly reported weekly in the California Administrative Notice Register. Effective January 1, 1988, the weekly report is known as the California Regulatory Code Supplement. CAL. GOV'T CODE § 11344(b) (West Supp. 1988). The "Z Regis-

of the state sales⁴ and use⁵ tax to motion picture producers.⁶ These amendments constitute what is only the second major revision of Regulation 1529 ("the Regulation") since its adoption in 1933;⁷ the first major revision was in 1974.⁸ This second round of major amendments did take

ter," which reported notices of proposed action by regulatory agencies, is now known as the California Regulatory Notice Register. CAL. GOV'T CODE § 11344.1(a) (West Supp. 1988).

4. California imposes upon all retail sellers a tax "[f]or the privilege of selling tangible personal property . . . in this state." The rate was originally "2½ percent of the gross receipts . . . on or after August 1, 1933." CAL. REV. & TAX CODE § 6051 (West 1987). The rate crept upward over the years, and since April 1, 1974 the rate has been 4 3/4 %. *Id.* The seller usually passes the cost along to the retail buyer.

5. California imposes upon all retail purchasers a tax "on the storage, use, or other consumption in this state of tangible personal property." The rate is currently 4 3/4 %. CAL. REV. & TAX CODE § 6201 (West 1987). The tax liability is relieved when the purchaser obtains a receipt for the tax payment from the retailer. *Id.* § 6202. The purpose of the use tax is to reach transactions involving property purchased from outside the state and thus not subject to California sales tax, lest an unfair burden be placed upon retailers in this state. For an application of the use tax to master sound tapes, see *Capitol Records v. State Bd. of Equalization*, 158 Cal. App. 3d 582, 588-89, 204 Cal. Rptr. 802, 805 (3d Cir. 1984) (citing Traynor, *The California Use Tax*, 24 CAL. L. REV. 175 (1935)).

6. "'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 imprinting." CAL. REV. & TAX CODE § 6006(b) (West 1987). Regulation 1529 "references" section 6006, i.e. the Board cites it as a statute which its regulatory action will interpret and implement. Cal. Regulatory Code Supp. 88, No. 2. An administrative agency must "reference" its regulations; CAL. GOV'T CODE § 11349.1 (West Supp. 1988).

Movie film negatives have been held to be "tangible personal property" for sales tax purposes and properly valued on their total worth even though valued in part for their intangible intellectual content. *Michael Todd Co. v. County of Los Angeles*, 57 Cal. 2d 684, 21 Cal. Rptr. 604 (1962). In *Todd*, the court noted that its holding "will not conflict with . . . Sales Tax Ruling 19 (18 Cal. Admin. Code, § 1929) (motion picture producers are 'consumers' of film for purposes of sales and use tax)." 57 Cal. 2d at 695 n.4, 21 Cal. Rptr. at 610 n.4. (For the renumbering of Regulation 1929 to Regulation 1529, see *infra* note 7.)

7. Board Sales Tax Ruling No. 19 was effective August 1, 1933. It was adopted as a restatement of previous rulings as of January 1, 1945. It was amended by renumbering from Regulation 1929 to Regulation 1529 effective December 3, 1971. Cal. Admin. Notice Reg. 71, No. 45.

8. Until its 1974 amendments, Regulation 1529 provided in full:

Producers of motion pictures are consumers of all film and other tangible personal property used in production, and tax applies to sales to producers of such property. Tax does not apply to amounts received by the producer of the right to exhibit or reproduce motion pictures.

Tax applies to charges by a laboratory for the printing of motion picture films whether the raw film stock is furnished by the laboratory or by the customer. Cal. Admin. Notice Reg. 71, No. 45.

In 1974 the Regulation was completely revised. The first paragraph of the 1971 version was retained as subdivision (a); the second paragraph of the 1971 version disappeared into subdivisions (b)(20), a definition of "film and processing," and (c)(1)(B), application of tax to producer prints.

Subdivision (b) was added to the Regulation as an extensive definitions section: (b)(1) defined "production" in general, and "commercial," "still" and "stock shot," "billboard" and

note of technological developments since 1974, such as synthetically created imagery⁹ and intermediate electronic storage,¹⁰ but this was done simply by expanding the existing definitions. The chief concern of the 1987 amendments was that "many of the smallest and most productive segments of the industry are being subjected to harsh tax assessments."¹¹

Subdivision (a) of the Regulation states the general rule, unchanged since 1933: "Producers of motion picture productions are consumers of all film and other tangible personal property used in production, and tax applies to sales to producers of such property."¹² Subdivision (c)(1)(A), added in 1974, restates this general rule: "A producer, including a sub-producer or coproducer, is a consumer of tangible personal property used in making a production and tax applies to all sales of such property to him, inclusive of charges for fabricating or processing."¹³ But (c)(1)(A) goes on to state a fundamental exception to the general rule: "No tax liability arises from fabricating or processing performed by the producer for his own account, *using his own employees*. Similarly, no tax liability arises from fabricating or processing performed by a subproducer or coproducer with respect to the production."¹⁴

Subdivision (c)(2) has been the locus of taxing power in the Regula-

"animated motion picture" as "productions;" (b)(2) defined "producer," including "sub-producer" and "coproducer." Subdivisions (b)(3) through (b)(24) defined many aspects of the motion picture industry, from "sponsor" to "facilities fee." Cal. Admin. Notice Reg. 74, No. 47. See Appendix for the full text of Regulation 1529.

In the 1971 version and its predecessors, the locus of the Regulation's taxing power was the first sentence. Significantly, it was generally understood that a producer could not be liable for sales tax for work performed by the producer's employees, because there had not been a sale by a "retailer" pursuant to section 6051; likewise, there had not been a purchase from a "retailer" pursuant to section 6201. See generally *Capitol Records*, 158 Cal. App. 3d at 592 n.9, 204 Cal. Rptr. at 808 n.9.

With the 1974 version, the locus of taxing power shifted to subdivision (c), "Application of Tax." See *infra* text accompanying notes 12-17.

9. Regulation 1529(b)(19)(A). The "Special Effects—Matte Shot or Glass Shot" definition now includes "synthetically created imagery." Cal. Regulatory Code Supp. 88, No. 2. See Appendix for text of subdivision (b)(19)(A).

10. Regulation 1529(b)(20)(B). The "Work Print" definition now includes "intermediate electronic storage." Cal. Regulatory Code Supp. 88, No. 2. See Appendix for text of subdivision (b)(20)(B).

11. Dronenburg Letter, *supra* note 1. "These proposed regulations focus on certain aspects of post-production which have long needed to be addressed, in light of business changes over the decades since Regulation 1529 was originally promulgated." Letter of Carol Lynn Akiyama, Senior Vice President of the Alliance of Motion Picture & Television Producers, to the Members of the State Board of Equalization (Oct. 20, 1987) [hereinafter AMPTP Letter].

12. See *supra* notes 7 and 8.

13. Cal. Admin. Notice Reg. 74, No. 47.

14. *Id.* (emphasis added). Previously the implicit understanding was that the producing of goods by an employee does not create a sales tax liability; see *supra* note 8.

tion since its creation in 1974; it governs the classification of charges to the producer as taxable or nontaxable. From 1974 through 1987, this classification depended on "whether or not the persons performing the fabrication do so in the capacity of *employees* of the producer."¹⁵ It was here that the Board of Equalization ("the Board") performed its major work in 1987, when it removed the provisions equating "employee" with "'long-term' studio personnel," and left the less precise "special employee" provisions.¹⁶ While these modifications did not unhinge the compass, there is now more play in the bearings.

III. PUTTING OUT TO SEA

The Board's amendments to subdivision (c)(2) are most easily viewed as a whole. It will be seen that independent post-production companies, such as film fabricators, sound, sound effects, music editing and special effects companies, were special objects of the Board's concern.

The 1974 version of subdivision (c)(2) had five unnumbered paragraphs; the 1987 version has four, of which two are reworked and two completely new. The portions bracketed show 1974 language deleted in 1987, and the italicized language was added in 1987.

The process of producing a motion picture generally consists of a number of basic steps with respect to which weekly charges are made by a studio to a producer. The following is a classification of charges to producers utilizing the facilities and personnel of others who are not subproducers or coproducers. Where fabrication or processing is involved, the classification is based on the custom of the industry with respect to whether or not the persons performing the fabrication or processing do so *under the supervision of the producer* in the capacity of [employees of the producer] *an employee or special employee*.

The classification of studio personnel as a special employee is not affected by the fact that the loaned out employee may be the only employee of the company which contracts with the producer to provide the services of the loaned out employee.

In general, those ["long-term"] studio personnel who per-

15. Regulation 1529(c)(2) (emphasis added). Cal. Admin. Notice Reg. 74, No. 47.

16. Regulation 1529(c)(2). Cal. Admin. Notice Reg. 74, No. 47.

Basically, the amendments update the definition of 'long-term studio employee' to include *employees of any duration* who perform creative work under the supervision of the producer The adoption of this definition will have a positive impact on all phases of the industry, particularly sound effects and special effects editing.

Dronenburg Letter, *supra* note 1 (emphasis added).

form work of a creative or artistic nature [under the supervision of the producer or the person who is designated to act in his behalf,] *in the fabrication of motion picture film, sound, sound effects, music editing and special effects* are considered to be [acting as] special employees [of the producer]. Those studio personnel who perform work [which is] of a mechanical or technical nature are generally considered not to be [acting as] employees of the producer.

[In general, when a producer obtains the use of particular premises, facilities and personnel of a studio under a contract calling for the completion of all or substantially all of a production using such premises, facilities and personnel, those personnel will be deemed to be "long-term" studio personnel as that term is used in this regulation.]

[If, upon expiration of the contract, it is found necessary to do additional post-production work on the production covered by the contract, personnel furnished by the studio for such post-production work will also be deemed to be "long-term" studio personnel.]

[If the contract is with a studio which performs only one segment of a production, e.g., mobile units or independent sound studios, the term "long-term" studio personnel will be deemed to include those studio personnel whose collective services the producer acquires together with the premises and facilities on a regular basis for more than one week and for more than two consecutive, full working days each week.]

*The classifications apply only to charges made by persons who contract directly with producers. Subcontractors cannot qualify as special employees of the producer. Charges made by subcontractors for photography, production recording, sound effects editing, music editing, special effects and film editing are generally taxable.*¹⁷

The basic tax question remains the same in the 1974 and 1987 versions: whether the fabricating or processing studio¹⁸ personnel will be considered the producer's "employee" or "special employee," as opposed to "not an employee." Under both the 1974 and 1987 versions, if the

17. Regulation 1529 (c)(2) (footnote in regulation omitted). See Appendix at (c)(2) and (c)(2)(A) et seq. For a discussion of the charges list see *infra* text accompanying notes 26-28.

18. In both the 1974 and 1987 versions, "studio" is defined at (b)(3) as "a place or facility where productions or parts of productions are made. . . . [W]here the context requires, the term 'studio' refers to the owner or operator of the studio." See Appendix at (b)(4).

studio personnel are employees or special employees, then the studio and producer will have no tax liability pursuant to subdivision (c)(1) because the fabricating or processing has been performed "by the producer for his own account."¹⁹ Paragraph two of the 1974 (c)(2) subdivision provided that "'long-term' studio personnel" performing work of a "creative or artistic nature" are "special employees of the producer;" thus the studio and the producer who used it were not liable for the sales tax, because a "special employee" is an "employee" for purposes of the tax exemption in paragraph one.

Paragraph three of the 1974 version afforded the same "'long-term' studio personnel" status to production workers and their companies (studios). Paragraph four did the same for post-production companies. Paragraph five of the 1974 version extended long-term employee status to personnel of one-segment production companies, such as "independent sound studios." Finally, paragraph five provided a safe harbor for all of these "long-term" personnel, when it defined "long-term" as "services . . . acquire[d] . . . on a regular basis for more than one week and for more than two consecutive, full working days each week."²⁰ The problem with the 1987 (c)(2) amendments is not that the Board of Equalization intended to "include employees of any duration;" many post-production companies no doubt applauded that intention, and implementing that intention may be essential to foster an adequate supply of skilled fabricators and the development of new technology. Rather, the difficulty is that in its desire to "update"²¹ the definition of "long-term studio employee," the Board discarded the objective "long-term" criterion and therefore deprived the studio and the producer of this objective defense to tax liability.

In sum, to be an "employee" or "special employee" with (c)(1) tax-exempt status under the 1974 version of (c)(2), the production company had to pass a two-part test: its personnel had to be "long-term," and they had to perform work of a "creative or artistic" rather than "mechanical or technical" nature. The "long-term" test had an objective, time-based

19. See *supra* text accompanying note 14.

20. See *supra* text accompanying notes 16 and 17. Since the phrase "regular basis" is open to interpretation, its presence in the definition does mark a shoal in the harbor.

Shortly after the effective date of the 1974 safe harbor provision, the Board clarified the length of time necessary to guarantee "long term" studio personnel status to independent sound studios and other facilities performing only one segment of a production. The term "week" was interpreted as a consecutive seven-day period rather than a calendar week; therefore a period of more than nine days was needed to qualify under the term "more than one week and for more than two consecutive working days each week." Opinion of Sales Tax Counsel for the Board, May 5, 1975.

21. Dronenburg letter, *supra* note 16.

criterion. Under the 1987 version only the "creative or artistic" test remains; because these terms are not defined in the Regulation, the effect is to leave the independent "studio personnel" at sea.

IV. STUDIO PERSONNEL FACE A CUSTOMARY STORM

The first paragraph in both versions of subdivision (c)(2) provides that the "custom of the industry" will be the basis of the "employee" classification and thus the producer's (c)(1) sales tax exemption. The juxtaposition of the 1974 version's paragraph two, with its distinction between the "creative or artistic" and the "mechanical or technical," implies that the custom of the industry will be the criterion used to distinguish the creative from the mechanical, and hence the "employee" from mere "personnel who perform [mechanical] work," who are "not . . . employees of the producer" for tax exemption purposes. In the 1987 version, the interposition of the "only loaned out employee" paragraph obscures this role of "custom of the industry" as the criterion distinguishing between "creative" and "mechanical," but the need for the criterion remains; this third 1987 paragraph has retained much of the 1974 vocabulary and syntax. It is not clear, however, whether the "custom of the industry" is to function solely as a narrow test of artistic versus mechanical, or also as a more general test of who is to be an "employee" for producer sales tax exemption purposes.

The phrases "studio personnel" and "special employees" have been retained in the 1987 (c)(2) paragraph three. What is new is the deletion of "long-term," and the recitation of film fabrication, sound, sound effects, music editing and special effects personnel as special employees. As a result of these changes, the 1987 third paragraph poses two challenges to the "custom of the industry" standard; the first is technological, the second economic.

The development of motion control photography, computer generated images, intermediate electronic storage media,²² digital sampling and the like have blurred the line between the "creative" and the "mechanical." This is especially so while new techniques are still being worked out, before "custom" has an opportunity to establish distinctions between "creative" and "mechanical." It would appear unfair and ultimately counterproductive for the state to impose revenue tax penalties on a producer who initiates or refines techniques that may benefit the entire motion picture industry.

As a more general test of the "employee" concept, the "custom of

22. See *supra* notes 15 and 16 and accompanying text.

the industry” faces a fundamental challenge: the custom has changed. The 1987 amendment language does not directly reflect that change, and hence lacks clarity. Implicit in the Board’s choice of “employee” and “special employee” terminology to describe what production and post-production companies do for the producer is the hierarchical notion of a master/servant relationship; in fact, post-production companies are largely composed of former personnel from major studios, who work independently now that the major studios contract out for post-production work. The 1987 second (c)(2) paragraph speaks of a “company which contracts with the producer,” and the fourth paragraph speaks of “persons who contract directly with producers.” Nevertheless, subdivision (c)(2) is silent on how contracting parties should specify the producer’s right to control the manner and means of accomplishing the desired result, to guarantee that the contract results in a tax-exempt employer-employee relationship and not an independent contractor relationship subject to tax.²³

Finally, in the first paragraph of the 1987 version of (c)(2) the “custom of the industry” is called upon to perform a new function, that of interpreting the phrase “under the supervision of the producer.” The existence of the word “supervision” makes explicit, but does not resolve, the contract drafting problem.

V. USING THE 1987 COMPASS

The four paragraphs of subdivision (c)(2) are followed by extensive lists of taxable and nontaxable studio charges in (c)(2)(A)-(K); this structure was first created in the 1974 version.²⁴ While many charge items formerly listed as taxable are now nominally exempt,²⁵ the exemption is actually controlled by the (c)(2) language concerning “employees” and

23. For the impact of the independent contractor doctrine on use taxation of master sound tapes, see *Capitol Records, Inc. v. State Bd. of Equalization*, 158 Cal. App. 3d 582, 592, 204 Cal. Rptr. 802, 807-08 (3d Dist. 1984).

24. Regulation 1529(c)(2)(A)-(K). Cal. Regulatory Code Supp. 88, No. 2.

25. For example, in (c)(2)(D) “Photography,” in the 1974 version “cameramen other than long-term studio cameramen” were taxable, and in the 1987 version all “cameramen” are exempt. In (c)(2)(E) “Sound,” “production recording, including looping, foleying, and sound replacement, by other than long-term studio personnel” was taxable in 1974; in 1987 all “production recording,” etc. is listed as exempt. The same excision of the “other than long-term studio personnel” was performed on (c)(2)(F) “Music,” (c)(2)(G) “Music Editing and Cutting,” and (c)(2)(J) “Film Editing.” See Appendix.

In the “Special Effects” category (c)(2)(H), “miniatures, matte shots, glass shots, inserts, optical printer, montages, animation, laps, wipes, fades and dissolves, titles, end credits, opening credits” were formerly taxable charges to the producer and are now in the exempt category. See Appendix.

There were no changes to the (c)(2)(I) category “Film and Processing.” All materials

“special employees.” Consequently, the (A)-(K) amendments give an impression that in more circumstances fewer charges will be taxable, but this impression may be misleading for the reasons outlined above.²⁶

VI. GUARANTEE OF SAFE PASSAGE AS AN ALTERNATIVE

Subdivision (c)(2)(L) sets forth a suggested form Producer Exemption Certificate.²⁷ Here the producer expressly assumes the risk that if the work does not qualify as exempt, the producer will report and pay the sales tax. If the Certificate was intended to function as a protection for an independent production company or a technological innovator, it may be counterproductive; express assumption of tax liability would have a sobering effect on a producer, who might therefore be inclined to take a safer course than if each contracting party were left to its own interpretation of subdivision (c)(2).

VII. APPEALS TO HIGHER AUTHORITY

This writer did not discover any cases construing subdivision (c)(2) of Regulation 1529. The California Supreme Court²⁸ and Third District Appellate Court²⁹ do refer to the 1974 version of the Regulation, but not specifically to subdivision (c)(2). An earlier version of the Regulation was also noted by the California Supreme Court.³⁰

Section 11349.1 of the California Government Code provides that

other than “negative developing, other than by reverse processing” remain taxable. *See* Appendix.

26. See text accompanying notes 22 and 23.

27. The Producer Exemption Certificate provides in pertinent part:

I HEREBY CERTIFY. That I am a producer engaged in the production of a motion picture under circumstances in which work performed by studio personnel provided for under [contract or invoice no.] is done under the supervision of the producer in the capacity of a special employee which is exempt from tax pursuant to Regulation 1529.

In the event it is subsequently determined that the work does not qualify as exempt, it is understood that *I am required by the Sales and Use Tax Law to report and pay tax* measured by the purchase price.

Regulation 1529(c)(2)(L). Cal. Regulatory Code Supp. 88, No. 2 (emphasis added).

28. *Simplicity Pattern Co. v. State Bd. of Equalization*, 27 Cal. 3d 900, 909-13, 167 Cal. Rptr. 366, 371-73 (1980).

29. *Capitol Records, Inc. v. State Bd. of Equalization*, 158 Cal. App. 3d 528, 597, 204 Cal. Rptr. 802, 811-12 (3d Cir. 1984). In fact, Regulation 1529(e)(3) was amended Oct. 26, 1983, as an emergency regulation effective Nov. 17, 1983, to provide that the tax applied to leases of video cassettes, videotapes, and videodiscs for private use. Cal. Admin. Notice Reg. 83, No. 47. That 1983 amendment was not an issue in the 1984 *Capitol Records* case, and is beyond the scope of this discussion. *See* Appendix for text of subdivision (e)(3).

30. *Michael Todd Co. v. County of Los Angeles*, 57 Cal. 2d 684, 695, 21 Cal. Rptr. 604, 610 (1962), construing the 1945 version, then numbered as Regulation 1929.

the Office of Administrative Law (OAL) must review all proposed regulations to ensure compliance with a standard of "clarity," and five other standards.³¹ Section 11349(c) of the Government Code defines clarity as "written or displayed so that the meaning of the regulations will be easily understood by those persons directly affected by them."³² The OAL, as an agency of the executive branch, has no authority to write or rewrite regulations; it only reviews their language in light of the six standards.³³

This writer questions the extent to which the 1987 version of (c)(2) meets the clarity test of being "easily" understood. A fundamental difficulty with the "custom of the industry" standard is that it has changed, as the Board of Equalization admits.³⁴ Indeed, it is foreseeable that custom will shift to accommodate perceived economic and tax advantages and avoid disadvantages; to the extent this tendency occurs, a circularity has been built into the classification of charges to producers. Moreover, even if the "custom of the industry" were unchanging, the scope of this criterion is not clear: is it to be narrow (distinguishing artistic from mechanical), broad (distinguishing employee from independent contractor), or both? What "custom" criterion is to be applied to technologies too new in time or undeveloped in practice to have acquired a customary use? What degree of "supervision of the producer" must a contract expressly or implicitly require to ensure that the supervision is the kind leading to "employee" or "special employee" tax-exempt status?

Footnote 1 to subdivision (c)(2) encourages requests for a specified ruling from the Board.³⁵ If that is not satisfactory, several alternatives are available. One can pursue further clarifying amendments with the Board.³⁶ One can file suit for a declaratory judgment that the Regulation fails to meet the statutory criterion for clarity (or one or more of the

31. CAL. GOV'T CODE § 11349.1 (West Supp. 1988). The six standards are necessity (substantial need for the regulation), authority (legislatively delegated power to adopt the regulation), clarity (clear on its face), consistency (not inconsistent with a state or federal statute or another regulation), reference (to the statute which the regulation interprets and implements), and nonduplication (of another regulation or statute, unless duplication is needed for clarity). See generally Bolz & Garcia, *The Other Side of Administrative Law*, CAL. LAW., Nov. 1987, at 47, for practice under the California Administrative Procedure Act. In 1987 the Legislature made extensive amendments to the Act. 1987 Cal. Stat. 1375.

32. CAL. GOV'T CODE § 11349(c) (West Supp. 1988).

33. CAL. GOV'T CODE § 11340.1 (West Supp. 1988).

34. "I have long felt that this regulation . . . is vague, inconsistently applied and no longer an accurate reflection of the nature and custom of business practices in the industry." Dronenburg Letter, *supra* note 1. As we go to press, Mr. Dronenburg has joined with Assemblyman Richard Katz, D-Sepulveda, in sponsoring A.B. 2833, the California "Taxpayers Bill of Rights."

35. See *supra* text accompanying note 17.

36. CAL. GOV'T CODE § 11347 (West 1980).

other criteria).³⁷ Once a tax imposed has paid, one can bring suit against the Board to recover it. In that case, the Board cannot successfully contend that "the assessment, grounded on an . . . administrative classification, may be overturned only if such classification was arbitrary, capricious, or without rational basis."³⁸ Rather, the standard of review will be that "[t]he interpretation of a regulation, like the interpretation of a statute, is . . . a question of law, and while an administrative agency's interpretation of its own regulation deserves great weight, the ultimate resolution of such legal questions rests with the courts."³⁹

VIII. THE ODYSSEY CONTINUES

The following are suggested for further amendment of the Regulation:

1. Delete the word "technical" from the distinction between "creative or artistic" and "mechanical or technical." Etymologically, the word means "art" as well as "skill" or "trade;" it is inherently ambiguous. The ambiguity is heightened by developments in motion picture "technology" and "technique."

2. Define the word "artistic," "creative" and "mechanical" for purposes of the Regulation.

3. Insert language that more fully describes the customary notion of "supervision by the producer." This description would specify the criteria used to find that a producer has control over the manner and means by which a "special employee" will accomplish the desired result, and thus distinguish that person from an independent contractor.

4. Delete the existing language in footnote 1 to subdivision (c) (2),⁴⁰ and substitute a provision that in ambiguous cases a tax-exempt charge will be presumed, until the Board makes a "specific ruling" on its own motion and gives due notice to members of the industry.

Hopefully the present and continued efforts to amend Regulation 1529 will diminish production uncertainties and audit disputes, and will promote the economic health of production and post-production studios.

37. CAL. GOV'T CODE § 11350 (West Supp. 1988).

38. *Simplicity Pattern Co. v. State Bd. of Equalization*, 27 Cal. 3d 900, 905, 167 Cal. Rptr. 366, 368 (1980).

39. *Id.*

40. For the current text of footnote 1 to subdivision (c) (2) of the Regulation, please see the Appendix. Footnote 1 was added with the other major revisions in 1974. Cal. Admin. Notice Reg. 74, No. 47. In 1987, the word "shared" was substituted for "stated" and "specified" was substituted for "specific," both in the second sentence. Cal. Regulatory Code Supp. 88, No. 2. These changes serve to emphasize that at present footnote 1 places the burden of resolving ambiguous cases of tax liability upon the taxpayer.

It is heartening that the Vice-Chairman of the Board of Equalization can characterize the classification of producer charges as "a problem which has hurt an industry so vital to California."⁴¹ And whether the 1987 amendments are truly a "great step forward,"⁴² or just a "step in the right direction,"⁴³ perhaps the dry land has begun to appear under Ulysses' feet.

41. Dronenburg Letter, *supra* note 1.

42. *Id.*

43. AMPTP Letter, *supra* note 11.

State of California
BOARD OF EQUALIZATION

SALES AND USE TAX REGULATIONS

Regulation 1529. MOTION PICTURES.

Reference: Sections 8006-8009, 6010.4, Revenue and Taxation Code.

(a) GENERAL. Producers of motion picture productions are consumers of all film and other tangible personal property used in production, and tax applies to sales to producers of such property. Tax does not apply to amounts received by the producer for the right to exhibit or reproduce motion picture productions.

(b) DEFINITIONS.

(1) "PRODUCTION". "Production" means a motion picture prepared for showing on screens or through television for theatrical, commercial, advertising or educational purposes. The motion picture may be on film or video tape and have live, or animated, or a combination of live and animated action. Herein, the word "film" includes video tape or other recording media. The motion picture may tell a story, explain, describe, promote, or announce an idea, project, program, process, product, or event. But in order for a motion picture to constitute a production, it must be entirely on motion picture film, have continuity and direction, and be complete in itself, as distinguished from "trailer" or "stock" shots.

(A) "Commercial" as a Production. "Commercial" means a motion picture that is intended to advertise, promote, or announce its subject. Commercials may qualify as productions if they are entirely on film and meet the requirements of direction, continuity, and completeness. Although a commercial may have been produced to be shown preceding, within, or following a particular film or program, for the purposes of determining whether the commercial meets the test of a "production" each commercial shall be considered separately from the particular film or program. A commercial is not a "production" if audio or video aids such as slides, telops, live camera, narration, sound effects or any combination of them are needed to complete the subject shown on the film. Audio or video aids, however, such as "logos" and "dealer tags" preceding, within, or following a commercial film to identify the program, dealer or prices are not needed to complete the commercial story unless the commercial makes reference to them. If the producer of the commercial film also produces aids that supplement the commercial film, these aids will be considered a part of the commercial production, but are not productions by themselves.

(B) "Still" or "Stock Shot" as a Production. A motion picture film of a still picture or sign (includes logos) by itself, is not a production and stock shots are not productions. They may, however, be incorporated with films or film clips the result of which is a production.

(C) "Billboard" as a Production. The term "billboard", as applied to the television film industry, means a short commercial film used at the beginning, end, and within a television program. They are usually shown for the purpose of bringing the sponsor's name or product to the viewer's attention and are commercial in nature and purpose. They are productions only when they meet the same standards set forth in Paragraph (A) above, which determine whether commercials are productions.

(D) "Animated Motion Picture" as a Production. An animated motion picture is a motion picture consisting of a series of drawings shown in rapid sequence to give the appearance of action. The making of an animated motion picture film includes six general steps:

1. "Storyboard". Covers story planning with a client through a discussion of rough visualization of the high points of the script.
2. "Layout". Consists of preparation of a sufficient number of pictures in technical and artistic detail to guide the animation artists.
3. "Animation". Consists of the drawing of step-by-step scenes necessary to produce the entire action.
4. "Inking and/or Painting". Consists of tracing and/or painting the scenes prepared in Step 3 on celluloid cells.
5. "Photographing". Consists of photographing the cells on a continuous roll of film.
6. "Dub-In Sound". Consists of fabricating the sound track that goes on the film.

Regulation 1529. MOTION PICTURES. (Continued 1)

If the film is a production, the producer will be considered to be the consumer. An animation film studio need not do all six general steps in order to be considered the producer of the film. If an animation film studio contracts with an advertising agency or anyone else to produce a film and is responsible for and in general charge of making the finished film, the studio will be the producer.

(2) **"PRODUCER"**. A "producer" is any "person" as defined in Section 6005 who is responsible for and in general charge of the making of a production either for his own account or for the account of a principal. A person who is responsible for and in complete charge of making a production may subcontract for segments of the production. Where this is done, the person responsible for the production is the consumer of the segments subcontracted and the subcontractor is the retailer thereof. (Application of tax, see (c) below.) As used in this regulation, the term "producer" also includes "subproducer" and "coproducer" as defined in (A) and (B) below.

(A) **"Subproducer"**. A "subproducer" is any person who contracts to make a production for a producer who holds or subsequently acquires a prime contract to make the production. Thus, a subproducer is a subcontractor. However, all subcontractors are not necessarily subproducers.

(B) **"Coproducer"**. A "coproducer" is any person who, in respect to the making of a production, contributes property, literary material, personnel, services or financing, has a right to share in the receipts or profits of the production, and shares significantly in the responsibility of producing a production. Examples of what constitutes such a sharing are:

1. Responsibility for preparing or furnishing, or the right to approve, the final script, budget, principal members of the cast, director, other personnel, place of production, music or title of the production.
2. The right to require retakes of scenes or sequences, to cut, recut, edit, re-edit or reassemble the production, to change the title of the production, to determine disputes on matters relating to production or to take over supervision and control of production under certain circumstances.

(3) **"SPONSOR"**. A "sponsor" is a person who contracts with a producer to make a production.

(4) **"STUDIO"**. A "studio" is a place or facility where productions or parts of productions are made. It contains the necessary equipment for this purpose and personnel are available there to operate the equipment. Hereinafter, where the context requires, the term "studio" refers to the owner or operator of the studio.

The term "studio", as hereinafter used, includes mobile units or vehicles equipped in much the same manner as ordinary studios and used in making film or video tape productions. The term also includes sound recording studios used in connection with making productions.

(5) **"FABRICATOR—RETAILER"**. A "fabricator—retailer" is a person who performs fabrication or processing labor, either himself, or in conjunction with his employees, for another.

(6) **"DIRECTION" AND "CONTROL"**. "Direction" involves the selection of effects to be produced for the desired screen portrayal and the means adopted for producing those effects. "Control" means the exercise of direction over the employees performing fabrication or processing labor. The mere right to approve completed work does not constitute direction and control.

(7) **"SUPERVISION"**. "Supervision" is the exercise of direction and control by persons delegated to so act by a producer.

(8) **"FABRICATION"**. "Fabrication" is the completion of, or a step in the process of completing an operation or operations involving the production of tangible personal property not itself constituting a production.

(9) **"TALENT"**. "Talent" includes stars, contract players, borrowed players, free-lance players, dancers, swimmers, skaters, extras, stand-ins, stuntmen, and other persons engaged to appear or take an active part in a picture.

(10) **"SETS"**. "Sets" are artificial settings for scenes of motion pictures. They may either be interiors of a temporary or portable nature, or may be of a permanent nature erected on real property, e.g., Western streets or city streets.

(11) **"TRANSPARENCIES" OR "REAR SCREEN PROJECTIONS"**. "Transparencies" or "rear screen projections" are filmed backgrounds projected on a screen simultaneously with the filming of live action.

Regulation 1529. MOTION PICTURES. (Continued 2)

(12) "PROPERTIES". "Properties" are physical adjuncts of all kinds other than sets and wardrobe. The term includes but is not limited to:

(A) Painted backdrops.

(B) Set dressings which are property necessary to complement the set. These are items such as furniture of all types, lighting fixtures, utensils of all types, and greens both live and artificial.

(C) Action props, which include guns, animals, vehicles, breakaway items such as glass and furniture, and any other items necessary to effect action.

(13) "WARDROBE". "Wardrobe" means the costumes of the performers.

(14) "PHOTOGRAPHY". "Photography" means exposing the film to light and recording thereon the action taking place before the camera.

(15) "SOUND". "Sound" includes recording of narration, dialogue, music, and special effects, each usually on a separate magnetic track. The steps in sound recording are as follows:

(A) "Production Recording". Initial recording of dialogue, special effects, and narration before, during or after photography. This may also include "looping" (initial recording of a replacement of defective portions of a sound track.)

(B) "Scoring". The process of recording on film or tape a musical score or accompaniment which is synchronized with the action of the picture. The term includes any post-scoring work designed to correct deficiencies in the original scoring.

(C) "Sound Track Transfer". A "print" or copy of original recording.

(D) "Sound Effects Editing". "Sound effects editing" is the process of viewing the film action, selecting the desired effects from a library or recording new sound effects, synchronizing the sound effects with the action and building sound effects tracks composed of the desired effects, and blank leader stock where no effects are required. The completed effects track is either sold or leased to the producer who in turn uses it in fabricating a composite magnetic track.

(E) "Rerecording, Dubbing, Composite Recording and Mixing". "Rerecording, dubbing, composite recording, and mixing" are terms used to describe the fabrication of composite magnetic sound tracks which are then used to make optical sound tracks on negative film. The fabrication of a sound track consists of a process wherein music, sound effects, and dialogue, previously recorded on separate sound tracks, are rerecorded so as to produce a composite sound on a single sound track. Prior to the fabrication of the composite sound track, the producer has filmed and edited the picture and has recorded all or most of the sounds.

The producer brings the film and the various single sound tracks to the sound recording studio for fabrication. Here he reviews the work he has done without regard to sound, volume or expression. Sometimes during the review he decides upon picture retakes and re-editing. He may change the music or order retakes of the dialogue. This phase of the production is referred to as rehearsal. The producer, at this time, is deciding what he wants done and how he wants it done.

After the final review, when the sound studio has been fully instructed by the producer in regard to what is to be done, the first "take" or recording is made. This may be followed by "retakes" in their entirety or in segments until the desired sound track is fabricated.

All the rehearsal sessions, during which time the producer is in the process of putting together his material for recording, except the final review, are considered not to be a part of the sound studio's actual fabrication of the sound track.

(16) "MUSIC". "Music" is the composing, arranging, copying, and performing of the musical background and/or musical selections for a production.

(17) "MUSIC EDITING". "Music editing" is the process of viewing the film's action, selecting the desired music from a library or from music specially recorded for a production, and timing the music to the action.

(18) "MUSIC CUTTING". "Music cutting" is the process of building music tracks composed of music and blank leader stock which is synchronized with the action.

Regulation 1529. MOTION PICTURES. (Continued 3)**(19) "SPECIAL EFFECTS".**

(A) **"Matte Shot or Glass Shot"**. A visual effect employing composite photography which combines live action with a painted or otherwise synthetically created image such as motion control photography, computer generated images, retouched photographs, animation, miniatures, or other photographic techniques.

(B) **"Montage"**. A succession of images to illustrate an association of ideas or passage of time.

(C) **"Miniature"**. A motion picture representation of a scene or element of a scene on a non-real life scale or perspective.

(20) "FILM AND PROCESSING".**(A) "Negative"**.

1. Color or black and white raw stock unexposed and designed for negative image.
2. Undeveloped exposed raw stock.

(B) **"Work Print"**. The "work print" is also known as a rush or daily print and may be in black and white or color. It is a positive print made from the developed negative. It is first used by the film editor in editing the picture. The technique involves cutting and splicing the work print to the desired results. The work print is next used by the negative cutter to cut and conform the original negative to the work print. The work print may also be in the form of images transferred to videotape or other electronic storage media which is for temporary use only and is not in the final release format.

(C) **"Fine Grain" or "Interpositive"**. "Fine grain" (black and white) or "interpositive" (color) is a positive film produced from the negative. It is also known as the master positive. It is an intermediate film used for the storing and processing of images and for creating duplicate negatives for release printing or other purposes such as archives or visual effects.

(D) **"Dupe Negative" or "Internegative"**. "Dupe" or "duplicate negative" (black and white) or "internegative" (color) is a negative film that is produced from the fine grain or interpositive and is used for producing release exhibition prints.

(E) **"Answer Print"**. "Answer print", sometimes known as first trial or composite print, is the first release print. It is produced from either the original negative or dup_A negative.

(F) **"Release Prints"**. "Release prints" are the prints used for exhibition.

(21) **"FILM EDITING"**. "Film editing" is the revision and preparation for release of a motion picture by cutting the work print and rearranging scenes, deleting or adding thereto.

(22) **"NEGATIVE CUTTING"**. "Negative cutting" is the physical act of cutting the negative film to conform to the work print subsequent to the act of editing the work print by the film editor.

(23) **"VIDEO TAPE"**. "Video tape" is magnetic tape which records picture and sound and requires no processing.

(24) **"FACILITIES FEE"**. A "facilities fee" is an amount charged by the studio to a producer under a studio facilities contract which entitles him to the use of basic facilities, such as stage space, projection room, sound facilities, cutting room, dressing rooms, office space, parking, grip equipment, props, set dressings, drapes, backings, etc., and to services, such as accounting, budgeting, janitors, etc. Items provided by studios to producers are usually divided into "below-the-line" elements and "above-the-line" elements. The term "below-the-line" includes all elements relative to production other than basic format, scripts, music, actors, extras, writers, producers, directors, story editors, musicians, and producer's staff (including secretaries, script secretaries, and the like). The amount of the facilities fee is usually determined by negotiation between the studio and the producer. Examples of methods of determining the fee are:

(A) A 5 percent of below-the-line costs fee plus separate charges for stage rentals, electrical department facilities, office rental, accounting services, camera and sound equipment, etc.

(B) A fee of 20 percent of below-the-line costs up to a certain maximum per show. This fee includes the use of all studio facilities plus separate charges for over maximum usage.

(C) A fixed amount for each production.

(c) APPLICATION OF TAX.**(1) STATUS OF PRODUCER.**

(A) **Generally**. A producer, including a subproducer or coproducer, is a consumer of tangible personal property used in making a production and tax applies to all sales of such property to him, inclusive of charges for fabricating or processing. No tax liability arises from fabricating or processing performed by the producer for his own account, using his own employees. Similarly, no tax liability arises from fabricating or processing performed by a subproducer or coproducer with respect to the production.

Regulation 1529. MOTION PICTURES. (Continued 4)

(B) **Prints.** The first answer print, and release prints specified in the original contract between the producer and a sponsor, as a firm order, are part of the production and the producer is the consumer thereof. Release prints made for the sponsor as a result of orders pursuant to a mere offer in the original contract to furnish additional prints are not part of the production and the producer is the retailer of such prints. After a production contract has been completed, the sponsor may request the producer to supply him with additional prints, or may permit the producer to sell prints to others. In such cases, the producer is the retailer of the prints.

(C) **Transfer of Motion Pictures.** The outright transfer of a motion picture production by the producer, including the negative, the print, and all rights connected with the picture, prior to the release date, is not a sale for sales and use tax purposes, whether or not the picture was produced for a sponsor.

(D) **Special Production Partnerships.** If two or more persons engaged in the production and distribution of motion pictures for use in any media form a partnership for the purpose of reducing the cost of producing motion pictures through the sharing of the use of equipment, studio facilities, and the services of personnel, the furnishing (without transferring title to tangible personal property) of such equipment, facilities, and services by the partnership to its members for the purpose of the production of motion pictures by its members does not constitute a "sale" or "purchase". (Effective October 1, 1972.)

(2) **CLASSIFICATION OF CHARGES TO PRODUCERS.** The process of producing a motion picture generally consists of a number of basic steps with respect to which weekly charges are made by a studio to a producer. The following is a classification of charges to producers utilizing the facilities and personnel of others who are not subproducers or coproducers. Where fabrication or processing is involved, the classification is based on the custom of the industry with respect to whether or not the persons performing the fabrication or processing do so under the supervision of the producer in the capacity of an employee or special employee.

The classification of studio personnel as a special employee is not affected by the fact that the loaned out employee may be the only employee of the company which contracts with the producer to provide the services of the loaned out employee.

In general, those studio personnel who perform work of a creative or artistic nature in the fabrication of motion picture film, sound, sound effects, music editing and special effects are considered to be special employees. Those studio personnel who perform work of a mechanical or technical nature are generally considered not to be employees of the producer.

The classifications apply only to charges made by persons who contract directly with producers. Subcontractors cannot qualify as special employees of the producer. Charges made by subcontractors for photography, production recording, sound effects editing, music editing, special effects and film editing are generally taxable.¹

(A) Story and Scenario.

<u>Taxable</u>	<u>Exempt</u>
Mimeographing or other forms of printing or duplicating.	Writers. Rights purchased. Studio writers. Royalties. Secretaries and typists.

(B) Talent.

<u>Taxable</u>	<u>Exempt</u>
None.	Cast. Directors.

(C) **Rentals Generally.** Tax applies to rentals of tangible personal property as explained in Regulation 1660.

Under a studio facilities contract, a producer is entitled to the use of certain property and services for a facilities fee. Included within the property made available are items of tangible personal property, the furnishing of which constitutes a rental.

¹This list is intended to be illustrative, not exhaustive. If charges are made which do not fall within one or more of the examples and the taxability of which is not indicated by analogy to the examples, or by the principles shared herein, a request for a specified ruling under the particular facts and circumstances should be addressed to the Board.

Regulation 1529. MOTION PICTURES. (Continued 6)

(I) Film and Processing.

<u>Taxable</u>	<u>Exempt</u>
Special and optical effects film (raw stock).	Negative developing, other than by reverse processing.
Negative cutting.	
Laboratory charges.	
Dupe negative or internegative.	
Negative stock.	
Reverse processing method of developing negatives into positives.	
Kodachrome, Ektachrome, etc., film.	
Fine grain or interpositive developing.	

(J) Film Editing.

<u>Taxable</u>	<u>Exempt</u>
Negative cutting.	Film editors, other than charges for negative cutting. On-line and off-line videotape editing.

(K) Other Charges.

1. Fringe Benefits. The taxable charges for labor include the fringe benefit charges made for workmen's compensation, social security, sick leave, vacation pay, severance pay, etc.
2. Surcharge on Materials. The taxable charges for materials include direct surcharges to the producer for handling and other direct costs.
3. Overhead Charge. In addition to the direct taxable charges made for labor, material, fringe benefits, material surcharges, and rentals (not including the 55 percent factor described in (c) (2) (C)) an amount to cover overhead must be included within the measure of tax. This amount represents an allocation to taxable transactions of general operational overhead which is recovered by the studio through the facilities fee or some other charge. In view of the difficulty of determining the amount of such overhead fairly allocable to taxable transactions, it is determined to be 5 percent of direct taxable charges.

(L) Exemption Certificate.

Producers purchasing, contracting for fabrication or processing under circumstances in which an exemption is claimed pursuant to Section (c) (2) (A) through (K) of this regulation should issue an exemption certificate to his/her supplier substantially in the following form.

PRODUCER EXEMPTION CERTIFICATE

I HEREBY CERTIFY. That I am a producer engaged in the production of a motion picture under circumstances in which work performed by studio personnel provided for under _____

contract or invoice #

is done under the supervision of the producer in the capacity of a special employee which is exempt from tax pursuant to Regulation 1529.

In the event it is subsequently determined that the work does not qualify as exempt, it is understood that I am required by the Sales and Use Tax Law to report and pay tax measured by the purchase price.

Date Certificate Given _____

Purchaser _____
Company Name

Address _____

Signed By _____
(Signature of Authorized Person)

Title _____
(Owner, Partner, etc.)

Seller's Permit No. (if any) _____

Description of Purchase _____

Regulation 1529. MOTION PICTURES. (Continued 5)

In addition, billings are made for additional costs of materials and labor for sets, props and wardrobes. Such costs include the labor of carpenters, electricians, painters, plasterers, etc., to fabricate flats, to revamp and change existing flats and to assemble into a set (flats are portable components of sets and are usually prefabricated). Usually the facilities contract provides that title to these items remains in the studio. Under these circumstances, charges billed out as the cost of materials and labor are considered rentals.

In view of the difficulty of determining the amount of taxable rentals included within the facilities fee and the additional costs billed for sets, props and wardrobes, the taxable rental so included will be deemed to be 55 percent of the actual set designing, set construction and set striking costs billed to the producer. The 55 percent factor covers set rentals, and rentals of all other items furnished under a studio facilities agreement whether charged to production cost or included as a portion of the facilities fee. It includes the overhead charge specified in (c) (2) (K) 3.

If title to any particular item is actually transferred, e.g., an item of wardrobe to an actress, the entire charge for the item is taxable.

Rentals of tangible personal property by motion picture and television studios which do not have a studio facilities agreement with the producer-lessee are taxable in the same manner as rentals generally.

Charges involving rentals of permanent standing sets, which are real property rather than personal property, are not taxable where the transactions are clearly identifiable in the lessor's records.

(D) Photography.*Taxable*

Camera rentals — when rentals are taxable under rules applicable to rentals generally. Sales of materials purchased including prints of production stills, less applicable tax-paid purchased credit.

Exempt

Cameramen, directors of photography including directors of photography acting as camera operators.

(E) Sound.*Taxable*

Magnetic tape.
Equipment rentals unless nontaxable under rules applicable to rentals generally.

Exempt

Production recording, including looping, Foley, and sound replacement, sound transferring, re-recording, dubbing, mixing.
Sound effects editing.

(F) Music.*Taxable*

Equipment rentals unless nontaxable under rules applicable to rentals generally.

Exempt

Production recording, including scoring.
Copyists. (First or original copy only. Charges for additional copies are taxable.)
Composers, arrangers, musicians and singers, when engaged directly by or in the name of the producer.
Rights.
Music, transferring, rerecording, dubbing, mixing.

(G) Music Editing and Cutting.*Taxable*

None.

Exempt

Music editing.

(H) Special Effects.*Taxable*

Sales of models, props, paintings, etc.
Stock shots, other than rentals.

Exempt

Rental of stock shots or other motion picture films or video tapes.
Miniatures.
Matte shots.
Glass shots.
Inserts.
Optical printer.
Montages.
Animation, including animation drawings, inkings, paintings, tracings, and celluloid cells.
Laps, wipes, fades and dissolves.
Titles, end credits, opening credits.
Computer generated graphic effects.

Regulation 1529. MOTION PICTURES. (Continued 7)

A seller is relieved of liability for the sales tax, if the purchaser timely certifies in writing to the seller that the fabrication and processing is exempt pursuant to this regulation provided that the certificate is taken in good faith. A certificate will be considered timely if it is given at any time before the seller bills the purchaser, or any time within the seller's normal billing and payment cycle, or any time at or prior to the delivery of the property to the purchaser.

(d) INCOMPLETE PRODUCTIONS. Receipts from sales of incomplete productions to persons other than producers are subject to tax. The seller is a fabricator-retailer in such instances. Purchases of manufacturing aids used in making incomplete productions are generally subject to tax. To support exemption the fabricator-retailer must keep complete records to show that title to manufacturing aids passed to the customer prior to use by the fabricator-retailer and that items purchased were separately itemized on billings to customers. The sale to out-of-state customers of manufacturing aids located in this state and used here following the sale is not exempt as a sale in interstate commerce.

Any person must be ready to substantiate a claim that a film produced by him is a production rather than an incomplete production.

(e) MISCELLANEOUS.

(1) SLIDE FILMS AND FILM STRIPS. A person who makes slide films or film strips for customers is a retailer rather than a consumer, and tax applies to charges made to customers.

(2) PICTURES PRODUCED FOR UNITED STATES GOVERNMENT. The fact that motion pictures are produced under contract with the United States does not affect the tax liability of the producer. A producer of a production is regarded as the consumer of the property used in making the production and the tax applies to the sale of such property to the producer.

(3) DISTRIBUTION OF MOTION PICTURES. Rental receipts from motion picture films are not subject to tax, whether or not the films are productions complete in themselves. On and after September 1, 1983, tax applies to leases of video cassettes, videotapes, and videodiscs for private use under which the lessee or renter does not obtain or acquire the right to license broadcast, exhibit, or reproduce the video cassette, videotape, or videodisc. For a more complete explanation, see Regulation 1660.

(4) APPLIANCE MAKE-UP. A person who fabricates and applies expendable appliance make-up is the consumer of materials and make-up used, and tax does not apply to charges made to the customer.

(f) OPERATIVE DATE. The amendments to this regulation are operative January 1, 1988.

History Effective August, 1933.

Adopted as of January 1, 1945, as a restatement of previous rulings.

Amended by renumbering November 3, 1971, effective December 3, 1971.

Amended November 14, 1974, effective December 22, 1974. Totally revised regulation, added definitions, and added explanation and list of taxable charges to producers.

Amended October 26, 1983, as an emergency regulation, effective November 17, 1983. Paragraph (e) (3) amended as an emergency regulation to provide that tax applied to leases of video cassettes, videotapes, and videodiscs for private use.

Amended November 18, 1987, effective January 1, 1988. In subdivision (b) (1), amended definition of the word "him" in the definition of a "Production" to include other recording media as well as video tape. In subdivision (b) (19) (A), amended definition of "Mute Shot or Glass Shot" to include otherwise synthetically created images such as motion control photography, computer generated images, retouched photographs, animation, miniatures, or other photographic techniques. In subdivision (b) (19) (B), amended definition of "montage" to include the phrase "or passage of time" after the word "ideas". In subdivision (b) (19) (C), amended definition of "miniature" as follows: "motion picture representation of a scene or element of a scene on a non-real life scale or perspective." In subdivision (b) (20) (A), amended definition of "negative" to include "color or black and white raw stock unexposed and designed for negative image" and "undeveloped exposed raw stock." In subdivision (b) (20) (B), amended definition of "work print" to include the sentence "The work print may also be in the form of images transferred to videotape or other electronic storage media which is for temporary use only and is not in the final release format." In subdivision (b) (20) (C), amended definition of "Fine Grain" or "interpositive" film as follows: "Fine grain" (black and white) or "interpositive" (color) is a positive film produced from the cut negative. It is also known as a "master". The subdivision is amended as follows: "'Fine grain' (black and white) or 'interpositive' (color) is a positive film produced from the negative. It is also known as the master positive. It is an intermediate film used for the storing and processing of images and for creating duplicate negatives for release printing or other purposes such as archives or visual effects." In subdivision (c) (2), added

Regulation 1529. MOTION PICTURES. (Continued 8)

provisions to provide that where fabrication or processing is involved, the classification of such work as taxable or nontaxable is based on the custom of the industry with respect to whether or not the persons performing the fabrication or processing do so under the supervision of the producer in the capacity of an employee or special employee. The subdivision is also amended to delete reference to the phrase "long-term" studio personnel. In subdivision (c) (2) (A) through (K), amended regulation to provide that charges for certain work are not taxable when such work is of a creative or artistic nature and is performed by persons considered to be special employees working under the supervision of the producer. In subdivision (d), amended the regulation to delete reference to animation studios since such work is creative or artistic in nature and, if done under the supervision of the producer, charges for such work are not taxable. The subdivision is also amended to provide that "Receipts from sales of incomplete productions to persons other than producers are subject to tax." In subdivision (e) (1), amended regulation to make a grammatical correction. Added subdivision (e) (4), to provide as follows: "'Appliance Make-up.' A person who fabricates and applies expendable appliance make-up, is the consumer of materials and make-up used and tax does not apply to charges made to the customer." Added subdivision (f), to make the amendments to Regulation 1529 operative January 1, 1988.

Regulations are issued by the State Board of Equalization to implement, interpret or make specific provisions of the California Sales and Use Tax Law and to aid in the administration and enforcement of that law. If you are in doubt about how the Sales and Use Tax Law applies to your specific activity or transaction, you should write the nearest State Board of Equalization office. Requests for advice regarding a specific activity or transaction should be in writing and should fully describe the facts and circumstances of the activity or transaction.