INTERNAL POLICY DIRECTIVE 2005-1
May 27, 2005
SINGLE BUSINESS TAX - FILM LIBRARIES

POLICY ISSUE

Are film libraries Tangible Personal Property for purposes of apportionment under Michigan's Single Business Tax?

POLICY DETERMINATION

Yes. Films and tapes are capable of being possessed, seen, touched, weighed, and measured and therefore qualify as tangible personal property. In addition films and tapes have intrinsic value because of the information stored on them. Therefore, the value of the film or tape should be used in determining the property factor for purposes of apportionment under the Single Business Tax.

DISCUSSION

Black's Law Dictionary Seventh Edition, defines tangible personal property as follows:

> Corporeal personal property of any kind; personal property that can be seen, weighed, measured, felt, or touched, or is in any way perceptible to the senses.

In addition, Barron's Law Dictionary, Third Edition, provides the following definition of tangible property:

> Property either real or personal, capable of being possessed; such as is capable of being apprehended by the senses, which is accessible, identifiable . . . . For taxation purposes, tangible property generally refers to personalty [personal property] and is that moveable property which has a value of its own, rather than merely the evidence or representative of value, and which has a visible or substantial existence.

Accordingly, films and tapes can qualify as tangible personal property if they are capable of being possessed, or apprehended with the senses. Traditionally the Department viewed film and tapes as intangible property. In support of this position the Department relied on 26 CFR 1.48-1(f), which used motion pictures and television film as examples of intangible personal property. The Department's reliance on the regulation was well placed because the Single Business Tax Act does not define the term "tangible personal property". As a result, MCL 208.2(2) of the SBTA requires the Department to rely on the definition used by the laws of the United States relating to federal income taxes.

26 CFR 1.48-1(f) was held to be invalid in *Walt Disney Productions v United States*, 480 F2d 66 (9th Cir, 1973), *cert den* 415 US 934 (1974). The Court held that the regulation was invalid and that motion picture negatives are tangible personal property. The Court in *Walt Disney Productions* was dealing expressly with the question of whether motion picture negatives were tangible personal property. The Court stated that it agreed with the District Court that the quoted regulation was invalid and that it was plainly inconsistent with the expressed purpose of the applicable statute as shown by the legislative history. Historically, the Department took the position that the *Walt Disney Productions* case applied only to motion picture negatives and that 26 CFR1.48-1(f) was still valid in all other cases.

However, Federal Courts have continued to hold that films, tapes, and master negatives are tangible personal property. In *Walt Disney Productions v U.S.*, 549 F2d 576 (9th Cir, 1976) the Court held that master negatives are tangible personal property. See also, *Texas Instruments Inc. v U.S.,* 551 Fed 599 (5th Cir, 1977), films and tape "have intrinsic value because of the seismic information thereon does not exist as property separate from the physical manifestation. The seismic data tapes and films are tangible personal property . . . ."; and *Comshare, Inc. v U.S.*; 27 F3d 1142 (6th Cir, 1994), "[w]here the value of information is dependent upon its having been embodied in a tangible medium, case law from other circuits teaches, acquisition of the medium at a price that includes the value of the information encoded on it constitutes acquisition of "tangible" property the full cost of which qualifies for the tax benefits associated with such property."

Based on the relevant case law, it is apparent that reliance on 26 CFR 1.48-1(f) is no longer warranted. The Courts have repeatedly found it to be an invalid interpretation of the Internal Revenue Code. Specifically, the courts have found that under the Internal Revenue Code, motion picture negatives, master negatives and television film qualify as tangible personal property.

In an attempt to determine if an item is intangible property, the Department has traditionally looked to see if the item produces royalties. The Department has taken the position that any item that produces a royalty is intangible property. Even though the courts have held that recording intellectual property (intangible property) on master negatives, film, and videotape results in a tangible product, the intellectual property (intangible property) still retains a separate value. Generally, when a royalty is paid, it is for the use of the intellectual property (intangible property) and not for the use of the tangible property that was ultimately created. In the case of a motion picture negative, the royalty would be paid for the use of the ideas and concepts of the motion picture (the intellectual/intangible property) but not for the actual negative (the tangible property).

For example, if a film company wants to remake Gone With the Wind it would pay a royalty for the intellectual or intangible property used to make the original motion picture. This may include the use of the original script and design of costumes (the ideas used in the motion picture). It would not involve the use of the motion picture negative. In this instance the royalty would be paid for the use of the intellectual property (intangible property).

Conversely, a television network may negotiate a royalty payment with the holder of the motion picture negative which, simply allows the network to air the original version of Gone With the Wind. In this scenario the network is actually paying a royalty for the right to use the motion picture negative in order to broadcast the movie (tangible property).

Accordingly, although it is the Department's position that motion pictures, master negatives, television film and videotapes qualify as tangible personal property and should be included in the property factor for purposes of apportionment under the Michigan Single Business Tax, when determining the value of the film library it is inappropriate to use the income derived from royalty payments that are generated from the use of the intellectual (intangible) property.

Since it is the Department's position that film libraries are tangible property, the provisions of MCL 208.47 control the valuation of film libraries. MCL 208.47 states:

> Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is

the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

In conclusion, it is the Department's position that motion pictures, master negatives, television film and videotapes qualify as tangible personal property and should be included in the property factor for purposes of apportionment under the Michigan Single Business Tax. The value of the motion pictures, master negatives, television film and videotapes should be valued according to the provisions of MCL 208.47 and added together to determine the value of a film library.