



**STATE BOARD OF EQUALIZATION**

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April 10, 1995

Re: X-----  
Industrial Design

Dear X-----,

Your letter dated February 13, 1995 to Mr. X----- of the Board's X----- District office has been referred to the Legal Division for a response. You ask whether your client's sale of various goods and services is subject to California sales or use tax.

You state:

"Our client is a free-lance industrial designer. He provides a variety of concepts in the form of sketches to assist his customers in their design direction. His involvement ranges from initial concept generation to various stages of refinement. All activities are conceptual design type services which are preliminary work to product development. His work does not represent final models or control drawings used for the actual development of the product. All designs are passed on to others who refine the design so that it may become a final product. He also does some graphic design work which again is primarily conceptual. Many of the concepts are developed on paper or electronically. Computer files are provided to the customers, who then make their own alterations before they are put into use."

Discussion

Sales tax is imposed on a retailer's gross receipts from the retail sale of tangible personal property in this state unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code § 6051.) The term "sale" includes any transfer of title or possession, in any manner or by any means whatsoever, of tangible personal property for a consideration. (Rev. & Tax. Code § 6006(a).) On the other hand, persons engaged in the business of rendering services are consumers, not retailers, of the tangible personal property they transfer incidentally to the performance of the service. (Reg. 1501.) Tax applies to the sale of the property to those persons

or to their use of that property. (Id.) The distinction between the sale of tangible personal property and the transfer of such property incidental to the providing of a service is set forth in Sales and Use Tax Regulation 1501:

"The basic distinction in determining whether a particular transaction involves a sale of tangible personal property or the transfer of tangible personal property incidental to the performance of a service is one of the true object of the contract; that is, is the real object sought by the buyer the service per se or the property produced by the service .... "

The general application of these rules to engineering and architectural activities is set forth in Business Taxes Law Guide Annotations 515.0380 (12/15/85; 4/25/88) and 515.0040 (2/27/64). These annotations explain that the fees charged by architects or engineers for their ability to design, conceive or dictate ideas, concepts, designs or specifications are not subject to tax. The architect or engineer renders professional services, and the charge for the service is nontaxable even though the architect or engineer incidentally transfers an architectural design or engineering drawing as a means of conveying the plan.

If your client undertakes engineering activity on behalf of its customers and your client's "design direction" consists of the development of and improvement to product inventions of its customers, the application of tax is set forth in Business Taxes Law Guide Annotation 515.0480 (11/4/64):

"The charges for design and engineering services in connection with the development and improvement of an invention are not subject to tax if no tangible personal property is required to be delivered under the contract. Tax applies only to the sale of property to be used in rendering the services. However, when the contract requires the delivery of an end product, the charges for the development and engineering services are taxable."

If your client's activities come within this annotation, we would regard the preliminary sketches by your client of its customer's ideas as property transferred incidental to the providing of a service. Tax would not apply to the sketches or service unless your client's "design direction" is part of a contract with a customer for the delivery of an end product or for your client to prepare production drawings used to manufacture the product. (See Business Taxes Law Guide Annot. 515.0440 (2/27/64).) Where your client provides production drawings, the transfer of such drawings is subject to tax unless your client contributes engineering knowledge and skill to the final production drawings as opposed to merely preparing a production drawing based on another's general layout or preliminary design. (Id.)

You also ask if tax applies to your client's preparation of graphic designs. The transfer of artwork such as pasteup, mechanical, assembly, or camera ready copy, or the transfer of photo reproduction of such properties, is subject to tax without any deduction on account of the cost or expense of typography. (Reg. 1541(f) (5).) "Artwork" within this provision includes charts, graphs, diagrams, and designs. (See, e.g., Business Taxes Law Guide Annotation 430.0365 (12/18/74).) This does not mean that tax applies only if your client creates the artwork, but rather

that tax applies if your client includes the artwork, which may have been provided by its customer, on printed matter it transfers to its customer. The fact that artwork may be generated by computer processes rather than by pasteup or mechanical methods does not alter the application of tax to artwork. Tax applies on the above activities even when your client transfers the artwork onto a computer disc for sale to its customer and provides no other tangible personal property (i.e., printed materials) to that customer. (See Regs. 1541(f), 1502 (c) (2) .)

In the present case, we assume that your client's "graphic designs" do not constitute engineering drawings as discussed above. If so, tax applies on your client's sale of these designs whether they are transferred on paper or disk to its customers. The fact that these designs are preliminary or may be modified by its customers does not alter the application of tax on the sale of these materials.

Please note that Revenue and Taxation Code section 6596 sets forth the circumstances under which a taxpayer may be relieved of liability for taxes when relying on a written response to a written request for opinion. To come within that section, the request for opinion must identify the taxpayer as well as all relevant facts relating to the particular transaction. Our opinion above does not come within section 6596 since you have not identified and have not fully described all relevant facts regarding your client's transactions with its customers.

If you have any further questions, please write again.

Sincerely,

Warren L. Astleford  
Staff Counsel

WLA:plh