COLORADO
Department of Revenue
Taxation Division

Office of Tax Policy
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DOR_TaxPolicy@state.co.us

PLR-16-009

April 12, 2016

XXXXXXXXXXXXX
Attn: XXXXXXXXX
XXXXXXXXXXXXX
XXXXXXXXXXXXX

Re: Licensed Movies and Content

Dear XXXXXXXXXXXXXXX,

You submitted on behalf of XXXXXXXXXXXXXX ("Company") a request for a private letter ruling to the Colorado Department of Revenue ("Department") pursuant to Department Rule 24-35-103.5. This letter is the Department's private letter ruling. This ruling is binding on the Department to the extent set forth in Department Rule 24-35-103.5. It cannot be relied upon by any taxpayer other than the taxpayer to whom the ruling is made.

Issues

Do the movies/content and the hard drives Company acquires from film distributors constitute "tangible personal property" subject to sales/use tax?

Conclusion

Both the digital movies/content and the computer hard drives that Company receives from the film distributors constitute tangible personal property subject to Colorado sales/use tax. The film distributors, as lessors of this property, are responsible for paying this tax to the Department, notwithstanding any contractual agreement between the parties to the contrary.

Background

Company operates two businesses in the State of Colorado, each of which is a movie theater or motion picture exhibitor. It contracts with motion picture distributors via a Master License Agreement to exhibit motion pictures. The Master License Agreements specify the motion picture, the dates of play and the percentage that Company pays for film rental.

The movie/content is sent to Company by the motion picture distributor and delivered to Company by courier via a computer hard drive. The movie/content is copied to Company's master library server from where it is downloaded for subsequent playback. The movie/content hard drive is immediately returned to the motion picture distributor via courier. The content requires a digital key or KDM that is delivered via email. The key or KDM only authorizes the movie or content to be played for the contracted amount of time. The key expires and the movie or content is no longer available for Company to play once

the contracted amount of time occurs. The content is then deleted from Company's master library server. The tangible hard drive that the content is delivered on is not required for every showing of the movie/content. Company does not purchase or own the hard drive, movie/content, or the digital key. Company only licenses to exhibit the movie/content for the contracted amount of time.

After the movie/content is done playing at a location, a report (box office report) of how many admissions were sold and the gross earnings for the days/weeks of play is sent to the film distributor. The gross earnings are multiplied by the agreed upon film rental percentage and a payment is then made to the film distributor for the film rental.

Structure of Analysis

To determine whether the movies/content and the computer hard drives are subject to tax, the Department will examine the following questions:

1. Is the item taxable under§ 39-26-104(1). C.R.S.?
    a. Is the item tangible personal property sold or purchased at retail?
2. Is the item eligible for any exemptions?
    a. Is the item exempt under§ 39-26-713(1)(a), C.R.S.?
        i. Did the lessor pay Colorado sales or use tax on such tangible personal property upon its acquisition?
3. Does Company's temporary possession of both computer hard drives and digital movies/content represent the lease thereof and if so, which party bears the obligation for any applicable sales/use tax?

Discussion

Colorado imposes tax on the sale, use, storage, or consumption of tangible personal property. The principal question Company raises is whether the film rental agreements between motion picture distributors and Company involve "tangible personal property." The Colorado Court of Appeals has twice considered the taxability of film rental agreements and ruled that such agreements involve the sale and use of tangible personal property for sales or use tax purposes.[1] In both *American Multi-Cinema, Inc. v. City of Westminster,* 910 P.2d 64 (Colo. App. 1995) and *Cinemark USA, Inc. v. City of Fort Collins,* 190 P.3d 793 (Colo. App. 2008), the theater operator acquired copyrighted motion picture film reels from the distributor that it used for movie exhibitions and subsequently returned to the distributor after use. The theater operators contended that their transactions and agreements with film distributors did not predominantly involve tangible personal property (i.e. the film reels upon which copyrighted material was conveyed), but rather an intangible, incorporeal property right to exhibit the copyrighted material.

The Court ruled in each case that the license to exhibit copyrighted material was inseparable from the tangible film reels, and the film rental agreements were consequently transactions involving the acquisition of tangible personal property. "[T]he purpose of a motion picture exhibitor...is to obtain a finished product which it can exhibit to the public" and "there can be no question...that...reels of motion picture film, or a cassette of video film, is an item of tangible personal property."[2]

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[1] American Multi-Cinema, Inc. v. City of Westminster, 910 P.2d 64 (Colo. App. 1995) and Cinemark USA, Inc. v. City of Fort Collins, 190 P.3d 793 (Colo. App. 2008).

[2] American Multi-Cinema, Inc. v. City of Westminster, 910 P.2d 64 (Colo. App. 1995)

Although the physical medium by which you receive the copyrighted material differs from these cases, the Court's conclusions nonetheless apply. The computer hard drives by which you receive films are no less tangible than the film reels contemplated in these cases. The fact that the content of the computer hard drives are uploaded to Company's master library prior to showing the movie, while the film reels in each case were used instantaneously to exhibit movies/content, is also immaterial. In *Cinemark,* the Court found that payment pursuant to the film agreement depended upon the transmission of the films by way of some tangible medium and was taxable as a consequence. This is true whether movies/content are transmitted via film reel or computer hard drive and whether that tangible medium was utilized concurrent or prior to the movie screenings.

Company suggests that what it receives from film distributors pursuant to the agreements is not tangible hard drives, but rather intangible digital movies/content. For Colorado sales and use tax purposes, tangible personal property is defined as "corporeal personal property."[3] Corporeal is typically defined as that which is physical, tangible, or material in nature. Digital goods, such as e-books, MP3 music files, or the digital movies/content you receive are indeed physical, tangible, or material in nature - that is, possessing a physical existence within a material realm - and are thus subject to Colorado sales and use tax. The Department agrees with the Nebraska Supreme Court's discussion of this issue in the similar context of electronic signals transmitted via satellite:

> "The mere fact that the signals may be received and stored shows that a tangible thing is in issue. The concept of physically storing an intangible thing is beyond comprehension."[5]

The fact that digital movies/content can be received and stored in a computer hard drive and the master library server - themselves both indisputably tangible - demonstrates the tangible nature of the digital movies/content. Thus, Company acquires tangible personal property as a result of your licensing agreements in both the form of the computer hard drive and in the form of the digital movies/content.

Finally, Company states that it purchases neither the tangible hard drives on which the movies/content are transmitted nor the movies/content, and that it possess such items only temporarily before returning them to the film distributor. Again, in *Cinemark* the Court considered the impact of temporary possession and found that it did not prevent the taxability of the transaction. The use tax imposed by the City of Ft. Collins in that case applied whether the tangible personal property in question was purchased, leased, rented, sold, used, stored, distributed or consumed. Similarly, the State of Colorado levies sales or use tax on leases of tangible personal property.[6] A lease is generally defined as the right to use or possess an item for a provided period of time. In this case, Company acquires possession and use of both the hard drives and digital goods. Therefore, it has engaged in a taxable lease and use of that property. However, the party obligated to pay the tax depends on the duration of the lease. For leases of three years or less, the lessor (in this case, the film distributor), bears the obligation to pay the applicable sales or use tax, either at the time of acquisition or at the time when the property is first put into use. However, the

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[3] § 39-26-102(15), C.R.S.

[4] Merriam-Webster Desk Dictionary (1995); American Heritage College Dictionary, 3rd Ed. 1993.

[5] May Broadcasting Co. v. Boehm, 241 Neb. 660,666 (1992).

[6] §§ 39-26-102(23) and 713(1), C.R.S.

lessor may obtain prior permission from the Department to acquire the property tax free and collect the applicable sales tax on the lease payments.[7] We are unaware of the Department granting any such permission to the film distributor(s) in this case. Irrespective, responsibility falls on the film distributor, either to pay sales or use tax on the hard drives and movies/content they lease to Company, or to collect from Company and remit to the Department sales tax on the lease payments (provided prior permission has been obtained from the Department).

Miscellaneous

This ruling applies only to sales and use taxes administered by the Department. Please note that the Department administers state and state-collected city and county sales taxes and special district sales and use taxes, but does not administer sales and use taxes for self-collected home rule cities and counties. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes. Visit our web site at www.colorado.gov/tax for more information about state and local sales taxes.

This ruling is premised on the assumption that Company has completely and accurately disclosed all material facts. The Department reserves the right, among others, to independently evaluate Company's representations. The ruling is null and void if any such representation is incorrect and has a material bearing on the conclusions reached in this ruling and is subject to modification or revocation in accordance to Department Regulation 24-35-103.5.

This ruling is binding on the Department to the extent set forth in Department Regulation 24-35-103.5. It cannot be relied upon by any taxpayer other than the taxpayer to whom the ruling is made.

Enclosed is a redacted version of this ruling. Pursuant to statute and regulation, this redacted version of the ruling will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted version of the ruling.

Sincerely,

Office of Tax Policy
Colorado Department of Revenue

This ruling cannot be relied upon by any other taxpayer other than the taxpayer to whom the ruling is made.

[7] § 39-26-713(1), C.R.S.