

210.0445

STATE OF CALIFORNIA
BOARD OF EQUALIZATION
APPEALS SECTION

In the Matter of the Petition)	
for Redetermination Under the)	DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)	
)	
REDACTED TEXT)	No. REDACTED TEXT
)	
)	
<u>Petitioner</u>)	

The Appeals conference in the above-referenced matter was held by Staff Counsel Elizabeth Abreu on April .7, 1994, in Hollywood, California.

Appearing for Petitioner:	REDACTED TEXT Attorney
Appearing for the Sales and Use Tax Department:	Allen Youssefia Senior Tax Auditor Mr. Leon Adams District Principal Auditor

Protested Item

The protested tax liability for the period October 1, 1988 through December 31, 1991 is measured by:

	<u>Item</u>	<u>State, Local and County</u>
B.	Purchases of original art from out-of-state used for reproduction subject to use tax. (Per revised audit.)	\$ 246,750

Petitioner's Contentions

1. Petitioner purchased original pieces of art for resale. Use of the pieces for reproduction purposes was incidental to petitioner's primary purpose in purchasing the paintings.

2. Taxing the use of the original pieces of art and their subsequent sale would be double taxation which is unconstitutional.

Summary

Since 1982 petitioner, a California corporation, has been a literary agent which represents the **REDACTED TEXT** estate and the copyright owners of **REDACTED TEXT** works. Petitioner arranges for publication of the works of **REDACTED TEXT** and sells special edition leather bound books written by **REDACTED TEXT**.

Petitioner also operates an art gallery which sells limited edition art prints (lithographs) which are high quality reproductions of original paintings. Most of the lithographs depict scenes from fictional books written by **REDACTED TEXT**. The art gallery was opened in 1986 and moved to its present location in 1987, because the first location was too cramped.

After opening the art gallery, petitioner purchased numerous pieces of original art, including the eight paintings in issue in this audit. We have conflicting information regarding the purchase dates of these eight paintings, but it appears they were purchased at different times between 1987 and 1989, inclusive. All but one of these paintings were purchased ex-tax from out-of-state sellers who were not registered with the Board. The audit staff agreed at the Appeals conference that the painting entitled **REDACTED TEXT** was purchased tax-paid in California and should be deleted from the measure of tax.

The sales prices of each of the remaining paintings were as follows:

<u>Painting</u>	<u>Price</u>
REDACTED TEXT	<u>\$ 75,000</u>
REDACTED TEXT	<u>\$ 80,000</u>
REDACTED TEXT	<u>\$ 80,000</u>
REDACTED TEXT	<u>\$ 2,000</u>
REDACTED TEXT	<u>\$ 2,000</u>
REDACTED TEXT	<u>\$ 2,000</u>
REDACTED TEXT	<u>\$ 2,000</u>

As of April 14, 1994, none of these paintings had been sold.

Petitioner sent each of the seven paintings to **REDACTED TEXT**, a company in Chicago, Illinois, which specializes in making high quality lithographs of original art. Some of the paintings were sent to Chicago by common carrier. Others were crated and taken on a plane by an employee of petitioner to hand deliver to **REDACTED TEXT**. **REDACTED TEXT** kept each of the paintings for about two days. It took pictures of each painting, developed the negatives to make sure that the negatives were not flawed, made color transparencies and press proofs, and then sent the paintings back to petitioner. It took **REDACTED TEXT** several months to create a lithograph from a negative.

Petitioner offered for sale a limited number of lithographs of different pieces of original art, including lithographs of the paintings in issue. Lithographs were on display at the art gallery and were also offered for sale through brochures and catalogs.

In its 1991 Christmas brochure, petitioner offered full size lithographs of the paintings in issue for prices ranging from \$1,200 to \$3,937.50. In the 1992 spring catalog, the prices were higher, the most expensive being \$6,250 for early numbered editions of **REDACTED TEXT**. There were 500 limited editions of each painting.

The audit staff initially contended that petitioner was liable for use tax measured by the sales prices of the paintings because petitioner did not purchase the original art for resale. The audit staff also contended that petitioner made a taxable use of the paintings. The staff's position was based on the following:

1. None of the original paintings was on display at the art gallery at the time of the audit;
2. Petitioner told the auditor that original paintings were expensive and therefore kept in a vault;
3. Petitioner indicated that while it was selling lithographs, the originals would gain in value, especially if the painter died or became famous;
4. A taxable use was made of the paintings when they were taken out of their frames, shipped out-of-state, and photographed by
5. Many of the paintings were purchased with detailed contracts which transferred not only the painting, but the painters' or owners' copyrights and reproduction rights in the painting. Thus, petitioner's main intention when purchasing the paintings was to make reproductions;
6. During the 39 month audit period, only one original painting was sold. That painting, which had not been photographed for reproduction, was deleted from the revised audit; and

7. Within two weeks after the auditor met with petitioner, petitioner sold four other original paintings. (These four other paintings do not include any of the paintings in issue.) The auditor believed that this showed petitioner could sell original paintings if it intended to do so and if it promoted the paintings.

Petitioner asserts that, from time to time, it did display original art at the gallery but that it did not have room to display all of its artwork at once. Occasionally an artist would come to the gallery, at which time petitioner would display only that artist's works, both originals and lithographs. Petitioner also contends that some of its promotional materials indicated that originals could be purchased and that there were signs in the gallery that said originals could be purchased. Originals were kept in vaults when they were not being displayed because they were very valuable.

Petitioner indicated at the conference that it purchased copyrights and reproduction rights to original art because it might resell the art to a purchaser who wanted both the art and these rights. For example, petitioner sold a piece of art entitled **.REDACTED TEXT** and the reproductions rights for this piece to a gallery in Florida. Selling a piece of art by itself does not entitle a purchaser to reproduce it. The seller must own the reproduction rights, and the purchaser must purchase these rights before the purchaser can make reproductions.

Petitioner further explained that limited editions are prints or lithographs made from a single photograph and plate of the original art. A person purchasing a limited-edition has no assurance that prints would not be made from other plates made of the artwork. Sometimes there may be European and United States limited editions of the same painting.

Petitioner stated that four of the paintings in issue were not reproduced until several years after they were purchased. (The remaining three paintings, **REDACTED TEXT**, **REDACTED TEXT** and **REDACTED TEXT**, were photographed within one to five months after purchase.) Petitioner contends that if its primary purpose was reproduction, petitioner would not have waited so long to reproduce these paintings. At the time these paintings were purchased, original paintings were popular but limited editions were not. Currently original paintings are not as popular because of the high price. However, originals are making a comeback as a hedge against inflation.

Petitioner kept the paintings in an inventory account. It did not depreciate them or keep them in an investment account.

Analysis and Conclusions

Revenue and Taxation Code section 6201 imposes a use tax on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer for the purpose of storage, use, or other consumption in this state. The use tax is imposed upon the purchaser and applies to the use or storage in California of tangible personal property purchased out-of-state.

The term "use" includes the exercise of any right or power over tangible personal property incident to the ownership of that property except that it does not include the sale of that property in the regular course of business. (Rev. & Tax. Code§ 6009.) The term "storage" includes any keeping or retention in this state for any purpose other than sale in the regular course of business. (Rev. & Tax. Code§ 6008.) Property held for resale is not subject to use tax unless the purchaser makes a use of the property other than retention, demonstration, or display. (Rev. & Tax. Codes§§ 6008, 6009, and 6244(a).)

In the present case the audit staff initially contended that petitioner did not purchase the paintings in issue for resale, relying in part upon the fact that petitioner did not display these paintings at the art gallery. However, it is not necessary to demonstrate or display an item held for resale. An item may merely be "retained" and still held for resale. During the Appeals conference the audit staff appeared to concede that the property was initially purchased for resale. This conclusion of the staff does not, however, end our inquiry.

Revenue and Taxation Code section 6244(a) reads:

"(a) If a purchaser who gives a resale certificate or purchases property for the purpose of reselling it makes any storage or use of the property other than retention, demonstration, or display while holding it for sale in the regular course of business, the storage or use is taxable as of the time the property is first so stored or used."

Petitioner withdrew the paintings in issue from inventory in California to use them in the production of lithographs. This is a use other than retention, demonstration, or display; therefore, this use is taxable under section 6244(a). In essence, petitioner used the paintings as manufacturing aids to produce the lithographs. Without the paintings, the lithographs could not be produced. The sale or use of a manufacturing aid is taxable. (See Sales and Use Tax Regs. 1525 and 1525.1.)

Petitioner relies in part upon Mcconville v. State Board of Equalization (1978) 85 Cal.App.3d 156, in which the court imposed the use tax because the horses in issue were being held as capital assets since the owner depreciated them for income tax purposes. Petitioner did not depreciate the paintings in issue. However, works of art are generally not depreciable because they have no determinable useful life. (See Rev.Rul. 68-232, 1968-1 C.B. 79, Rev.Rul. 79-432, 1979-2 C.B. 289, Clinger v. Comm. (1990) T.C.M. 1990-459, and Associated Obstetricians & Gynecologists. P.C., v. Comm. (6th Cir. 1985) 762 F.2d 38.)

The fact that a taxpayer keeps property in an inventory account for accounting purposes is a factor that the Board considers in determining the application of tax, but it is not controlling. If a taxpayer makes a taxable use of property while holding it for resale, the use will be subject to tax even though the taxpayer does not treat the property as a capital asset in its books and records.

Petitioner also contends that under Burroughs Corp v. State Board of Equalization, (1984) 153 Cal.App.3d 1152, petitioner's use is not taxable because its primary purpose in purchasing the paintings was to resell them. We would first point out that the Board won the Burroughs case; any use of Burroughs for a nontaxable result must, at best, be dicta. More importantly, petitioner loses sight of the court's statement on page 1160 of the Burroughs decision that:

"...the dispositive question is whether the primary purpose in using the captives was to test other components, a taxable use, or to prepare the captives for resale, an exempt use."

To paraphrase the court as applicable here, the dispositive question is whether the primary purpose in using the original paintings was to produce lithographs, a taxable use, or to prepare the original paintings for resale, an exempt use. It is quite clear that the primary purpose in shipping the paintings to Chicago, and having them photographed, was to produce valuable lithographs for sale, a taxable use. The Burroughs court, after reviewing the authority in prior court opinions, decided that no primary purpose had been established since the use for interactive testing was equivocal. Here, we do not have the Burroughs problem of an equivocal use. The shipping to Chicago and photographing of the original paintings was primarily to produce valuable lithographs, not primarily for the purpose of reselling the original paintings. Such

use was a taxable use, "... taxable as of the time the property is first so stored or used. (Section 6244(a).)

Our conclusion that the primary purpose in shipping and photographing the paintings was to produce valuable lithographs for sale is further supported by documents in our files and other information received from petitioner. The brochures and catalogs in the audit working papers promote sales of numerous lithographs. None of them promote sales of original art. There is a 1992 price sheet in the audit working papers for some original paintings. It does not include the paintings in issue. This price sheet is very plain compared to the glossy brochures which contain pictures of the lithographs and clearly promote the sales of the lithographs.. The price sheet does not contain any promotional language or pictures. There is only one other flyer in the audit working papers for an original painting, but it is not for one of the paintings in issue. Both the price sheet and flyer were prepared after the audit period.

In addition, petitioner made numerous sales of lithographs but sold relatively few original paintings. None of the paintings in issue have been sold even though, according to information provided by petitioner, they were purchased five to seven years ago.

Finally, based upon petitioner's 1992 price list, petitioner could receive several million dollars from the sales of the lithographs of some of the paintings in issue. For example, if all the lithographs for the painting **REDACTED TEXT** were sold at the prices offered in the 1992 spring catalog, petitioner's revenues from these sales would total \$2,850,000. Thus, sales of lithographs were potentially very lucrative and an important reason for purchasing the original paintings.

The language in section 6244(a) is mandatory. Once property purchased for resale is used, the "use is taxable as of the time the property is first so ... used." Thus, with respect to each painting, petitioner became liable for use tax at the time it withdrew the painting from inventory for use in reproduction.

Petitioner also contends that taxing the use of each painting and the subsequent sale of each painting is impermissible double taxation. We are unaware of any such prohibition. It is settled law in California that the eventual resale of tangible personal property by a person who has purchased such property for use will not prevent the original sale of such property from being a retail sale subject to tax. (See Kirk v. Johnson (1940) 37 Cal.App.2d 224.)

In the present case, it is petitioner's use of paintings purchased ex-tax that is subject to use tax. (Rev. & Tax. Code§ 6201.) If petitioner subsequently sells the paintings at retail in California, it is petitioner's retail sales of the paintings which are subject to sales tax. (Rev. & Tax. Code§ 6051.)

Recommendation

Delete the sales price of **REDACTED TEXT** from the measure of tax. Deny the petition in all other respects.


ELIZABETH ABREU
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