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Rev. Rul. 55-706

Advice has been requested as to the proper treatment for Federal income tax purposes of proceeds from the sale of fully depreciated motion picture films in a transaction as described below.

X pictures corporation, a corporation whose stock is widely held, is engaged in the business of producing motion picture films and distributing films owned by others as well as its own films. The corporation sold 200 of its old films to another corporation. X corporation has never before sold films to exhibitors, but has rented them either for a fixed daily or weekly fee, or upon a percentage of box office receipts. Ownership of the films has not been relinquished by X during this rental process. X has, on occasion, leased or licensed rights for television exhibition of certain films for a limited period. However, X has retained ownership of the leased films, and at the end of the license or lease period, all television rights have reverted to X.

Neither the purchasing corporation nor any of its officers or stockholders own any shares of stock in X corporation; nor are any of such officers or stockholders related to the principal stockholders, officers, or members of the board of directors of X corporation. The films sold in this transaction were all old films, originally produced and released during the period from 1931 to 1946. The films were <Page 301> fully depreciated on the corporation's books and were carried at a zero basis. Although the films have a residual value as re-issues or re-releases for exhibition purposes in foreign countries or for long-range television purposes, they were producing negligible rental income to X corporation. The motive for the sale was to convert dormant assets into working capital, increase the net worth of the corporation, improve its balance sheet, and provide an additional base for bank borrowing. A substantial payment was made to X at the time of sale, the balance payable in four installments, secured by a mortgage, pledge, and assignment with respect to the films. The mortgage and pledge will remain in force until the full purchase price is paid. The purchasing corporation may possibly engage X corporation to act as a distributing agent for some of the purchased films on the usual distribution fee basis charged for such a service.

No participating interests in the films sold were held by any individuals as joint venturers in a particular production. The films sold were produced by the efforts of individuals who were paid by X the then full market value of their efforts and services. None of such individuals owned stock in the corporation at the time the films were made, or owned any stock or stock options in the corporation at the time of the sale of the films. None of the individuals contributed efforts and services to the production of these films with a view toward subsequently realizing additional money returns, directly or indirectly, through the medium of the sale of the films upon a capital gain basis.

Section 1221 of the Internal Revenue Code of 1954 excludes from the definition of a capital asset the following items, among others:

(1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;

(2) property, used in his trade or business, of a character which is subject to the allowance for depreciation provided in section 167, ***;

(3) a copyright, a literary, musical, or artistic composition, or similar property, held by-

(A) a taxpayer whose personal efforts created such property, or

(B) a taxpayer in whose hands the basis of such property is determined, for the purpose of determining gain from a sale or exchange, in whole or in part by reference to the basis of such property in the hands of the person whose personal efforts created such property;

From the facts presented, it is evident that the 200 films were not stock in trade, or property of a kind which would properly be included in inventory if on hand at the close of the taxable year, or property held primarily for sale to customers in the ordinary course of trade or business. Rather, they were the subject of leases by the taxpayer to exhibitors on a rental basis. Although fully depreciated, they were assets of a character subject to the allowance for depreciation, used in the trade or business.

There is excluded from the definition of property used in the trade or business, as provided in section 1231(b) of the 1954 Code, a copyright, a literary, musical, or artistic composition, or similar property held by a taxpayer described in paragraph (3) of section 1221. Many corporations, including some whose stock is widely held and traded on established stock exchanges, create copyrights as well as other property described in paragraph (3) of section 1221. The property <Page 302> created by these corporations is not considered to be created by the personal efforts of a taxpayer where all of the costs and expenses are paid for by the corporation at the current going rate for the services rendered. The production of each of the films in the instant case involved a multiplicity of skills and abilities, the combined efforts of numerous individuals of various backgrounds and trades, and the use of substantial amounts of capital. Thus, no single individual may be said to have created by his personal efforts the films in question or a property in the films.

Based on the foregoing circumstances, it is held that since the sale of the 200 films was an isolated and unusual sale the films were not property held primarily for sale to customers in the ordinary course of trade or business. It is further held that the gain realized from the sale of the films is taxable as long-term capital gain under the provisions of section 1231 of the 1954 Code, provided the conditions of that section are otherwise met.