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Patricia S. Schroeder
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August 31, 2005

The Honorable Charles Grassley, Chairman
Committee on Finance
United States Senate
Washington, DC 20510

The Honorable Max Baucus, Ranking Member
Committee on Finance
United States Senate
Washington, DC 20510

RE: Comments on The Technical Corrections Act of 2005 (H.R. 3376, S. 1447).

Dear Messrs. Thomas, Grassley and Baucus:

On behalf of The Association of American Publishers (“AAP”), I want to thank you for including book publishing within the definition of “qualifying production property” in Section 199 of the Internal Revenue Code of 1986, as amended (“Code”). As you know, the AAP is the principal trade association of the U.S. book publishing industry, with over 300 members. Book publishing is very labor intensive so the inclusion of book publishing clearly promotes the purposes of the American Jobs Creation Act of 2004.

On February 14, 2005, the Treasury Department issued Notice 2005-14, I.R.B. 2005-7 (“Notice”), in an effort to resolve certain interpretive issues that have arisen under Code Section 199. The Treasury Department invited comments regarding the Notice and the AAP submitted comments to the Treasury Department on the Notice on March 22, 2005 (copy of our comments are attached for your review).

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An issue of specific interest to the publishing industry concerns gross receipts derived from the distribution of books, journals, and similar materials irrespective of the physical or electronic or other medium used to effectuate such distribution to the customer. Our members' publications are increasingly being made available in electronic or other medium in addition to, or in lieu of, traditional printed copies, leaving open the question of whether receipts from the distribution of these materials in electronic or other medium also constitute "domestic production gross receipts" as defined in Code Section 199 (c) (4). We have reviewed your letter to The Honorable John W. Snow, Secretary of the Treasury, dated July 21, 2005, where you note near the end "...that gross receipts from the provision of services are not treated as domestic production gross receipts, regardless of the fact that computer software may be used to facilitate such service transactions". We do not believe that the mere provision of a book or journal in electronic or other medium should be considered a service.

The Notice uses Treasury Regulations ("Regs.") Section 1.48-1 (c) as the basis to determine what is included in the definition of "tangible personal property". The provisions of Regs. Section 1.48-1 (c) were drafted to maximize the benefits available to taxpayers eligible to claim the investment tax credit. It is understandable that the provisions of Regs. Section 1.48-1 (c) focus more on the distinction between real and personal property than the distinction between tangible and intangible property. The investment tax credit was available only with respect to qualified investment in depreciable tangible personal property. Accordingly, the investment tax credit was generally available with respect to the purchase of machinery used to manufacture or produce inventory. It was generally not available with respect to the inventory itself. As a result, the distinction between real and personal tangible property was of critical importance for many taxpayers; the distinction between tangible and intangible personal property was much less often of critical importance.

By contrast, the provisions of Code Section 199 deal with gross receipts from the sale of tangible personal property. In few cases will the tangible personal property that falls within the provisions of Code Section 199 be depreciable. In the vast majority of instances, it will constitute inventory or property held for sale to customers in the ordinary course of business. As a result, the context in which the distinction between tangible and intangible property is to be made is dramatically different from that existing for purposes of Regs. Section 1.48-1 (c). Consequently, the flexibility brought to bear in making the distinction between tangible and intangible personal property for purposes of Code Section 199 should be the same as that brought to bear in making the distinction between real and personal tangible property for purposes of Regs. Section 1.48-1 (c).

The provisions of Code Section 263A and the Regs. adopted there under which are also used as a basis in the Notice. The principal focus of the provisions of Code Section 263A is on the production of inventory (or other property held for sale to customers) and is thus similar to the principal focus of Code Section 199 which is on the generation of gross receipts from the sale of inventory (or property held for sale to customers). In each case, it is inventory (or property held for sale to customers) that is at issue. The focus of the analysis as to what distinguishes tangible from intangible property for purposes of Code Section 199 should therefore be similar to that embodied in the Regs. adopted under Code Section 263A.

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Regs. Section 1.263A-2(a)(2)(i) confirms that, in general, “section 263A applies to the costs of producing tangible personal property”. Regs. Section 1.263A-2(a)(2)(ii), which is cited with approval in Section 3.04(8)(b) of the Notice, includes in the term “tangible personal property” videocassettes, computer diskettes, books, and similar items. Regs. Section 1.263A-2(a)(2)(ii)(A)(1) deals specifically with books. It provides that Code Section 263A applies to various categories of prepublication costs, including the costs incurred by publishers in writing, editing, compiling, illustrating, designing and developing a book. Regs. Section 1.263A-2(a)(2)(ii)(A)(1) explicitly states that these prepublication costs are required to be capitalized as costs of producing tangible personal property.

If we were permitted to borrow and rephrase the well-known utterance of Gertrude Stein, we would suggest that what Regs. Section 1.263A-2(a)(2)(ii) in essence provides is that “a book is a book is a book” for purposes of Code Section 263A regardless of the medium by which it is transmitted to the customer, and that, as such, it is treated as tangible personal property for purposes of Code Section 263A. We respectfully submit that the same non-technical line of analysis should apply for purposes of determining whether a book or journal constitutes tangible or intangible inventory for purposes of Code Section 199. We believe that a book transmitted electronically to the customer should be classified as a tangible item of inventory for purposes of both Code Section 199 and Code Section 263A.

Clearly, the proper focus of Code Section 199 should be on the treatment of the qualification of a publisher’s prepublication costs rather than the method of delivery selected by the customer. The majority of the production activities and costs involved in the publishing of a book, journal or magazine occur before the activities associated with the determination of the medium of presentation.

Finally, we note that applying a more expansive, non-technical analysis to the definition of the term “tangible personal property” for purposes of Code Section 199 would not be inconsistent with the provisions of Federal copyright law or recent judicial decisions issued interpreting such law. In this regard, 17 U.S.C.A. Section 102(a) provides,

“ Copyright protection subsists, in accordance with this title, in original works of authorship fixed in any tangible medium of expression, now known or later developed, from which they can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine of device.”

Thus, copyright protection depends on some degree of embodiment in a tangible medium of expression. The policy behind the Copyright Act was to foster the creation of original works of authorship in an era of rapid changes in the technology of delivery, and it has worked very well. We submit that the same policy considerations are applicable in this instance.

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While we hope that the Treasury Department will adopt our comments when regulations are issued, our members wanted to voice their concerns now in the event that some corrections may be needed as a result of the issuance of regulations which may occur within the next month.

Sincerely,

A handwritten signature in black ink that reads "Pat Schroeder". The signature is written in a cursive, flowing style.

Patricia Schroeder
President & CEO

cc: The Honorable John W. Snow
Secretary of the Treasury
U.S. Department of the Treasury
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