

BOARD OF EQUALIZATION

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition)	
for Redetermination Under the)	DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)	
)	
M--- F--- G---)	No. SR -- XX-XXXXXXX-010
)	
)	
<u>Petitioner</u>)	

The Appeals conference in the above-referenced matter was held by Staff Counsel Michele F. Hicks on September 24, 19XX in Van Nuys, California.

Appearing for Petitioner:

Mr. P--- J. L---
Certified Public Accountant

Ms. J--- O---
Office Manager

Appearing for the
Sales and Use Tax Department:

Mr. Alan J. Stagner
District Administrator

Mr. Jack A. Infranca
District Principal Auditor

Mr. William Faiola
Supervising Tax Auditor

Mr. G. McNamee
Supervising Tax Auditor

Protested Items

The protested tax liability for the period September 1, 1986 through December 31, 1990 is measured by:

Item

State, Local
and County

A. Claimed exempt fees for standby labor and strike labor disallowed	\$517,438
B. Fees for Art Director and Assistant Art Director not reported	\$805,505

A penalty of 10 percent has been added for failure to file returns for September 1, 1986 through December 31, 1986.

Petitioner's Contentions

1. Fees charged for standby labor, strike labor, and art direction are nontaxable fees charged for services.

2. Petitioner relied on written information from the Board in not reporting the standby and strike labor as taxable.

Summary

Petitioner is engaged in the business of manufacturing and selling sets for commercials under the dba J--- S---. Prior to 1988, any art direction services provided by petitioner were not itemized on J--- S---' invoices. In 1988, petitioner also began operating under the dba J--- I--- which began billing for petitioner's art direction services.

Both the billings from J--- S--- and J--- I--- are consolidated on petitioner's income tax returns as a sole proprietorship.

As described by petitioner, petitioner's clients contact J--- S--- with an idea, or sometimes a drawing, of a set for a commercial. Petitioner submits two bids, one for the set from J--- S--- and one from petitioner for art direction. There is no written contract.

J--- S--- builds the set, takes it to the shooting location, and sets it up. An employee of J--- S--- may be at the site to make any necessary changes to the set. J--- S--- bills the "standby" fee at an hourly rate.

Petitioner may provide art direction during the shooting of the commercial. As the art director, petitioner positions the props and orders any changes to the set during the shooting session. The standby laborers make any necessary changes.

When the shooting is finished, J--- S--- provides "strike" labor to disassemble and dispose of the set.

Petitioner contends that the standby and strike charges are separate transactions from the fabrication of the set and are charges for exempt services since they are optional with the clients and occur after the sale of the set is completed.

Petitioner also contends that the art direction which he provides is a separate service and is not related to the sale of tangible personal property. Petitioner argues that there are instances where J--- S--- fabricates a set and petitioner does not act as art director. There are also instances where petitioner acts as the art director and J--- S--- does not fabricate the set.

The audit staff contends that petitioner is the retailer of the sets and that taxable gross receipts include all services rendered in connection with the sale. The staff argues that the set manufacturing, standby, art direction and strike constitute one transaction, an indivisible package deal. The true object of the contract is the sale and delivery of the set. The art direction and standby facilitate the use of the set and strike concerns disposal of the set.

After the Appeals conference, petitioner submitted a listing of 56 jobs from January 1992 to September 1992 where J--- S--- fabricated and sold the sets. For 20 of the 56 jobs, petitioner was not the art director. Petitioner also submitted documentation to show that in 1992 he worked as the art director on two jobs where J--- S--- did not sell the sets. Petitioner also submitted 11 invoices from 1992 on which there was either no charge for standby, no charge for strike, or on four of the invoices, no charge for either standby or strike.

The staff responds that these records are for sales that occurred in 1992, after the close of the audit period. Therefore, the staff has not reviewed any backup documents for the list of J--- S---' 1992 jobs. The staff would like to see what records from the audit period show regarding art direction without set fabrication and set fabrication without art direction. The staff has always maintained that any transaction in which petitioner provided only art direction without also having sold the sets, would be exempt as a service; however, petitioner did not provide evidence of any such transactions during the audit period.

The staff also points out that petitioner has provided evidence of only two post audit transactions where he was the art director and J--- S--- did not fabricate and sell the sets. From the documents, it appears that these two jobs (I--- and M---) were shot in British Columbia and geography dictated that another set retailer be used. The staff also notes that petitioner acted as an employee on these jobs and questions whether an invoice was even issued by J--- I---.

Petitioner has also submitted a letter dated January 15, 1988 written by a Board auditor from Arcadia District in response to a request from Mr. D--- V---, an attorney. The letter states the opinion that standby labor is taxable if the labor involves fabricating or creating as new item, but if the labor is for repainting or rewallpapering, it is not taxable. The letter states that strike labor is not taxable since fabrication is not involved and the customer already owns the set at the

time of the strike labor. The letter also states that since the taxpayer is not identified, the letter is for general information only and a copy of Regulation 1540, Advertising Agencies, Commercial Artists and Designers, is enclosed. Petitioner claims he relied on the opinion that standby and strike labor were not taxable.

The audit staff responds that this letter does not meet the requirements of Revenue and Taxation Code Section 6596. The letter was not written to petitioner or his known agent and includes a specific disclaimer that the contents are only for general information.

Analysis and Conclusions

The sales tax applies to sales of tangible personal property in this state measured by the "gross receipts" from the sale of the property. (Revenue and Taxation Code Section 6051). The term "gross receipts" means the total amount of the sales price, including any charges for services that are part of the sale. (Revenue and Taxation Code Section 6012(a) and (b)). Thus, Sales and Use Tax Regulation 1524(a) provides as follows:

"Tax applies to the gross receipts from retail sales (i.e., sales to consumers) by manufacturers of tangible personal property the sale of which is not otherwise exempted. The measure of the tax is the gross receipts of, or sales price charged by, the manufacturer, from which no deduction may be taken by the manufacturer on account of the cost of the raw materials or other components purchased, or labor or service costs of any step in the manufacturing process, including work performed to fit the customer's specific requirements, whether or not performed at the customer's specific request, or any other services that are a part of the sale. In addition, no deduction may be taken on account of interest paid, losses or any other expense."

Business Taxes Law Guide Annotation 295.1690, August 16, 1978, provides:

"`Services that are part of the sale' include any the seller must perform in order to produce and sell the property, or for which the purchaser must pay as a condition of the purchase and/or functional use of the property, even where such services might not appear to directly relate to production or sale costs."

We conclude that the standby labor, the strike labor, and the art direction are services performed in conjunction with the sale of the sets and are services which are part of the sale of tangible personal property.

Charges for standby labor refer to charges for adjustments to the set when it is at the shooting site. Any charges for adjustments or alterations to the set are charges for continued fabrication of the set for its use at the site. Art direction facilitates the use of the set. Strike

labor disassembles the set and disposes of it. As such they are services intrinsically linked to the sale of the set.

Petitioner argues that the customer may choose not to use the standby or strike labor. Although the customer may choose not to use the standby or strike labor, the vast majority of J--- S---' sales do include charges for standby and strike. When these services are provided, the functional use of the set is facilitated and these services become part of the sale of the tangible personal property.

Petitioner argues that his art direction is not part of a package deal. However, the fact is that we have been presented with no instance during the audit period where petitioner was the art director and J--- S--- did not provide the sets. The only two post audit instances of this scenario appear to have taken place in British Columbia and petitioner was hired as an employee of the production company to do art direction. It is questionable whether J--- I--- even issued invoices in these instances.

At the Appeals conference, the audit staff asked petitioner's representatives whether petitioner, as art director, ever hired another company to construct the set. The answer was "no". The billings from J--- I--- and J--- S--- are two invoices for a single transaction which encompasses set design, construction, set up, standby, art direction and strike. J--- S--- bills for the set design, construction, set up, standby and strike. J--- I--- bills for the art direction, if ordered.

We agree, and the audit staff agrees, that when petitioner provides art direction without also providing the set, his art direction is a nontaxable service. However, when petitioner's art direction is provided in conjunction with his sale of the set, it is a service that facilitates the functional use of the set and is part of the sale of tangible personal property.

We also conclude that petitioner's failure to pay the tax is not excused by his reasonable reliance on written advice by the Board under Revenue and Taxation Code Section 6596. Petitioner did not write to the Board and describe his specific activities and transactions. The letter was not written to petitioner as required by Section 6596. Further, the letter included a specific disclaimer that its purpose was merely for general information.

Recommendation

Redetermine without change.

M--- F--- G---
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June 15, 1993
295.0029

Michele F. Hicks, Staff Counsel

Date