

**REPORT OF THE
CHIEF LEGISLATIVE ANALYST**

Date: 10/24/12
Submitted in J&D Committee
Council File No: 09-1914-S13
Item No.: 0
~~Priority~~: CLA

DATE: October 23, 2012

TO: Honorable Members of the Jobs and Business Development Committee

FROM: Gerry F. Miller *HEK*
Chief Legislative Analyst

Council File No.: 09-1914-S13
Assignment No.: 12-08-0636

Radio and Television Broadcaster Taxation Methods

SUMMARY

On July 25, 2012, the City Council instructed this Office and the City Administrative Officer to report relative to: 1) an evaluation of the City's taxing system for the radio and television broadcasting industries, including a maximum tax similar to the Entertainment Production Cap (C.F. 09-1914-S13); 2) the establishment of a minimum tax and its impact on the entertainment cap; and, 3) the consistency of agency fees, impact of a minimum tax or entertainment cap on the General Fund, and impact on the General Fund if extended to broadcasting.

Additionally, on September 7, 2012, the Motion Picture Association of America (MPAA) submitted comments to City staff, relative to the City's taxing methods for Radio and Television broadcasters (Attachment 1).

RECOMMENDATIONS

That the City Council:

- 1) Instruct the Office of Economic Analysis, in conjunction with the Office of Finance, to conduct a review of the potential impact on the radio and television broadcast industry of both the current tax structure and a revised structure for this industry;
- 2) Consider an adjustment to the tax method for radio and television broadcasters as part of the overall discussion of the Gross Receipts Tax; and,
- 3) Instruct the Office of Finance and request the City Attorney to continue to meet with the Motion Picture Association of America to further discuss the letter submitted by MPAA on September 7, 2012.

Current Tax Method for Radio and TV Broadcasters

Los Angeles Municipal Code (LAMC) Section 21.45 (Fund Class 5) includes Radio Broadcasters, Television Broadcasters and Theater Operators. Radio and television broadcasters are businesses engaged in the business of producing and broadcasting, or broadcasting local or network programs or advertising material. The Office of Finance reports that in Fiscal Year 2011-12, there were 4,241 accounts registered under this Fund Class, including broadcasters and theater operators. Gross receipts for business performance within the City are taxed at a rate of \$1.27 per \$1,000 under Fund Class 5¹.

¹ LAMC shows tax rate at \$1.37 per \$1,000. However the rate was reduced by Council in 2009.

LAMC Section 21.15(h) provides the Office of Finance with the authority to make rules and regulations for the apportionment of gross receipts for business activities taking place outside the City, in compliance with the Commerce Clause of the United States Constitution and the Equal Protection Laws of the California Constitution. According to the Office of Finance, the City apportions the gross receipts in a manner that clearly reflects the proportion of the taxed activity that is actually carried out within the City. The Office of Finance applies one of three standard taxing methods to businesses in Fund Class 5, pursuant to City Clerk Ruling No. 15² (See Table 1).

Table 1 – 80-20 Factor Apportionment Methods

<i>Method 1:</i>	Business location within City 100% performance within City 100% of gross receipts → Taxable
<i>Method 2:</i>	Business location within City Most business performance <u>outside</u> the City 20% (administrative support) of gross receipts → Taxable 80% (business performance) of gross receipts → Tax Exempt
<i>Method 3:</i>	Business location outside the City Most business performance <u>within</u> the City 20% (administrative support) of gross receipts → Tax Exempt 80% (performance) of gross receipts → Taxable (<i>Operation Bulletin, September 15, 1975</i>)

Some businesses may conduct all of their business activity within the City. However, there are businesses that conduct a portion of their business activity outside the City. The 80-20 Factor apportionment method captures the business activity attributed to the City. The Office of Finance applies the 80-20 Factor to apportion business performance that takes place within the City. The 20 percent represents administrative support functions which include accounting, billing, collecting and administrative.

If the 80-20 Factor does not fairly reflect the business activities in and out of the City, a taxpayer may request a deviation from Ruling No. 15. The LAMC allows for apportionment alternative methods in the event the Office of Finance or the taxpayer determine there is a better method for apportionment. The burden of proof lies on the taxpayer to demonstrate if the tax due should be less. Similarly, if a City auditor determines that the taxable portion of a taxpayer’s gross receipts should be higher, the City auditor may make a recommendation to modify the taxable percentage. Other tax apportionment methods used to deviate from Ruling No. 15 are listed in Attachment 2.

Extending the Entertainment Producers Cap to Radio and Television Broadcasters

According to the Office of Finance, in Fiscal Year 2011-12, there were 4,241 accounts comprised of radio broadcasters, television broadcasters and theater operators. Table 2 shows the breakdown of the accounts by gross receipts and taxes paid. These accounts generated a combined total of \$3.9 million in annual gross receipts revenue for the City. Approximately 2,419 (57%) of the accounts either reported no gross receipts or paid no gross receipts tax as a result of previously enacted tax incentives such as the Small Business Tax Exemption which exempts businesses with gross receipts under \$100,000 from paying taxes. The top one percent of businesses in this category earns, on average, between \$25 Million and \$85 Million per year and pays a corresponding average tax amount between \$38,000 and \$109,000.

² According to the Office of Finance, Ruling No. 15 is the apportionment formula used specifically for Section 21.190 (Professions and Occupations) but it is also applied to Radio and TV Broadcasting.

Table 2- Radio and TV Broadcaster Accounts by Gross Receipts

No. of Accounts *	Gross Receipts Range (\$)	Total Taxes Paid by Accounts	Average Gross Receipts Per Account	Average Tax Paid Per Account
1,398	0	\$0		\$0
1,021	0 to 99,999	\$0 ³	\$0	\$0
298	100,000 to 199,999	\$45,000	\$118,903	\$151
202	200,000 to 299,999	\$55,000	\$214,392	\$272
233	300,000 to 399,999	\$94,000	\$317,664	\$403
162	400,000 to 499,999	\$86,000	\$418,003	\$5313
128	500,000 to 599,999	\$78,000	\$479,823	\$609
99	600,000 to 699,999	\$69,000	\$548,795	\$697
75	700,000 to 799,000	\$56,000	\$587,927	\$747
60	800,000 to 899,999	\$53,000	\$695,538	\$883
52	900,000 to 999,999	\$59,000	\$893,398	\$1,135
291	1 to 2.5 Million	\$477,000	\$1,290,689	\$1,639
91	2.5 to 5 Million	\$355,000	\$3,071,731	\$3,901
67	5 to 10 Million	\$535,000	\$6,287,460	\$7,985
10	10 to 12 Million	\$124,000	\$9,763,780	\$12,400
16	12 to 15 Million	\$278,000	\$13,681,102	\$17,375
12	15 to 20 Million	\$264,000	\$17,322,835	\$22,000
9	20 to 25 Million	\$228,000	\$19,947,507	25,333
11	25 to 50 Million	\$422,000	\$30,207,588	\$38,363
6	50 Million +	\$654,000	\$85,826,772	\$109,000
4,241		\$3,932,000		

* 2,419 accounts either reported no gross receipts or paid no gross receipts tax

Entertainment Production Cap

Effective January 2011, the LAMC was amended to raise the minimum gross receipts threshold to \$5 Million and the maximum threshold to \$12 Million for motion picture, radio and television producers (C.F. 10-1238). The tax rate is computed using a rate-per-thousand of production costs. The minimum tax is \$145 per year or fractional part thereof for the first \$5 Million of tax measures, plus \$1.30 per year for each additional \$1,000 of the measure of tax in excess of \$5 Million. The maximum tax is \$9,245 for all measures of tax greater than \$12 Million. The effect of this tax reduction was estimated to be an approximate \$1 Million reduction in General Fund revenues. Note that the measure of tax for radio and television producers is based on cost of production, not on gross receipts.

The Office of Finance indicates that comparing the Entertainment Production Cap to the tax structure for radio and television broadcasters is not an entirely accurate comparison, given that the nature of business activity is different. Also, although the overall burden for broadcasters would be less under the proposed tax structure, the rate increase from a \$1.27 to \$1.30 per \$1,000 could trigger Proposition 218 compliance.

³ Taxpayers in the range \$0-\$99K overpaid taxes by \$15,000. Office of Finance will be returning this amount to the taxpayers.

However, to provide the Council with the information requested, the tax amounts have been calculated making the same threshold assumptions as are currently applied to motion picture and radio and television producers in Section 21.109 of the LAMC (See Tables 3 and 4).

Table 3 – Tax Rates - Extending Entertainment Cap to Broadcasters

Radio and TV Broadcasters Gross Receipts Range	Current Broadcaster Tax Rate	Proposed Broadcaster Tax Rate
\$0-\$5Million	\$1.27/\$1,000	\$0.029/\$1000 (Max. \$145)
\$5Million - \$12 Million	\$1.27/\$1,000	\$145 + \$1.30/\$1,000
\$ 12 Million +	\$1.27/\$1,000	\$9,245

Under the current tax structure, there are currently 1,691 businesses in Fund Class 5 each earning more than \$100,000 and less than \$5 Million (Table 4), with a combined total of \$1.1 Billion in gross receipts. Collectively, this group within Fund Class 5 pays \$1.4 Million in gross receipts tax to the City.

Under the proposed tax structure for broadcasters, businesses earning less than \$5 Million would be taxed at a rate of \$0.029/\$1,000 for a maximum tax of \$145 for businesses with \$5 Million in gross receipts.

Businesses with gross receipts between \$5 Million and \$12 Million pay a minimum of \$145 for the first \$5 Million plus \$1.30 per \$1,000 above the \$5 Million threshold. For example, a business with \$12 Million in gross receipts would be taxed as follows:

Gross Receipts	Tax Computation	Taxes Owed
\$5,000,000	[\$5,000,000] x [\$0.029/\$1,000]	\$ 145 (Maximum Tax)
\$7,000,000	[\$7,000,000] x [\$1.300/\$1,000]	\$9,100
\$12,000,000		\$9,245

Businesses with gross receipts above \$12 Million would be capped at \$9,245. Under the proposed tax structure, a business with gross receipts of \$12 Million would pay the same amount of tax as a business with gross receipts of \$85 Million.

It should be noted that under the proposed tax structure, the tax rate increases from the current \$1.27 per thousand to \$1.30 per thousand. This could trigger requirements under Proposition 218. The City Attorney would need to opine with regard to Proposition 218 implications.

Altogether, if the City modifies the gross receipts tax structure for Fund Class 5, which includes radio and television broadcasters, there will be an estimated General Fund reduction of approximately \$3.2 Million, or over three times greater than the impact of the Entertainment Production Cap (See Table 4).

Table 4 – General Fund Impact of Extending Entertainment Cap to Broadcasters

	No. of Accounts	Combined Gross Receipts	Business Taxes Owed		General Fund Impact
			Current Tax Rate	Proposed Tax Rates	
\$100,000 to \$5 Million	1,691	\$1,123,622,047	\$1,427,000	\$33,000	\$(1,394,000)
\$5 Million to \$12 Million	77	\$518,897,638	\$659,000	\$185,000	\$(474,000)
\$12 Million to \$15 Million	16	\$218,897,638	\$278,000	\$148,000	\$(130,000)
\$15 Million to \$20 Million	12	\$207,874,016	\$264,000	\$111,000	\$(153,000)
\$20 Million to \$25 Million	9	\$179,527,559	\$228,000	\$83,000	\$(145,000)
\$25 Million to \$50 Million	11	\$332,283,465	\$422,000	\$102,000	\$(320,000)
\$50 Million +	6	\$514,960,630	\$654,000	\$55,000	\$(599,000)
TOTAL	1,822	\$3,096,062,993	\$3,932,000	\$717,000	\$(3,215,000)

Agency Fees

On September 7, 2012, the Motion Picture Association of America submitted comments relative to the City's taxing methods for radio and television broadcasters (Attachment 2). Our Office has reviewed the letter and had preliminary discussions with the MPAA, the Office of Finance and the City Attorney. It appears that the comments submitted by the MPAA have broader tax impacts as well as implications under Proposition 218 requiring further analysis. It is therefore recommended that the Council instruct the Office of Finance and request the City Attorney to continue to meet with the MPAA to discuss the letter submitted by MPAA.

Impact on Business Retention

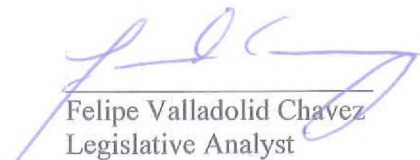
Previous adjustments to the taxing structure have had as a stated goal the attraction or retention of businesses in the City. It is unclear whether a reduction of this tax rate would lead to greater retention of businesses in the City, would attract additional business to the City, or would have a positive impact on other taxes, such as sales tax. Should the Council wish to pursue this further, it is recommended that the Office of Economic Analysis conduct a study of the impact of a reduction on the radio and television broadcast industry.

Gross Receipts Tax Consideration

There is currently a proposal to reduce and eliminate the City's gross receipts tax over a period of time. The tax structure for Radio and Television Broadcasters could be impacted by this proposal. The Council may wish to consider an adjustment to the tax method for radio and television broadcasters as part of the overall discussion of the Gross Receipts Tax.

FISCAL IMPACT

Council approval of the recommendations included in this report will not result in a General Fund impact. However, should the Council adopt a policy that changes the current taxing method for Fund Class 5 (radio and television broadcasters) to the same thresholds as the Entertainment Production Cap, there would be an estimated reduction in General Fund revenues of approximately \$3.2 Million.



Felipe Valladolid Chavez
Legislative Analyst

Attachments: 1) MPAA Letter dated September 7, 2012
2) Alternative Tax Apportionment Methods

GFM: fvc

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September 7, 2012

Mr. Felipe V. Chavez
Legislative Analyst
Office of the Chief Legislative Analyst
City Council, City of Los Angeles
255 City Hall, 200 N. Spring Street
Los Angeles, CA 90012

RE: Submission of Motion Picture Association of America Concerning
the Application of the Los Angeles Business License Tax ("LABLT")
to the Radio and Television Broadcasting Industries

Dear Mr. Chavez:

On behalf of the Motion Picture Association of America and its member companies, we are pleased to submit these comments to augment our original white paper in support of Resolution 09-1914-S13 (Garcetti). We appreciate the attention your office is giving to these issues, as well as the interest of your colleagues in the Chief Administrative Officer's office and the Office of Finance.

Specifically, we are following up on the issues raised in our meeting of August 9, 2012 and in your e-mail of Friday, August 10, 2012. You have asked for some case studies which illustrate some of the difficulties the broadcast companies have had with the City's application of the LABLT ordinance, as well as further comments from MPAA concerning the terms "constitutionally required" and "agency fees".

Comparison of BLT Ordinance to Office of Finance Implementation Policies

In order to assist you understand how some of the issues in the case studies arise, we start by comparing the law (Los Angeles Municipal Code §21.45(a) (3))

to the Office of Finance's interpretation and implementation of that law.¹ The Municipal Code states:

"3. When gross receipts are constitutionally required to be apportioned and are derived from or attributable to activities engaged in both within and without the City, gross receipts shall be apportioned in a manner that is fairly calculated to determine the amount of gross receipts derived from or attributable to engaging in business in the City. This apportionment shall be made on the basis of payroll, value and situs of tangible property, general expense, or by reference to any of these or other factors, or by any other method of apportionment, that will fairly determine the amount of gross receipts derived from or attributable to engaging in business in the City. Gross receipts derived from or attributable to sources within the City shall include gross receipts from any activities carried on in this City." (Emphasis added)

As noted in our White Paper and as emphasized above, the law permits a broad range of legally permissible apportionment methods, and does not require the use of a particular method.

Appendix A is "Lesson 29" of the Office of Finance's Training Materials. Item 5 of those materials is entitled: "Apportionment of Gross Receipts". Items (B)-(D) state:

- B. Emphasize that gross receipts are apportioned based on the activities carried on by the taxpayer (through employees and property).
- C. Often taxpayers request an apportionment based on viewership (where viewers are located), this is NOT an acceptable method of apportionment.

¹ At the recent meeting convened by the Mayor's Office on August 9, 2012, the Office of Finance referred to their Business License Tax Auditor Training Manual as the best reference source for how they apply the law to taxpayers. <http://finance.lacity.org/form/TAX%20AUDITOR%20TRAINING%20MANUAL.pdf>. We ignore for the purposes of this discussion, whether it is appropriate for the Office of Finance to rely on its training materials as "authority", and instead cite them merely for the purpose of establishing Finance's interpretation and implementation practices of LAMC §21.43. We do note, however, that much of the information in the Training Materials appears to come directly from the Draft City Clerk Ruling 20 (White Paper, Appendix B) which was never adopted by the City Clerk. Reliance by the Office of Finance upon this Draft Ruling and its own Training Manual is inappropriate and is an exercise in underground regulation (see LAMC sec. 21.15(h)).

- D. The usual method used is something similar to Ruling 15 (80-20 factor) if applicable. If not applicable, use cost allocation method (as discussed in lesson 27).” (Capitalization and underscore in original)

Essentially, the Office of Finance has unilaterally removed the ability of taxpayers to use the variety of apportionment methods specifically allowed by §21.43. Lesson 29 (5)(D) cites Ruling 15 with approval, yet in Lesson 27 (which discusses the application of Ruling 15) it is noted that “Ruling 15 is the apportionment formula used specifically for Sec. 21.190 activities only.” Nonetheless, the materials also concede that:

“However, in practice, we also apply it to other service type classification sections such as. . . 21.189.2/21.45 (a) (Radio and TV Broadcasting)...”

The materials also instruct auditors to “use [the] cost allocation method”. Notably absent is any acknowledgement of the legal authority of the taxpayer to use other apportionment formulae, and the criteria an auditor should use to evaluate those alternative methods to see if the method “. . . fairly determine(s) the amount of gross receipts derived from or attributable to engaging in business in the City” as required by the ordinance.

Moreover, there is no authority of which we are aware that would legally preclude the use of an audience factor as part of a legally permissible apportionment methodology proposed by a taxpayer. As noted in the white paper, an audience factor is used by the State of California to apportion the income of broadcasters (18 CCR §25137-8.2 - Appendix B)². This practice also violates the plain wording of the ordinance.

Inconsistency on Documentation Required to Establish Apportionable Expenses

Attached as Appendix C are six different case studies illustrating the difficulties with the inconsistent and inappropriate manner in which radio and television broadcasters are taxed under the LAMC by the OOF. The cases show different apportionment methods (indeed, different positions on whether the broadcaster was entitled to apportionment at all), different levels of documentation supporting the methodologies, and vastly different results

² It should be noted that while Regulation 25137-8.2 establishes a property, payroll and sales (i.e. audience) factor for use in apportioning broadcaster income, since 2011 taxpayers have had the option to apportion using the sales factor only (see Revenue and Taxation Code §25128)

(apportionment factors ranging from a low of approximately 30% and a high in excess of 90%) being applied to broadcasters' gross receipts.

Collectively, they show an interpretation of the law (as show in the OOF Training Manual) at odds with the LAMC, and audit practices that are inconsistent with the law (and even the OOF's own Training Manual).

"Constitutionally Required"

Section 21.45 (a)(3) states, in pertinent part: "3. When gross receipts are *constitutionally required to be apportioned* and are derived from or attributable to activities engaged in both within and without the City....." (Emphasis added).

Neither the LAMC nor the Training Materials relied upon by the Office of Finance define "constitutionally required" nor give any insight into what factual conditions must exist before apportionment of a broadcaster's gross receipts is required. In some audits, the Office of Finance has simply denied that a broadcaster is entitled to apportionment at all (See Case Study #1). In this case study, the taxpayer had to take its appeal all the way to the Board of Appeals, which ultimately decided that apportionment was required (but did not allow additional hearing time on the *type* of apportionment allowable).

This ambiguous language in the LAMC should either be defined or stricken from the code entirely and apportionment granted for all broadcasters.

"Agency Fees"

When advertising time is sold by the broadcasting industry, and the buy is placed by an advertising agency, the agency charges a fee for the labor it performs. That fee, however, is pursuant to an agreement between the agency and *its client*, not between the agency and the broadcaster. (In other words, the advertising agency is not acting as the agent of the broadcaster in selling the advertising time). For example, if the advertiser defaulted on its payment for the advertising time it purchased, the agency's remedy would lie against its client, and not the broadcaster. Nonetheless, in at least one prior audit of a radio station, agency fees were included in the measure of *the broadcaster's* gross receipts. Broadcasters maintain that these receipts are never those of the broadcaster to begin with, and should not legally be included in gross receipts.

The Office of Finance's Training materials are silent on the treatment of agency fees, and indeed make no mention of them. In the Draft City Clerk Ruling 20 (Appendix A to the White Paper) the Office of Finance stated: "Gross receipts will be determined as defined in Sections 21.00 and 21.189.2 L.A.M.C. with no exclusion for 'agency commissions.'" Thus it would appear at least that the Office of Finance has had an ambiguous policy on whether agency commissions are to be included in the gross receipts of the broadcaster, or that of the advertising agency which placed the advertising in the first place.

Agency commissions should *not* be included in the gross receipts of the broadcaster, and the revised §21.45 should be amended to exclude these commissions.

Activities in the City of Los Angeles versus "local activities in the State of California." (LAMC §21.45(a)(4))

LAMC §21.45(a)(4) states:

4. Notwithstanding the foregoing, the gross receipts used in the measurement of the tax under this section shall be limited to receipts that are generated, produced, or attributable *to local activities in the State of California*. (Emphasis added)

Draft City Clerk Ruling No. 20 states:

Advertising The City Clerk deems that revenue from *advertising placed within California* is taxable. This revenue is typically denoted as local sales within the industry. Revenue derived from advertising placed outside the State of California is *exempt*. This revenue is typically denoted as 'national sales' within the industry." (Emphasis added)

The broadcasting companies are unaware of any legal authority which would allow the City of Los Angeles to constitutionally tax activities occurring outside its jurisdictional boundaries, even if the activities are within the boundaries of the State of California. The Municipal Code, and any training manuals or material, should make it clear that the City's taxing power extends only to activity conducted within the City of Los Angeles.

Moreover, the Office of Finance's Training Materials (Lesson 29, section 6(B).) discussing "exemptions" state:

"B. Emphasize that Sec. 21.189.2(d)/21.45(a-4) exemption is similar to Sec. 21.168.1"

That section, in turn, states:

"21.168.1 Out-of-State Sales Nothing defined in Section 21.41, as Multimedia Business, in Section 21.42, as Wholesale Sales or in Section 21.44, as Retail Sales, shall be construed to require the inclusion in the computation of the amount of the tax due under these sections the gross receipts of the sales of goods, which are shipped to the purchasers of the goods by the seller to points outside of the State of California."

Contrary to the claims in the Training Materials, there is no similarity between 21.45(a)(4) and 21.168.1. The broadcast exclusion is constitutional in nature—the City cannot tax revenue related to activities outside of its jurisdiction, whether it wanted to or not. By contrast, the exemption in 21.168.1 appears to be a true exemption—a "sale" occurred in the City limits, but if the property sold is transported outside the City limits (or in this case, the State of California) the gross receipts from the proceeds are not included in the seller's gross receipts. In short, the City *could* have legally taxed the sale, but chose not to. While arriving at the same result, the two sections operate on different legal premises.

Based on the above, we urge that §21.45(a)(4) be amended to change "State of California" to "City of Los Angeles".

National Sales

The Office of Finance's Training Materials (Lesson 29(6)(C)(a.)(i)) states that "national sales" are exempt from the business license tax. "National Sales" are those "... gross receipts from advertisements that are broadcasted [sic] nationally."

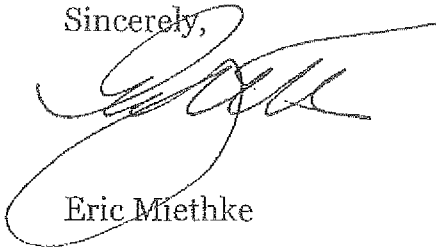
There is no dispute that national sales revenue is not taxable by the City of Los Angeles. The broadcast industry requests that §21.45 be amended to include an express statement that such national sales are excluded from taxable gross receipts.

Mr. Felipe V. Chavez
September 7, 2012
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Conclusion

Again, on behalf of the broadcasters in the MPAA, we appreciate the opportunity to express our views, and look forward to working with your office and other stakeholders to develop alternatives to the current illegal, unfair and unworkable system. If you have any questions concerning these materials, please feel free to contact me at (916) 446-6752, or Melissa Patack in the MPAA's Los Angeles office at (818) 935-5838. Thank you for your consideration, and we look forward to hearing from you.

Sincerely,

A handwritten signature in black ink, appearing to read "Eric Miethke", written over a large, stylized flourish.

Eric Miethke

EJM/ns

cc: Melissa Krance, Office of the Chief Administrative Officer
Henry R. Fong, Office of Finance
Robert Lee, Office of Finance
Chris Pearson, Office Mayor Antonio Villaraigosa
Guy Lipa, Office of Councilmember Eric Garcetti

APPENDIX A:

LESSON 29-AUDITOR TRAINING MANUAL
CITY OF LOS ANGELES-OFFICE OF FINANCE

Lesson 29

SEC. 21.189.2/21.45 (a) : RADIO & TELEVISION BROADCASTER

OUTLINE

1. WHO ARE SUBJECT TO SEC. 21.189.2/21.45 (a)?
2. TAXATION OF RADIO AND TV PRODUCER
3. TAXATION OF RADIO AND TV BROADCASTERS
4. TAXABLE GROSS RECEIPTS
5. APPORTIONMENT OF GROSS RECEIPTS
6. EXEMPTION

Lesson 29

SEC. 21.189.2/21.45(a): RADIO AND TELEVISION BROADCASTER

1. **WHO ARE SUBJECT TO SEC. 21.189.2/21.45(a)?**
(Reference: Sec. 21.189.2(a) & (b)/21.45(a,1 and 2)

- A. Broadcaster
- B. Producer and Broadcaster
- C. Person furnishing
 - a. services
 - b. program elements, or
 - c. facilities

which are furnished in connection with:

- a. production
- b. production and broadcasting
- c. broadcasting

2. **EMPHASIZE THAT A RADIO OR T.V. PRODUCER IS TAXABLE UNDER SEC. 21.109**

Clearly differentiate this from a person who is both the producer and broadcaster. Such person is taxable under Sec. 21.189.2/21.45(a).

However, a person furnishing services to a radio or T.V. producer is taxable under Sec. 21.189.2/21.45(a).

Discuss Schedule A: Reclassification of Radio and T.V.
Producers; P. M. Inafuku; 12-10-91.

3. **DISCUSS SCHEDULE B: PRODUCERS, BROADCASTERS, ETC.; P. M. INAFUKU; 9-15-93**

4. **WHAT ARE THE GROSS RECEIPTS TAXABLE?**

Gross receipts used in the measurement of tax are limited to receipts that are generated, produced, or attributable to local activities in the State of California.

5. **APPORTIONMENT OF GROSS RECEIPTS**

- A. Discuss Sec. 21.189.2(c)/21.45(a 3)
- B. Emphasize that gross receipts are apportioned based on the activities carried on by the taxpayer (through employees and property).
- C. Often taxpayers request an apportionment based on viewership (where viewers are located), this is NOT an acceptable method of apportionment.
- D. The usual method used is something similar to Ruling 15 (80-20 factor) if applicable. If not applicable, use cost allocation method (as discussed in Lesson 27).

6. **EXEMPTION**

- A. Discuss Sec. 21.189.2(d)/21.45 (a 4)
- B. Emphasize that Sec. 21.189.2(d)/21.45(a-4) exemption is similar to Sec. 21.168.1.
- C. Examples of exemptions:

- a. Broadcasters:

- (i) National Sales

The taxpayer's books and records reflect advertising income as national or local sales. We exempt the national sales.

National Sales is defined to be the gross receipts from advertisements that are broadcasted nationally.

Local Sales are gross receipts from local advertising, such as Worthington Ford.

- b. Program element providers

- (i) Service type such as director, scriptwriter

Income derived from out-of-state clients is exempt even though all the work is performed in the City. Not necessarily where billed, but where the client you're dealing with is.

Clearly explain that the current policy is to exempt those gross receipts from clients located out of California.

- (ii) Post production

Gross Receipts shipments of videotapes out of California are exempt.

CITY OF LOS ANGELES
INTRA-DEPARTMENTAL CORRESPONDENCE
OFFICE OF FINANCE

DATE: December 10, 1991

TO: Tax & Permit Division Personnel

FROM: Paul Inafuku, Chief I
Communications Officer

SUBJECT: RECLASSIFICATION OF RADIO AND TELEVISION PRODUCERS

The City Council amended Ordinance Section 21.109 L.A.M.C. (Motion Picture Producer) and Section 21.189.2 L.A.M.C. (Radio and Television Broadcaster) by Ordinance Numbers 167415 and 167416, effective December 27, 1991 (copies enclosed).

The definition of Section 21.109 has been expanded to include Television and Radio Producers.

Every person who only engages in producing radio programs, television programs or advertising material for such media is now classified under Section 21.109 (Motion Picture, Television and Radio Producers) instead of Section 21.189.2 (Radio and Television Broadcaster).

Any questions regarding classification should be directed to James Hickey, Principal Tax Auditor at (213) 368-7178.

PMI: rc
rcoratp

OFFICE MEMORANDUM
TAX and PERMIT DIVISION

DATE: September 15, 1993
TO: All Tax & Permit Division Employees
FROM: Paul M. Inafuku, Chief I *PMI*
SUBJECT: PRODUCERS -- BROADCASTERS -- POST PRODUCTION COMPANIES --
LOAN-OUT CORPORATIONS

Recent amendments to Section 21.109 (Motion Picture, Television and Radio Producers) and Section 21.189.2 (Radio and Television Broadcaster) required a review and/or a modified policy regarding the application of these sections. Listed below are some activities with the applicable business tax classifications.

MOTION PICTURE, TELEVISION AND RADIO PRODUCERS

<u>Activity</u>	<u>Tax Classification</u>
A producer <u>at risk</u> is the person or entity that bears the financial responsibility in the production.	21.109
In a situation where <u>no person is at risk</u> , a producer is the person that is responsible for the actual development or making of the program or advertisement. This is normally the person developing, filming and/or recording the material for release or viewing. Examples are producers of commercials and educational or training programs.	21.109
A motion picture, television or radio producer that provides the services of his/her employees to one or more other producers is classified under Motion Picture, Television and Radio Producers. The gross receipts from this activity should be included in the producer's taxable measure.	21.109
A motion picture, television or radio producer that furnishes studio facilities to other media producers where the facilities include, in addition to physical equipment, the services of technicians such as cameramen, soundmen, carpenters, electricians and set decorators is classified under Motion Picture, Television and Radio Producers. The gross receipts from this activity should be included in the producer's taxable measure.	21.109
A person that synchronizes pictures with sound, or makes or produces sound scores is classified under Motion Picture, Television and Radio Producers.	21.109

RADIO AND TELEVISION BROADCASTER

<u>Activity</u>	<u>Tax Classification</u>
A radio or television broadcaster is the person that engages in <u>producing and broadcasting</u> or <u>broadcasting</u> local or network programs or advertising material.	21.189.2
A person that <u>furnishes services, program elements or facilities</u> in connection with <u>production, production and broadcasting</u> , or <u>broadcasting</u> is included in the definition of Radio and Television Broadcaster.	21.189.2

POST PRODUCTION

<u>Activity</u>	
Post production activity which involves <u>reconstruction</u> of motion pictures, television programs or commercials by synchronizing pictures with sound, or making or producing sound scores is classified under Motion Picture, Television and Radio Producers.	21.109
Post production activity for <u>motion pictures, training or educational programs, theater commercials, etc.</u> , which <u>does not</u> involve reconstruction of the motion pictures, programs or commercials by synchronizing pictures with sound or making or producing sound scores and where there is a <u>transfer of new personal property</u> is classified under Retail Sales.	21.167
Post production activity for <u>television</u> which <u>does not</u> include reconstruction of the television programs or commercials by synchronizing pictures with sound, or making or producing a sound score is classified under Radio and Television Broadcaster.	21.189.2

TRANSFER OF FILM TO VIDEOTAPE

<u>Activity</u>	
Film transfer which involves the process of transferring a motion picture film to a <u>master videotape</u> , without any post production activity, for sale to the <u>ultimate user</u> is classified under Retail Sales.	21.167

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OFFICE MEMORANDUM
TAX and PERMIT DIVISION

All Senior Tax Auditors/Tax Auditors

TO: Terrance Manocchio

DATE: May 5, 1995

FROM: SEPTEMBER 15, 1993 MEMO ON "LOAN OUT" COMPANIES

A/C NO.:

I have attached a revised copy of the above memo clarifying the proper
x classifications to be used in audits involving "Loan-out" companies.

9

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Attachment

ED
502.1

SIGNED: 

9.2

MF 4

REVISED
(5/95)

FILM OR VIDEOTAPE DUPLICATION

Activity

Tax
Classification

Duplication of films/videotapes that are sold for resale is classified under Wholesale Sales. 21.166

Duplication of films/videotapes that are sold to the ultimate user is classified under Retail Sales. 21.167

LOAN-OUT COMPANIES

Activity

Tax
Classification

Current loan-out activities are subject to tax based upon what the activities are and the organizational structure of the loan-out company (sole proprietor/partnership/corporation) as follows:

- A. Loan-Out companies (sole proprietor/partnership/corporations) providing services for Radio & Television Broadcasters and/or Producers:
- Prior to 1/1/84: Misc. Svc - "Temp-Help Agency" 21.189.1
- After 1/1/84: Radio & Television Broadcaster 21.189.2
- B. Loan-Out companies providing services for Motion Picture Producers:
- (1) Loan-Out corporations/partnerships providing services to Motion Picture Producers. 21.189.1
- (2) Loan-Out sole proprietors providing services to Motion Picture Producers 21.190
- C. Motion Picture, Television and Radio Producers who loan out their employees to other producers include those receipts with their taxable computations. 21.109
- D. Radio and Television Producers who loan out their employees to other producers include those receipts with their taxable computations. 21.109

APPENDIX B:

Code of California Regulations

Title 18, §25137-8.2

(II) include talent salaries.

(iii) The value of a film shall not be included in the property factor until its release date.

(iv) Video cassettes and discs shall be included in the property factor at their inventory cost as shown in the taxpayer's books and records.

(B) Denominator.

(i) All real property and tangible property (other than films) whether owned or rented, which is used in the business, shall be included in the denominator.

(ii) Films, other than films the cost of which is expensed for California tax purpose at the time of production, shall be included in the property factor at original cost for twelve years beginning with the release date.

(iii) Films for a topical nature including news or current event programs, sporting events or interview shows, the cost of which is expensed for California tax purposes at the time of production, shall be included in the property factor at original cost for one year beginning with the release date.

(iv) All other films, other than those included in the denominator under clause (ii) or (iii) of this subparagraph, shall be aggregated and treated as a single film property which shall be included in the property factor. Such property shall be valued at eight times the gross receipts generated during the income year from the theater distribution, network television, television syndication, cable television, subscription and the marketing of video cassettes and discs through licensing or direct selling, or similar receipts, but in no event in an amount greater than the total original cost of such aggregated film property.

(C) Numerator.

(i) If tangible personal property (other than films) is located or used in this state for part of the income year, its value shall be determined by applying the ratio which the number of days the property is located or used in this state bears to the total number of days such property was owned or rented during the income year.

(ii) The total value of films that are included in the property factor under subparagraph (B) of paragraph (1) of this subsection shall be attributed to this state in the same ratio in which the total California receipts from such films as determined in subparagraphs (A), (B) and (C) of paragraph (3) of this subsection pertaining to the sales factor bears to the total of such receipts everywhere.

(2) Payroll Factor.

(A) In General.

(i) The denominator shall include all compensation paid to employees during the income years, including talent salaries. Residual and profit participation payments constitute compensation paid to employees.

(ii) The amount paid to a corporation for providing the services of an actor or director who is an employee of such corporation or for loaning the services of an actor or director who is under contract with such corporation shall, if substantial, be included in the producer's payroll factor as if the amount paid was compensation paid to an employee of the producer.

(B) Numerator. Compensation of employees in the production of a film on location shall be attributed to the state where the services are or were performed. Compensation of all other employees shall be governed by Regulations 25132 and 25133.

(3) Sales Factor Numerator. The numerator shall include all gross receipts for the taxpayer from sources within this state including the following:

(A) Gross receipts from films in release to theaters and television stations located in this state.

(B) Gross receipts from films in release to or by a television network for network telecast shall be attributed to this state in the ratio that the audience for such network stations (owned and affiliated) located in California bears to the total audience for all such network stations (owned and affiliated) everywhere. The audience shall be determined by rate card values published annually in the Television & Cable Factbook, Vol. I, "Stations Volume," Television Digest, Inc., Washington, D.C., if avail-

able, or by other published market surveys, or if none is available, by population data published by the U.S. Bureau of Census.

(C) Gross receipts from films in release to subscription television telecasters shall be attributed to this state in the ratio that the subscribers for such telecaster location in California bears to the total subscribers of such telecaster everywhere. If the number of subscribers cannot be determined accurately from records maintained by the taxpayer, the ratio shall be determined on the basis of the applicable year's statistics on subscribers published in Cable Vision, International Thompson Communication Inc., Denver, Colorado, if available, or by other published market surveys, or, if none is available, by population data published by the U.S. Bureau of the Census for all states in which the telecaster has subscribers.

(D) Receipts from sales and rentals of video cassettes and discs shall be included in the sales factor as provided in Regulations 25135 and 25136.

NOTE: Authority cited: Section 19503, Revenue and Taxation Code. Reference: Section 25137, Revenue and Taxation Code.

HISTORY

1. Renumbering of former section 25137-8 to new section 25137-8.1, including amendment of subsections (a) and (b)(7) and amendment of NOTE, filed 3-26-2012; operative 4-25-2012 (Register 2012, No. 13).

§ 25137-8.2. Motion Picture and Television Film Producers, Distributors, and Television Networks — Apportionment of Income.

(a) In General. When a business entity in the business of producing or distributing motion picture, film, or television programming, or television commercials, whether broadcast or telecast through the public airwaves, by cable, direct or indirect satellite transmission, or any other means of communication, either through a network (including owned and affiliated stations) or through an affiliated, unaffiliated, or independent television broadcasting station has income from sources both within and without this state, the amount of business income from sources within this state shall be determined pursuant to this regulation. This regulation does not apply to a business entity that earns receipts from the provision of cable television services.

(b) Definitions.

For purposes of this regulation only, the following definitions shall apply.

(1) "Advertising revenue" includes advertising from all sources, including but not limited to online advertisements, embedded advertisements, product placement, barter transactions, and the sale of air time used for advertising purposes.

(2) "Cable television services" means the transmission to subscribers of video programming or other programming service over a cable system.

(3) A "distributor" is a business entity that, upon completion of production, licenses a film for exhibition by a related or unrelated third party. The distributor may also develop and fund the campaign to market the film. A theater that exhibits the film is not a distributor based upon that fact. A producer may also be a distributor if it licenses its own films or those of others for exhibition.

(4) "Film" means the physical embodiment of a play, story, or other literary, commercial, educational, or artistic work, produced for telecast, as a motion picture, video tape, disc, or any other type of format or medium.

(A) A "film" is deemed to be tangible personal property.

(B) "Film" does not include video cassettes or discs sold for personal use.

(C) Each episode of a series of films produced for television shall constitute a separate film notwithstanding that the series relates to the same principal subject and is produced during one or more television seasons.

(5) A "producer" is a business entity that develops and creates motion picture, television, or web-based content.

(6) "Release date" means the date on which a film is placed in service. A film is placed in service when it is first telecast or exhibited to the primary audience for which the film was created. Thus, a motion picture theater film is placed in service when it is first publicly exhibited for entertainment purposes and an educational film is placed in service when it is first exhibited for instructional purposes. Each episode of a television series is placed in service when it is first telecast. A film is not placed in service merely because it is completed and therefore in a condition or state of readiness and availability for telecast or exhibition, or merely because it is telecast or exhibited to prospective exhibitors, sponsors, or purchasers, or it is shown in a "sneak preview" before a select audience.

(7) "Rent" shall include license fees for the exhibition or telecast of films.

(8) A "subscriber" to a subscription television telecaster is the individual residence or other outlet that is the ultimate recipient of the transmission.

(9) "Tangible personal property" used in the business, whether owned or rented, shall include but is not limited to sets, props, wardrobes, and other similar equipment.

(10) "Telecast" means the transmission of an electronic signal or other signal by radiowaves or microwaves or by wires, lines, coaxial cables, wave guides, fiber optics, satellite transmissions directly or indirectly to viewers or subscribers, or by any other means of communication.

(c) Apportionment of Business Income. The property, payroll, and sales factor of the apportionment formula for motion picture and television film producers, distributors and television networks shall be computed pursuant to Sections 25128 through 25137 of the Revenue and Taxation Code and the regulations adopted pursuant thereto except as provided in this regulation. Income from new technologies, including but not limited to video streaming and online websites, to the extent they are utilized by motion picture and television film producers, producers of television commercials and television networks to produce business income, shall be treated in a manner consistent with this regulation.

(1) Property Factor.

(A) In General.

(i) In the case of rented studios, the net annual rental rate shall include only the amount of the basic or flat rental charge by the studio for the use of a stage and other permanent equipment. Other equipment such as sound recording equipment rented from other sources or from the studio that is not covered in the basic or flat rental charge and used for one week or longer (even though rented on a day-to-day basis) shall be included. Lump-sum net rental payments for a period that encompasses more than a single income year shall be assigned ratably over the rental period.

(ii) The value of the films shall:

(I) be the original cost of producing the film as determined for federal income tax purposes, before any adjustment for federal credits that have not been claimed for state purposes, and

(II) include talent salaries.

(iii) The value of a film shall not be included in the property factor until its release date.

(iv) Video cassettes and discs shall be included in the property factor at their inventory cost as shown in the taxpayer's books and records.

(B) Denominator.

(i) All real property and tangible property (other than films), whether owned or rented, that is used in the business shall be included in the denominator.

(ii) Films, other than films the cost of which is expensed for California tax purposes at the time of production, shall be included in the property factor at original cost for twelve years beginning with the release date.

(iii) Films of a topical nature including news or current event programs, sporting events or interview shows, the cost of which is expensed for California tax purposes at the time of production, shall be included in the property factor at original cost for one year beginning with the release date.

(iv) All other films, other than those included in the denominator under clause (ii) or (iii) of this subparagraph, shall be aggregated and treated as

a single film property that shall be included in the property factor. Such property shall be valued at eight times the gross receipts generated during the income year from the theater distribution, network television, television syndication, cable or satellite television, subscription and the marketing of video cassettes and discs through licensing or direct selling, or similar receipts, but in no event in an amount greater than the total original cost of such aggregated film property.

(C) Numerator.

(i) If tangible property (other than films) is located or used in this state for part of the income year, its value shall be determined by applying the ratio which the number of days the property is located or used in this state bears to the total number of days such property was owned or rented during the income year.

(ii) The total value of films that are included in the property factor under subparagraph (B) of paragraph (1) of this subsection shall be attributed to this state in the same ratio that the total receipts from such films as determined in subparagraph (A) of paragraph (3) of this subsection pertaining to the sales factor bears to the total of such receipts everywhere.

(2) Payroll Factor.

(A) In General.

(i) The denominator shall include all compensation paid to employees during the income years, including talent salaries. Residual and profit participation payments constitute compensation paid to employees.

(ii) The amount paid to a corporation for providing the services of an actor or director who is an employee of such corporation or for loaning the services of an actor or director who is under contract with such corporation shall, if substantial, be included in the producer's payroll factor as if the amount paid was compensation paid to an employee of the producer.

(B) Numerator. Compensation of employees in the production of a film on location shall be attributed to the state where the services are or were performed. Compensation of all other employees shall be governed by Regulations 25132 and 25133.

(3) Sales Factor.

(A) The numerator shall include all gross receipts derived by the taxpayer from sources within this state including, but not limited to, the following:

(i) Gross receipts, including advertising revenue, from films in release to theaters and television stations located in this state.

(ii) Gross receipts, including advertising revenue, from films in release to or by a television network for network telecast shall be attributed to this state in the ratio that the audience for such network stations (owned and affiliated) located in California bears to the total audience for all such network stations (owned and affiliated) everywhere. The audience shall be determined by rate card values published annually in the Television & Cable Factbook (<http://www.warren-news.com/factbook.htm>), if available, or by other published market surveys, or if none is available, by population data published by the United States Census Bureau, provided that the source selected is consistently used from year to year for that purpose.

(iii) Gross receipts, including advertising revenue, from films in release to subscription television telecasters shall be attributed to this state in the ratio that the subscribers for such telecaster located in California bears to the total subscribers of such telecaster everywhere. If the number of subscribers cannot be determined accurately from records maintained by the taxpayer, the ratio shall be determined on the basis of the applicable year's statistics on subscribers published in Cable Vision, International Thompson Communication Inc., Denver, Colorado, if available, or by other published market surveys, or, if none is available, by population data published by the United States Census Bureau for all states in which the telecaster has subscribers, provided that the source selected is consistently used from year to year for that purpose.

(iv) Receipts from sales and rentals, licensing or other disposition of video cassettes and discs or any other format or medium intended for per-

sonal use shall be included in the numerator of the sales factor as provided in Regulations 25135 and 25136.

(d) This regulation applies to taxable years beginning on and after January 1, 2011.

NOTE: Authority cited: Section 19503, Revenue and Taxation Code. Reference: Section 25137, Revenue and Taxation Code.

HISTORY

1. New section filed 3-26-2012, operative 4-25-2012 (Register 2012, No. 13).

§ 25137-9. Railroads—Allocation and Apportionment of Income.

(a) Apportionment of Business Income. The property, payroll and sales factors of the apportionment formula for a railroad shall be computed pursuant to Section 25128 through 25137 of the Revenue and Taxation Code and the regulations adopted pursuant thereto (in Article 2.5 of Group 17 of this subchapter) except as provided in this regulation.

(1) Property Factor

(A) Definitions

1. "Original cost" is deemed to be the basis of the property for federal income tax purposes (prior to any federal income tax adjustments except for subsequent capital additions, improvements thereto or partial dispositions); or, if the property has no such basis, the valuation of such property as currently required for Interstate Commerce Commission purposes. If the original cost of property is unascertainable under the foregoing valuation standards, the property is included in the property factor at its fair market value as of the date of acquisition by the taxpayer (Reg. 25130(a)(1)).

2. "Rent" does not include the per diem and mileage charges paid by the taxpayer for the temporary use of railroad cars owned or operated by another railroad.

3. A "locomotive-mile" is the movement of a locomotive (a self-propelled unit of equipment designed solely for moving other equipment) a distance of one mile under its own power.

4. A "car-mile" is a movement of a unit of car equipment a distance of one mile.

(B) General—Railroad cars owned and operated by other railroads and temporarily used by the taxpayer in its business and for which a per diem or mileage charge is made are not included in the property factor as rented property. Railroad cars owned and operated by the taxpayer and temporarily used by other railroads in their business and for which a per diem charge is made by the taxpayer are included in the property factor of the taxpayer.

(C) Numerator

1. In determining the numerator of the property factor, all property, except mobile or movable property such as passenger cars, freight cars, locomotives and freight containers which are located within and without this state during the income year, shall be included in the numerator of the property factor in accordance with Sections 25129-25131, California Revenue and Taxation Code, inclusive, and California Administrative Code, Title 18, Regulations Section 25129-25131, inclusive.

2. Mobile or movable property such as passenger cars, freight cars, locomotives and freight containers which are located within and without this state during the income year shall be included in the numerator of the property factor in the ratio which "locomotive-miles" and "car-miles" in the state bear to the total everywhere.

(2) Payroll Factor—Compensation paid to engineers and trainmen or individuals engaged in similar activities, performing services on interstate trains shall be included in the numerator of the payroll factor in the ratio which the compensation required to be reported to this state for withholding tax purposes under the provisions of 49 USC 11504 bears to the total compensation required to be reported to the Internal Revenue Service.

(3) Receipts Factor

(A) General—Per diem and mileage charges which are collected by the taxpayer shall be excluded from the receipts factor.

(B) Numerator

1. The total revenue of the taxpayer in this state during the income year for the numerator of the revenue factor from hauling freight, mail and express (except mail and express handled in passenger service) shall be attributable to this state as follows:

(I) All receipts from shipments which both originate and terminate within this state; and

(II) That portion of the receipts from each movement or shipment passing through, into, or out of this state is determined by the ratio which the miles traveled by such movement or shipment on the lines of the taxpayer in this state bears to the total miles traveled by such movement or shipment on the lines of the taxpayer from point of origin to destination.

2. The total revenue of the taxpayer in this state from the transportation of passengers shall include:

(I) All receipts from the transportation of passengers (including mail and express handled in passenger service) which both originate and terminate within this state; and

(II) That portion of the receipts from the transportation of interstate passengers (including mail and express handled in passenger service) determined by the ratio which the miles traveled by such transportation on the lines of the taxpayer in this state bears to the total miles traveled in such transportation on the lines of the taxpayer from point of origin to destination.

NOTE: Authority cited: Section 26422, Revenue and Taxation Code. Reference: Section 25137, Revenue and Taxation Code.

HISTORY

1. New section filed 6-15-87, operative 7-15-87 (Register 87, No. 25).

§ 25137-10. Combination of General (Non-Financial) and Financial Corporations.

(a) Application.

(1) The income of a unitary business which is conducted by two or more entities, one or more of which would be classified as a bank or financial corporation and one or more of which would be classified as a general corporation for purposes of the Revenue and Taxation Code, sections 23001, et seq., whose predominant activity is other than financial activity, shall be allocated and apportioned pursuant to this regulation for income years beginning on or after January 1, 1989.

(2) A unitary business subject to this regulation normally consists of a parent corporation engaged by itself, or with or through a subsidiary or subsidiaries, in a mining, manufacturing, mercantile or service business which forms a unitary subsidiary or subsidiaries to perform financial functions which are ancillary to the parent's business.

EXAMPLES:

1. A corporation engaged in the operation of a department store establishes a unitary subsidiary to hold title to receivables arising from the extension of credit for the purchase of goods from the store. The unitary business is subject to the regulation.

2. A manufacturer of consumer products establishes a unitary subsidiary to provide financing to third-party marketers of its product and/or financing for the purchasers of such products from third parties. The unitary business is subject to the regulation.

3. A bank forms a unitary subsidiary to hold title to its headquarters buildings and branch locations. The unitary business is not subject to the regulation.

(b) Definitions.

(1) Bank or Financial Corporation. A "bank or financial corporation" is an entity whose tax, if it were doing business in California, would be determined pursuant to Revenue and Taxation Code sections 23181 and 23183.

(2) Financial Activity. "Financial" activity is an activity involving the use of moneyed capital in activities which are in competition with and which are substantially similar to those which national banks are permitted to conduct.

(3) General Corporation. A "general corporation" is a corporation whose tax, if it were doing business in California, would be determined pursuant to Revenue and Taxation Code section 23151. It is a corporation which is neither a bank nor a financial corporation. (See subsection (b)(1).)

APPENDIX C:

Case Studies

Case Study #1

A television station, located outside the City of Los Angeles, was subject to a multi-year audit. The television station broadcasts over a wide range of southern California. As a result of the audit, Office of Finance accepted apportionment based solely on where advertising agency that sold the local time was located (within and without the City). The Office of Finance did not address apportionment on the basis of expenses/cost of operation. Agency commissions and national advertising revenue were excluded from taxable gross receipts.

Case Study # 2

A broadcaster is located outside the City limits and does not transmit a signal. This broadcaster sells commercial advertising time for broadcast on its nationwide network of television stations. This taxpayer uses an apportionment method based on a numerator of sales executive salaries, working in the area of southern California, over a denominator of total nationwide costs of operation. The company is apportioning its national sales income, net of agency commissions.

Case Study #3

A television station is located physically inside the City of Los Angeles, with signal coverage inside and outside the City of Los Angeles over most of Southern California. Prior to 1988, the broadcaster had apportioned its gross receipts based on a combination of audience and geographic viewing area. In 1990, a City Clerk auditor rejected the broadcaster's apportionment formula and caused the broadcaster to use an expense methodology to apportion its gross receipts. The new methodology, based on expenses included costs associated with the day-to-day operations of the station. Since the broadcaster did not keep business records that identified in-city and out-of-city expenses, the taxpayer developed estimates of what portion of its operating costs were incurred inside and outside the City limits. Since 1990, the broadcaster has paid the City's business tax based upon the expense methodology, based upon its own estimates, which exclude National Sales and agency commissions from the gross receipts.

Case Study # 4

Taxpayer is the owner of a television station located in Los Angeles, California. Taxpayer's station broadcasts over a wide geographical area, referred to as its Designated Market Area (DMA). Its DMA includes 8 different counties located in multiple states. Taxpayer's station produces local programming and acquires additional programming for broadcast. Taxpayer's revenue is generated from the sale of advertising for broadcast on its station. Advertising is sold by the station's sales employees.

Taxpayer files an annual Business License Tax Return and pays tax on its local advertising revenue. Since taxpayer's revenue is generated from activity located both within and without the City, the station apportions its gross receipts subject to tax.

Taxpayer uses an apportionment formula based on a combination of the location of its television audience and the station expenses located within the City in relation to the total everywhere. Taxpayer uses the provisions of City Clerk Ruling 15 in conjunction with the expense portion of the formula to complete the annual apportionment calculation. Taxpayer is audited by the City and the apportionment formula is determined to be acceptable.

Case Study #5

Taxpayer is the owner of a radio station located in Los Angeles, CA. Taxpayer's station broadcasts in Los Angeles and throughout several additional counties in southern California. Taxpayer's station produces local programming and acquires additional programming for broadcast. Taxpayer's revenue is generated from the sale of advertising for broadcast on its station. Advertising is sold by the station's sales employees. The sales employees spend a majority of the time outside of their office selling advertising time for broadcast on the station.

Taxpayer files an annual Business License Tax Return and pays tax on its local advertising revenue. Since taxpayer's gross receipts is generated from activity located both within and without the City, it apportions its gross receipts subject to tax. Taxpayer uses an apportionment formula based on the station expenses located within the City in relation to total station expenses.

The City audits the taxpayer's returns. The City auditor determines the expenses used to calculate the apportionment formula are not supportable nor do they fairly represent the amount of business activity within and without the City of Los Angeles.

The taxpayer and auditor do not reach agreement on an apportionment formula which results in the disallowance of any apportionment of the station's gross receipts. Audit assessments are finalized based on 100% of gross receipts being attributable to Los Angeles. Taxpayer requests an Administrative Review Hearing. The Assessment Review Officer affirms the audit findings.

Taxpayer requests a hearing before the Board of Review (BOR). Taxpayer argues in the hearing that they are entitled to apportionment of the station's gross receipts. Taxpayer argues more than one method of apportionment exists to fairly represent the business conducted in the City. Taxpayer provides one method based on the activity of the sales employees and their substantial time spent at the advertiser's location. Another method is discussed that is based on the location of the station's listeners. The BOR renders no opinion or decision at the conclusion of the hearing.

Taxpayer is contacted by a City auditor who says the station is entitled to apportionment. The auditor says the taxpayer must use the 'general expense method' of apportionment. The auditor explains that the general expense method means an apportionment formula calculated by reviewing all the expenses of the station.

Taxpayer performs a complete and detailed analysis of all station expenses to arrive at a revised apportionment formula. Taxpayer submits a schedule with the revised formula to the auditor that apportions an increased amount of gross receipts to the City.

The BOR issues a decision that says the station is entitled to apportionment of gross receipts derived from local advertising revenue. The decision also substantially modifies the revised formula submitted by the taxpayer to exclude several expenses as not supportable of taxpayer activity within the City of Los Angeles. The final apportionment formula issued by the BOR apportions an even greater amount of gross receipts to the City.

Case Study # 6

Taxpayer is the owner of a television station located in Los Angeles, CA. Taxpayer's station broadcasts over a wide geographical area, referred to as its Designated Market Area (DMA). Its DMA includes 8 different counties located in multiple states. Taxpayer's station produces local programming and acquires additional programming for broadcast. The majority of taxpayer's revenue is generated from the sale of advertising which is aired during its daily broadcasts. Most advertising is generated by a group of taxpayer's employees (sales executives). The sales executives generally spend the majority of their time visiting potential advertisers or their representative (agency) directly. The sales executives typically spend a substantial amount of time at these locations discussing, negotiating and/or consummating deals for station advertising.

Taxpayer files an annual Business License Tax Return and pays tax on its local advertising revenue (gross receipts) in accordance with LAMC §21.45(a). Since taxpayer's gross receipts is generated from activity located both within and without the City, it apportions its gross receipts in accordance with LAMC §21.45(a) 3. Taxpayer uses an apportionment formula based on the average of the ratios of its geographical broadcast area, City population and its household television audience in relationship to that in its total viewing area. Taxpayer also includes in the formula the approach found in City Clerk Ruling 15 to attribute 20% of the non-City gross receipts.

The City audits taxpayer's annual returns and denies any apportionment of the station's gross receipts. Audit assessments are finalized based on 100% of gross receipts being attributable to Los Angeles. An Assessment Review Officer affirms the audit findings.

Taxpayer requests a hearing before the Board of Review (BOR). Taxpayer argues in the hearing that they are entitled to apportionment of the station's gross receipts. The BOR renders no opinion or decision at the conclusion of the hearing.

Taxpayer is contacted by a City auditor who says the station is entitled to apportionment. The auditor says the taxpayer must use an expense method of apportionment. Taxpayer requests additional hearing time to discuss the various methods of apportionment allowable under LAMC §21.45(a) 3. The BOR denies the request for additional hearing time.

Taxpayer prepares revised payroll expense method apportionment formula focused specifically on the sales executives and where they perform a majority of their activity, the location of the advertiser or their agency. Taxpayer submits a schedule with the revised formula to the BOR that apportions an amount of gross receipts to the City.

The BOR issues a decision that concludes the apportionment formula used on the returns as filed is not appropriate. The decision also substantially modifies the revised formula submitted by the taxpayer to include all station payroll in the factor, not just that of the sales executives. The final apportionment formula issued by the BOR apportions an amount of gross receipts to the City, more than double the amount apportioned by the taxpayer.

Alternative Tax Apportionment Methods

1) Cost Allocation Method

In some cases, where the 80-20 factor does not accurately capture the tax owed, the Office of Finance may use the Cost Allocation method to determine what percentage of gross receipts to apportion. When using Cost Allocation method, the Office of Finance includes the following expenses in the calculation: 1) payroll; 2) property: lease, rent or depreciation; and 3) expenses related to payroll and property.

2) Total Expense Method

The Office of Finance indicates that this is, theoretically, the most accurate method of apportionment. In using this formula, total expenses are defined as the aggregate of payroll expense, property expense, and all other expenses related to payroll and property. This could include payroll, payroll taxes, rent, equipment lease, depreciation, utilities, insurance, repairs and maintenance. The measure of tax is calculated as follows:

$$(\text{In-City Total Expenses} / \text{Total Expenses}) \times \text{Total Gross Receipts}$$

3) Total Payroll Method

The Office of Finance indicates that this method may not be as accurate and reflective of the true gross receipts as the Total Expenses Method because only the payroll expense is included in the formula. The measure of tax is calculated as follows:

$$(\text{In-City Payroll Expenses} / \text{Total Payroll Expenses}) \times \text{Total Gross Receipts}$$

4) Cost Maintaining Method

The Office of Finance indicates that this method is not an accurate and fair method of apportionment as it fails to account for profit. Under this method, the cost of maintaining pertains to all the costs incurred in the City including the expenses incurred to pay independent contractors since the purpose in this situation is not to develop a percentage to apportion gross receipts. Instead, the Office of Finance is attempting to determine the minimum amount that must be reported as gross receipts. To determine gross receipts in this situation the Office of Finance only considers total Los Angeles Cost Incurred in the City.