

**STATE BOARD OF EQUALIZATION**

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July 19, 1989

Mr. F--- M---
Manager State Tax
M--- P--- A---
of ---, Inc.
XXXX --- --- ---
--- ---, -- XXXXXX

Dear Mr. M---:

As you know, your January 25, 1989 letter to Mr. Glenn Bystrom regarding the interpretation of Revenue and Taxation Code section 6010.6, subdivision (a)(2), has been referred to me for reply. You wish to clarify when tax does not apply to the transfer of a qualified motion picture to a person under the following circumstance provided at section 6010.6, subdivision (a)(2)(B):

“The transfer is made to any person or persons holding, either directly or indirectly, or by affiliation, any exploitation rights obtained prior to the date that the qualified motion picture is exhibited or broadcast to its general audience.”

Preliminarily, I believe that exploitation rights pertain to the right to exploit the motion picture itself rather than the right to use the names and likenesses of the cast, recording or releasing of a music sound track, etc.

Before turning to the specific examples you provided, our interpretation of the terms “indirect” and “by affiliation” is as follows. We believe that, when a person holds a controlling interest in an entity which holds exploitation rights, the person “indirectly” holds exploitation rights. For example, a postrelease transfer to one of the partners of a partnership which holds exploitation rights is nontaxable provided such partner holds the controlling interest in the partnership. We would view the partner as holding the exploitation rights indirectly. Generally, in the absence of clear evidence to the contrary, we believe that a person holds a controlling interest in an entity when the person holds a majority ownership interest. On the other hand, a transfer to a person who holds exploitation rights “by affiliation” would occur when the transfer is to an entity which is controlled by the person who holds the exploitation rights. For example, if a person who holds exploitation

rights holds a controlling interest in a partnership, a postrelease transfer to the partnership would be nontaxable. The partnership would hold the exploitation rights by affiliation. We will turn now to the examples you provided and follow with our response.

“EXAMPLE 1 A parent company controls a production subsidiary and retains ownership of the copyright for all films that are produced. The parent also controls other subsidiaries which distribute the films in various markets. Upon completion of a film, exploitation rights are licensed to the distribution subsidiaries by virtue of a pre-existing agreement. Since the distribution subsidiary held the exploitation rights directly, a transfer of the film copyright to the distribution subsidiary after exhibition or broadcast would be non-taxable.”

We agree with your conclusion.

EXAMPLE 2 Same facts as Example 1 except that after theatrical exhibition, the film copyright is transferred to the production subsidiary. The subsidiary did not have exploitation rights directly prior to exhibition or broadcast. However, since this subsidiary is controlled by an entity that also controls an entity with distribution rights, the production subsidiary would be deemed to hold exploitation rights indirectly and therefore the transfer would be nontaxable.”

We assume that the subsidiary is truly a subsidiary of the parent; that is, the parent is the majority stockholder of the subsidiary. In such case, we agree that the transfer is nontaxable. We reach the conclusion based on the parent’s directly holding the copyright and transferring it to the subsidiary which would hold the exploitation rights by affiliation.

“EXAMPLE 3 The parent company is a general partner in a partnership which produces several films. The film copyrights are owned by the partnership. The films are licensed for theatrical exhibition to a distribution subsidiary controlled by the parent. Upon dissolution of the partnership, completion of theatrical distribution or for any other reason, the film copyrights are transferred to the parent. The parent would be deemed to hold exploitation rights indirectly because of its control over the distribution subsidiary. Accordingly, the transfer to the parent would be nontaxable.”

Assuming that the parent holds the controlling interest in either the distribution subsidiary or the partnership, we agree with your conclusion. The parent would indirectly hold the films distribution rights or the copyrights.

“EXAMPLE 4 The parent company is a general partner in a partnership which produces several films. The film copyrights are owned by the partnership. The films are licensed for theatrical exhibition to an entity not associated with any of the partners. The partnership retained other, non-theatrical, exploitation rights. The parent through its role in the partnership exercised control over the partnership activities and thus would be deemed to hold exploitation rights by affiliation. As a result, the transfer of a film copyright to the parent would be nontaxable.”

Assuming that the parent holds the controlling interest of the partnership, we agree that the transaction is nontaxable. The parent indirectly owns the exploitation rights retained by the partnership.

“EXAMPLE 5 Same facts as Example 4 except the film is transferred to a subsidiary controlled by the parent. The transfer would be nontaxable since the subsidiary is deemed to hold exploitation rights as a result of being controlled by the parent which held exploitation rights by affiliation with the partnership.”

Assuming that the parent held the controlling interest in both the partnership and the subsidiary, we agree that the transaction is nontaxable. The subsidiary is affiliated with the partnership since each is under the common control of the parent corporation/general partner.

“EXAMPLE 6 A partnership is licensed to distribute a film made by an independent production company. Upon completion of the initial distribution, the film copyright is transferred by the independent production company to one of the general partners. The transfer would be nontaxable since the general partner held exploitation rights by affiliation with the partnership.”

We assume that the partnership obtained its distribution license prior to the date the film is exhibited or broadcast to its general audience. In such case, we agree that the transaction is nontaxable if the general partner holds the controlling interest in the partnership. The general partner would indirectly hold the exploitation rights of the partnership.

“EXAMPLE 7 Same facts as example 6 except the film is transferred to a subsidiary controlled by a general partner. The subsidiary did not hold exploitation rights directly. As a result of the subsidiary’s affiliation with the general partner, the transfer would be nontaxable.”

Assuming again that the general partner controls both the partnership and the subsidiary, we agree that the transaction would be nontaxable for the same reason as expressed in response to example 5.

We hope this has answered your questions; however, if you need further information, feel free to write again.

Very truly yours,

Ronald L. Dick
Tax Counsel

RLD:sr

cc: Mr. Robert Nunes
Mr. Glenn A. Bystrom
Mr. Jeff McGuire
Mr. Gary J. Jugum
Mr. Donald J. Hennessy

In the original letter, the date in the header on pages 2 through 5 is incorrect and should actually be July 19, 1989, not July 18, 1989.
DR (7-18-05)