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January 20, 1993

BURTON W. OLIVER
Executive Director

Mr. S--- R. M---
M--- & S---, Inc.
XXXX West --- ---
---, Texas XXXXX

Dear Mr. M---:

This is in response to your letter to Ms. Phetteplace dated October 19, 1992. Since we do not understand all the facts in your letter, the discussion in this letter is based upon numerous assumptions. The first assumption is that all of the transactions occur in California. The second assumption is that following are the pertinent facts:

Corporations A and B are affiliated corporations as that term is used under the Internal Revenue Code. Corporation B purchases original artwork and issues resale certificates to the sellers. Under the purchase agreements, the sellers convey to Corporation B all of the sellers' interests in the artwork, including reproduction and licensing rights.

Corporation B resells some of the original artwork without leasing or making any use of the artwork other than retention, demonstration, or display before resale. With respect to other artwork, Corporation B transfers possession of the artwork to Corporation A which uses the artwork to make reproductions. After Corporation A is finished using the artwork for making reproductions, it returns the artwork to Corporation B. Corporation A gives Corporation B consideration for this transaction.

Revenue and Taxation Code section 6051 imposes a sales tax on all retailers measured by their gross receipts from retail sales of tangible personal property. Although the sales tax is imposed upon the retailer, the retailer may collect sales tax reimbursement (usually itemized on the invoice as "sales tax") from the purchaser if the contract of sale so provides. Civ. Code § 1656.1. "Gross receipts" is a very broad term and includes all receipts relating to a sale of tangible personal property, except installation charges. Rev. & Tax. Code § 6012.

Revenue and Taxation Code section 6201 imposes an excise tax, commonly referred to as the use tax, on the storage, use, or other consumption in this state of tangible personal property purchased from any retailer for storage, use, or other consumption in this state. The use tax complements the sales tax and is most frequently imposed upon in-state leases and out-of-state purchases of property used in California. The use tax is also imposed upon a purchaser who gives a resale certificate and then uses the property for purposes other than retention, demonstration, or display. In that case, the tax liability arises at the time the purchaser first makes a taxable use of the property, and the use tax is measured by the sales price of the property to the purchaser. Rev. & Tax. Code § 6094(a).

Unless tangible personal property is leased in substantially the same form as acquired by the lessor and the lessor has paid sales tax reimbursement or use tax measured by the purchase price of the property, a lease of tangible personal property is a continuing sale and purchase, and the lessor must collect and pay use tax measured by the rental payments. Rev. & Tax. Code §§ 6006(g), 6010(e), 6006.1, and 6010.1. Although the use tax is imposed on the lessee, the lessor must collect the tax from the lessee at the time rentals are paid by the lessee and give the lessee a receipt. Sales and Use Tax Regulation 1660(c)(1).

When Corporation B transfers the artwork to Corporation A, which uses the artwork to make reproductions, Corporation B is leasing the artwork to Corporation A. The lease is a continuing sale and purchase since Corporation B issued a resale certificate when it purchased the property, and Corporation B must collect and pay use tax measured by the rental receipts to the State of California. The rental receipts include all consideration Corporation B receives from Corporation A under the transaction, whether such amounts are referred to as royalties or licensing fees for reproduction rights or whether the consideration is paid in a lump sum or periodically, or is based on sales made by Corporation A, or is paid after Corporation A has returned the artwork. If Corporation B thereafter sells the artwork at retail, the sale is taxable. No credit or deduction is allowed based on the use tax collected and paid by Corporation B on the lease to Corporation A.

If Corporation B takes a picture of the original artwork and sells the negative to Corporation A, which uses the negative to make reproductions, rather than transferring possession of the artwork to Corporation A, Corporation B has made a taxable use of the artwork and must pay use tax measured by its purchase price of the artwork. In addition, Corporation B has made a sale of the negative to Corporation A and must pay sales tax on the sale. The sales price subject to tax includes all consideration received from Corporation A no matter what label the parties give to such amounts in their agreement. (E.g., royalties, licensing fees, fees for reproduction rights etc.) There is no exclusion or deduction for any amount which the parties regard as payment for reproduction rights or licensing. Finally, if Corporation B subsequently sells the artwork in a retail transaction, the sale is subject to sales tax.

Revenue and Taxation Code section 6596 provides the only basis for relief from tax if a taxpayer relies on incorrect written advice from the board. The primary conditions to qualify are that the request for opinion must be in writing and must disclose all relevant facts, including the identity of the taxpayer. Since you have not identified your client or disclosed all relevant facts, this opinion does not come within the provisions of section 6596 but rather is simply general advice regarding a set of assumed facts.

Sincerely,

Elizabeth Abreu
Tax Counsel

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