

**STATE BOARD OF EQUALIZATION**

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October 6, 1989

Ms. S--- W--- N---
H--- W--- T--- & M--- Lawyers
XXXXX --- Blvd.
--- ---, CA XXXXX-XXXX

Re: Movie Special Effects, Inc.

Dear Ms. N---:

This is in reply to your August 4, 1989 letter regarding the application of sales tax to certain transactions by M--- S--- E---, Inc. (MSE). You note that you wish our opinion to be subject to Revenue and Taxation Code section 6596. Since MSE is the only person you identified in your correspondence, our opinion will apply only to transactions by MSE, for purposes of section 6596. Your letter provides the following factual background and transactions.

“I. Factual Background.

A motion picture studio ('Studio') intends to produce a full-length theatrical motion picture (the 'Picture'). In order to produce certain special effects necessary for the Picture, Studio desired to obtain the services of an individual ('Individual') who has considerable experience in the field of special effects. Studio also desired to obtain the services of several other individuals (the 'Employees') who were employed by DISC, a payroll service, for the benefit of Individual and wholly-owned corporation ('Company'). For labor and union related reasons, Studio could not employ Individual and the Employees directly. Thus, Studio on behalf of MSE, entered into negotiations with Individual and Company.

“II. Subject Transactions.

MSE was incorporated June 2, 1980 by Individual for the sole purpose of providing special effects services to Studio in connection with the production of the Picture. MSE will enter into a contract (the 'Production Services Contract') with Studio pursuant to which MSE will create, develop and produce the special effects necessary for the Picture. Individual and the Employees will be employed by DISC payroll service for the benefit of MSE.

Pursuant to the Production Services Contract, Individual and the Employees will originate, create, develop, construct, operate and otherwise produce certain special visual and photographic effects (the 'Subject Effects') for the picture. The Subject Effects will include the operation and photographing of several sophisticated, mechanical 'creature characters'. Individual and certain of the Employees will engage in supervisory, management, consulting, advisory and related creative and business services from the inception of development of the special visual and photographic effects to the completion of production and integration of the special visual and photographic effects into the Picture through the pre-production (including budgeting, scheduling and story-boarding), principal photography post-production phases of the production of the Picture. MSE will agree to furnish the services of Individual on the set during principal photography to participate actively with the director and cinematographer of the Picture in photographing scenes involving the Subject Effects contemplated to be integrated into the Picture, including positioning of cameras, live performers and the creature characters, consulting concerning the lighting of sets in which the creature characters will appear, and choreographing movements of cameras, live performers and the creature characters.

Concurrently with the execution of the Production Services Contract, Individual and Studio will enter into a binding stock purchase agreement (the 'Stock Purchase Agreement') pursuant to which Individual will be unconditionally obligated to sell all of the MSE stock to Studio and Studio will be unconditionally obligated to purchase all of the MSE stock thirty days after the production of the Picture has been completed. After studio acquires the stock of MSE, Studio will promptly liquidate MSE or cause MSE to cease to do business."

You noted that MSE makes the following representations:

"A. MSE was incorporated on June 2, 1989 for the sole purpose of creating, developing and producing the special effects for the Picture.

"B. MSE has not, at any time prior to the subject Transactions, sold, transferred or otherwise disposed of any tangible personal property for any consideration whatsoever. During the term of the Production Services Agreement, MSE will not sell, transfer or otherwise dispose of any tangible personal property to any individual or entity other than to Studio pursuant to the Subject Transactions.

"C. MSE does not own, and will not acquire, any assets other than those required in order for MSE to perform its obligations pursuant to the Production Services Agreement.

“D. Promptly after the closing of the Stock Purchase Agreement, Studio will either liquidate MSE or will cause MSE to cease to engage in any trade or business.”

Given this information, you requested that we provide an opinion that the transactions are exempt from California sales and use tax.

In both your factual background and explanation of the transactions, you note that the individual and Employees will be “employed” by DISC. On the other hand, under the facts you presented, it is MSE which contracts with the Studio to provide the Individual and Employees to develop and produce the special effects. It then appears that MSE will be subcontracting to obtain the services of the Individual and Employees, and DISC is performing only a bookkeeping function.

Opinion

We have identified three relevant transactions:

1) MSE’s providing special effects to the Studio; 2) Individual’s sale of MSE’s corporate stock to the Studio; and 3) MSE’s transfer of assets to the studio pursuant to the liquidation of MSE.

MSE’S Providing Special Effects to the Studio

Since MSE was incorporated on June 2, 1989, we assume that all of the transactions will occur after September 22, 1988. On that date, section 6010.6 was added to the Revenue and Taxation Code to exclude from the definition of “sale” and “purchase” the performance of qualified production services in connection with the production of all or any part of any qualified motion picture. Persons performing those qualified production services are consumers of paintings, models and artwork used by those filming special effects, titles, or credits, and of film, tape, or other embodiment upon which sound, visual images or computer-generated graphics are created or recorded, notwithstanding that title to the property may be transferred pursuant to the qualified production services contract.

Subdivision (b)(4) of section 6010.6 defines “qualified production services” to include any fabrication performed by any person in any capacity (whether as an employee, agent, independent contractor, or otherwise) on film, tape, or other audiovisual embodiment in connection with the production of all or any part of any qualified motion picture. The term includes, but not limited to, photography, sound, music, special effects, animation, adaptation (language, media, electronic, or otherwise), technological modifications, computer graphics, dubbing, mixing, editing or cutting services.

We believe that the work performed by the Individual and the Employees is qualified production services. Tax does not apply to MSE’s charge to the studio for performing the qualified production services. Also, tax would not apply to MSE’s charge to the studio for

paintings, models, and artwork used by those filming the special effects, nor for film, tape or other embodiment upon which the sound, visual images, or computer-generated graphics are created or recorded. MSE should pay sales tax reimbursement or use tax on its purchase of such property to consume in performing the qualified production services. On the other hand, if MSE makes three or more retail sales of other tangible personal property during any 12-month period, MSE will be a retailer for purpose of those sales regardless that those sales are only to the Studio and no other persons.

Individual's Sale of Stock to the Studio

California sales tax is imposed on retailers for the privilege of selling tangible personal property at retail. The sale of shares of stock in a corporation is not considered to be a sale or purchase of tangible personal property for purposes of the Sales and Use Tax Law notwithstanding that for income tax purposes (e.g., Int. Rev. Code § 338), or other purposes, the sale of shares of stock may be treated as a sale of the tangible personal property of the corporation. See Business Taxes Law Guide Annotation 395.1250.

MSE's Transfer of Assets to the Studio Pursuant to the Liquidation of MSE

You note that, after the Studio acquires the stock of MSE, the Studio will promptly liquidate MSE or cause MSE to cease depends upon the facts of transaction. Generally, the ratable distribution in kind of corporate assets to shareholders upon liquidation and dissolution of the corporation is not regarded as a sale under Revenue and Taxation Code section 6006. (See BTLG Annots. 395.2280, 395.2240.) Further, unless MSE makes three or more retail sales to qualify as a retailer, a sale of the corporate assets to the studio in lieu of, or prior to, a liquidation would be an occasional sale under Revenue and Taxation Code section 6006.5, subdivision (a), and exempt from tax under section 6367. (See BTLG Annot. 395.2280.)

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

Very truly yours,

Ronald L. Dick
Tax Counsel

RLD:sr