

**STATE BOARD OF EQUALIZATION**

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 Executive Director

July 17, 1997

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**Re:** -----  
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Dear Mr. ---:

This is in reply to your April 22, 1997, letter regarding the application of sales and use tax to charges for photographs and illustrations leased by graphic artists for use as manufacturing aids to produce finished art.

You note the issue is part of an audit of a graphic arts shop, which you are representing. As you probably know, the Board's legal staff generally does not directly answer questions from taxpayers or taxpayers' representatives concerning an audit, which is in progress. Given the odds-on chance that the taxpayer and the audit staff may have different views of the facts, those questions are usually best answered by the appeals process. You sent to Supervising Tax Auditor --- --- of the San Francisco District Office a copy of your letter. I discussed your letter with Mr. --- ---, and he has agreed to my answering your questions.

You note the --- --- District Office has informed you that it is inappropriate for an advertising agency to use a title passage clause in the agency's contract with a client in situations where an agency leases a photograph from a photographer for use in preparing property the agency sells to its client. We agree. When an agency merely leases a photograph from a photographer, the agency does not have title to the photograph to pass to the client.

An agency wishing to avoid the so-called pyramiding of tax may, however, follow the procedures provided at subdivision (a)(2)(A) of Sales and Use Tax Regulation 1540, Advertising Agencies, Commercial Artists, and Designers, to act as an agent to lease property from a lessor on behalf of the client. In that case, the agency should pay use tax to the lessor on behalf of the client. The agency then would not be responsible for collecting use tax from the client on the lease. The agency should list and price its charges for reimbursement for the lease payment and for acting as agent separate from the agency's charge for the final product.

You suggest an agency may wish to not act as an agent on behalf of the client but rather to sublease the property to the client. We note that a lease of property generally occurs only where a lessor gives to another the temporary possession and use of property and the lessee agrees to return the property to the lessor at a future time (Civ. Code § 1925). For sales and use tax purposes, where a person contracts to use property for the benefit of another for a charge, the person using the property generally either performs a service for the other person (such as driving a passenger in a taxi cab), or performs fabrication labor (such as operating a lathe to turn a table leg for a customer). However, we recognize there can be situations where a person may rent tangible personal property to a customer and use the property on behalf of the customer. In that case, if the lessor does not require the lessee to use the lessor's operator of the property but, rather, makes it optional to the customer, we believe the transaction may be a lease. If the operator's labor results in the fabrication of tangible personal property, the charge for that labor results in a sale and is subject to sales tax (Rev. & Tax. Code §§ 6006, 6051).

An agency which wishes to sublease property to a client and use the property on behalf of the client has two alternatives. The agency may timely pay use tax to the lessor and, prior to making any use of the property, lease the property to the client in substantially the same form as acquired. Or, the agency may issue a resale certificate to the lessor and, prior to making any use of the property, sublease the property to the client and collect use tax from the client on that sublease. We caution that, in the latter event, the agency's sublease of the property is subject to use tax regardless that the agency's sale of the final product to the client is exempt from tax or is a nontaxable sale for resale.

We turn now to your specific questions. You ask the following:

- “1. Agency acts a[s] agent (Reg. 1540(a)(2)(A)) for the transaction between the photographer and agency client.
  - “a. It seems that the ‘buyout’ or ‘rights’ issue is irrelevant. I assume that the agency can pass the reimbursable sales tax charged by the photographer to the client. No additional sales tax would be due on related agency compensation. If the agency obtained the photograph from an out-of-state source who did not charge sales tax, then there would be a use tax liability on the cost of the photograph. Do you agree?”

We agree that, if an agency acts as an agent on behalf of the client in leasing a photograph from a photographer, the photographer is the retailer. Tax applies to the charge by the retailer, and tax does not apply to the agency's charge for acting as an agent in accordance with Sales and Use Tax Regulation 1540. If the agency leases the photograph from an out-of-state source which did not collect use tax, the client would be responsible for payment of use tax directly to the Board.

“2. Agency acts as seller of the ‘rights’ or buyout’ of the photograph.

“a. Should language similar to the following be added to the ‘Title Clause’ so that we can avoid the pyramid of tax? What language would you recommend?

“It is expressly understood that all intermediate products, such as photographs and illustrations, that we lease on your behalf are subleased to you prior [to] any use by us whether or not you take possession.”

The “Title Clause” noted above seems to confuse the situation where an agency would sublease photographs and illustrations with the situation where the agency would act as an agent “on behalf” of the client. Since you note you wish, in this instance, for the agency to act as the seller, we suggest the following clause:

“It is expressly understood that, when the agency leases from lessors intermediate products, such as photographs and illustrations, the agency subleases such property to you prior to any use by the agency whether or not the agency transfers possession of the property to you. Any use of the leased property by the agency is on your behalf.”

We believe the foregoing explanation has answered the rest of you questions; however, if you need further information, please feel free to write again and, if so, please provide the facts of any proposed transactions, and send a copy of that correspondence to Mr. --- - - -.

Very truly yours,

Ronald L. Dick  
Senior Tax Counsel

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cc: --- - - - District Administrator (--)  
Supervising Tax Auditor --- - - - (--)