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**STATE BOARD OF EQUALIZATION**

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION  
APPEALS DIVISION

In the Matter of the Petition for Redetermination of state and Local Sales and Use Taxes  <u>Petitioner</u>	) ) ) ) ) )	DECISION AND RECOMMENDATION    No.
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The above-referenced matter came on regularly for hearing before Hearing Officer Anthony I. Picciano on April 10, 1991 in Salinas, California.

Appearing for Petitioner:

Appearing for the Sales and Use Tax Department:                      Senior Tax Auditor

Protested Items

The protested tax liability for the period January 1, 1985 through December 31, 1987 is measured by:

<u>Item</u>	<u>State, Local and County</u>
A. Purchases for own use from California vendor where resale certificate issued.	\$ 6,745
D. Slide- productions claimed and disallowed.	\$ 16,622

## Petitioner's Contentions

A. Petitioner contends that it is the agent for its customers when it buys photographs and then uses them in the production of slide shows. Alternatively, the petitioner contends that passage of title of the photographs to the customer occurs before any use is made of them by the petitioner.

D. Petitioner contends that the modules it makes qualify for the exemption provided for motion picture productions and are therefore nontaxable.

## Summary

Facts:

The petitioner is a corporation that has been in business since April 1, 1984. It is in the business of advertising and graphic arts. The file shows that the petitioner was provided with a Tax Tips Pamphlet No.37 when it was issued its permit. That Pamphlet describes the procedure to be followed in order to avoid the application of use tax on the use of a manufacturing aid in addition to the application of sales tax to the sale of the end product. There have been no prior audits of the petitioner.

The petitioner produces slide/audio-tape shows that it calls modules. A module is comprised of slides and a sound track tape that is fully synchronized to the slides. The audio tape controls the slide projector via a pulse to achieve the necessary synchronization. The end result is a coordinated slide show that includes narration and/or music as a complement to the pictorial presentation.

The petitioner prepares a proposal for a particular project in the form of a letter and sends it to the prospective client. During the audit period, the proposals did not include a statement concerning the passage of title of tangible personal property purchased by the petitioner prior to its use on the customer's project. The proposal included a statement requesting the customer to sign it. Petitioner's proposals also included a total charge for the project and a price list for copies of the modules. The cost of photographs is not separately stated in the petitioner's proposals. Customers routinely signed and returned the proposals, alternatively there was an oral acceptance. The agreement would then serve as a letter of understanding between the petitioner and the customer. The petitioner completed the work under the auspices of the agreement. Petitioner invoiced the customers in accordance with the payment schedule incorporated in the agreement.

The petitioner purchased photographs ex-tax through the use of resale certificates. The petitioner then used the photography to produce modules for its customers. The petitioner retains the original module and the photographs used to produce it. It sells copies only to the customers who contracted for their production. The commercial sale of the modules is expressly excluded by "the agreement. The petitioner charges sales tax reimbursement on the sales of the copies of the modules to the customers. However, the petitioner does not charge tax on the contract price for the production of the original module. The petitioner does not use the original module in any fashion except as a master module used to produce copies for the customer" that contracts for its manufacture."

A revised audit was completed on August 8, 1988. The taxable measure considered herein is the product of that revised audit.

#### Audit Item A:

In order to arrive at the measure of use tax understated, the auditor conducted a test of calendar year 1987. The resultant understatement calculated from that test was expanded over the audit period based on a flat amount in the original audit. The result was compared with reported use tax and the error calculated on the difference. In the revised audit, in order to provide a more representative test, purchases were considered but the auditor calculated a percentage of error based on taxable sales which was then projected back into the audit period. The revised audit reduced the taxable measure of Audit Item A by \$3,383. The reason 1987 was chosen as a test period was because it was the last year of the audit and the petitioner had the best records for that year.

The auditor stated that the petitioner issued resale certificates when it purchased photographs. It used the photographs in the course of producing slide-shows/modules for its clients. According to the auditor, the Sales and Use Tax Regulations require, in order for a taxpayer to be relieved of the use tax imposed for the use of a manufacturing aid, it is necessary that there be a passage of title in writing of the manufacturing aid (photographs in this instance) to the customer before any use is made of the manufacturing aid. That step was not accomplished by the petitioner. Therefore, the petitioner is considered to have used the manufacturing aid prior to its being sold to the customer or not sold at all, and the application of tax to that use is appropriate.

The auditor argued that the petitioner was not an agent for its customers. She said there was nothing in writing that gave the petitioner the authority to do anything on behalf of its customers, therefore, it was not their agent. The auditor indicated that the petitioner had been given a pamphlet that covered the subject matter of this audit item. That pamphlet provided specific instructions for the prerequisites that must be met in order to make the use of the manufacturing aid nontaxable and those prerequisites were not completed by the petitioner.

The petitioner's representative argued that the petitioner's customers have always understood that it was purchasing the manufacturing aids (photographs) on their behalf and that the customers took title to the property immediately upon it being purchased. He agreed that the petitioner purchased them ex-tax by issuing a resale certificate. However, he said, the clients pay for them through the petitioner and the manner of payment is purely one of mechanics and convenience. To support the contention that the customer receives title to the aids prior to use, he offered to acquire statements from the petitioner's customers to that effect --- said he was discouraged from acquiring the signed statements because he was told that these statements would be self serving and of little value after the fact. --- argued that this type of communication could not be self serving because the customer had nothing to gain by signing the statement.

---, stated, in his experience in business law, a contract need not be in writing to be effective. However, even if it is in writing, the contract is the entire understanding of the parties which includes things that may not have been set in writing.

#### Audit Item D:

The auditor argued the petitioner produces slides and slides are what are transferred to its clients. Based on Sales and Use Tax Regulation 1529 in effect during the audit period, the sale of slides is taxable. The auditor perceived a distinction between something that simulates a motion picture, i.e., a synchronized slide show, and a true motion picture. She indicated that one of the requirements needed to meet the definition of a motion picture is, it must all be on film. This is not the case here. Therefore, the modules do not meet the criteria for motion pictures and their sales are taxable.

The auditor argued the total charge of the modules is taxable because the customer contracts for and buys the module. The module includes the slides and synchronized audio. She argued any services that are performed by the petitioner as part of that sale are taxable.

The petitioner's representative stated that it does not sell the original copy of the modules but instead sells copies. It pays sales tax on the sales of those copies. He argued, the bulk of the money that petitioner receives from its customers is for the performance of the services necessary to produce the original module and that service is not taxable. He claimed that petitioner's customers are not obligated to buy a copy of the module in which case there would be no transfer of property. The contracts only allow the customer to buy completed 'modules in accordance with a stated price schedule.

--- also argued that the modules meet the criteria established for motion pictures and on that basis are exempt from tax. He claimed the Sales and Use Tax Regulation that provides the exemption for motion pictures emphasizes the idea of production. He said the Sales and Use Tax Regulation specifically states that still pictures that are part of a complete' production are qualified for the exemption. The modules also meet the requirement of the definition of production in that they are embodied on film or tape. Lastly, argued that the modules petitioner sells are complete productions. They incorporate scripting, include music, are edited as a unit and present an entire story.

--- indicated that he was advised, had the petitioner completed the next step of incorporating the modules on video tape, their sales would not have been taxable. He argued that the film petitioner uses for the making of slides is thirty-five millimeter which is the same film used in the making of motion pictures. The only difference, according to him, is in the case of slides they are shown one frame at a time versus 24 frames per second in a motion picture.

#### Analysis and Conclusions

#### Audit Item A:

An excise tax has been imposed on the storage, use, or other consumption in this state of tangible personal property. See Revenue and Taxation Code section 6201. Every person storing, using or otherwise consuming in this state tangible personal property purchased from a retailer is liable for the tax. See Revenue and Taxation Code section 6202.

Revenue and Taxation Code Section 6009 provides in pertinent part:

"Use" includes the exercise of any right or power over tangible personal property incident to the ownership of that property..."

The petitioner purchased photographs ex-tax for the purpose of using them in the production of modules. The question presented is whether or not the use was made before or after the sale of the property to its customers. We find that the petitioner used the property before title is transferred to its customers based on the lack of credible evidence to the contrary. Aside from the petitioner's representative's testimony that the understanding between the petitioner and its customers is that title passes to the customer prior to use there is no evidence to support an opposite conclusion than the one reached here. The petitioner's declaration alone is not a substitute for credible and convincing evidence and absent any other proof, such evidence may be disregarded. (See Leonard v. Watsonville Community Hosp. (1956) 47 C.2d 509; People v. Schwartz 1947 31 Cal.2d 59, 64.). Since petitioner's obligation with respect to delivery of the property ended with the transfer of possession to the customer of a copy of the master module, there was a completed sale to the customer at that time. (See California Commercial Code Section 2401(2)).

Sales and Use Tax Regulation 1540 is controlling in this instance. It applies to Advertising Agencies, Commercial Artists and Designers and their use of tangible personal property. It provides as relevant to this decision:

“(a) (2) (A) **Items Acquired From Outside Sources.** All acquisitions by advertising agencies of tangible personal property such as collateral materials (catalogs, brochures, pamphlets, and the like), artwork (photographs, drawings, paintings, designs, lettering, and the like), are regarded as purchases by the agencies on their own behalf for resale or use unless the agency clearly establishes with respect to any acquisition that it is acting as agent for its client.... An advertising agency purchasing tangible personal property as an agent on behalf of its client may not issue a resale certificate to the supplier. It will be presumed that an advertising agency who issues a resale certificate to its supplier is purchasing the tangible personal property on its own behalf for resale and is not acting as an agent for its client....(Emphasis added.).

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“(d) **Items Purchased by Agency or by Artist or Designer.** An advertising agency, artist, or designer is the consumer of tangible personal property used in the operation of its business... The agency, artist, or designer is the seller of, and may purchase for resale, any tangible personal property that it resells before use, or that becomes physically an ingredient or component part of tangible personal property sold by it prior to use... An advertising agency, artist, or designer is the consumer of property such as photographs and art which it uses in the preparation of tangible personal property as to which it is acting as a seller unless, prior to any use having been made of the property, the property is sold or becomes an ingredient or component part of other tangible personal property sold. The agency, artist, or designer may purchase for resale photographs and art which, prior to any use, are sold or become physically an ingredient or component part of other tangible personal property that is sold by the agency, artist, or designer ... A photograph or art is regarded as having been used when a reproduction is made from the photograph or art.” (Emphasis added.)

The California Evidence Code Section 6702 establishes a statutory provision to be construed as establishing a rebuttable presumption. California Evidence Code Section 606 states that the

effect of a presumption affecting the burden of proof is to impose upon the party against whom it operates the burden of proof as to non-existence of the presumed fact. Western Contracting Corp. v. State Board of Equalization (1968) 265 C.A.2d 568,575; 71 Cal.Rptr.472.

The "Burden of Proof" means the obligation of a party, if he is to prevail on a particular fact, to establish by evidence a requisite degree of belief or conviction concerning such fact in the mind of the trier of fact. The burden of proof will generally require that a party establish the existence of a fact by the preponderance of the evidence. "Preponderance of the evidence" means evidence that, when weighed with that opposed to it, has more convincing force and greater probability of the truth. The petitioner has not provided sufficient evidence to overcome its burden of proof where, as here, the law provides a presumption that when the petitioner buys photographs ex-tax by issuing a resale certificate, it is not buying them on its client's behalf.

Civil Code Section 2295 provides -that an agent is one who represents another, called a principal, in dealings with third persons. In reference to agency, the burden of proving the existence of an agency rests on the one affirming its existence (Burbank v. National Casualty Co. (1.941.) 43 Cal.App.2d 773.) The petitioner argued that it is the agent for its customers when it buys the photographs ex-tax through the use of a resale certificate. However, the petitioner has not provided any evidence that would support that conclusion. The petitioner has not carried its burden of proof in the matter of it being the agent of its customers and we find that no agency existed.

Audit Item D:

The petitioner argued that it- was providing a tax free service with no transfer of tangible personal property until and unless the customer purchased a copy of the module. We find that the probability of a customer not buying a \$200 module after having spent \$8,000 for the production of that module is non-existent. Therefore, we consider that each customer does purchase at least one module and the fact that it is a copy is not consequential.

Sales and Use Tax Regulation 1501 provides in pertinent part:

"Persons engaged in the business of rendering service are consumers, not retailers, of the tangible personal property which they use incidentally in rendering the service. Tax, accordingly, applies to the sale of the property to them. If in addition to rendering service they regularly sell tangible personal property to consumers, they are retailers with respect to such sales and they must obtain permits, file returns and remit tax measured by such sales.

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"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. If the true object of the contract is the service per se, the' transaction is not subject to tax even though some tangible personal property is transferred."

It is clear that the only thing that petitioner's customers are interested in, is the end product, i.e., a copy of the master module, and that is what they contract for. Therefore, we conclude that the purchase and sale of the tangible personal property is the true object of the agreement between the petitioner and its customer. Further, the services that are provided are taxable as services that are part of and necessary to the sale of tangible personal property in the form of a copy of the master module. Therefore, those services are taxable as provided for in Revenue and Taxation Code Section 6012 (b) (1).

Section 6051 of the Revenue and Taxation Code imposes the sales tax on retailers for the privilege of selling tangible personal property at retail. The measure of tax is based on gross receipts from the retail sales in this state of tangible personal property. The petitioner makes sales at retail, and therefore, is a retailer. Therefore, any sales that petitioner makes are subject to sales tax absent an exemption being available to relieve it of that liability.

The petitioner claims that it should be granted the sales tax exemption that is provided for the sale of motion pictures. We disagree. Sales and Use Tax Regulation 1529 in effect during the audit period requires, in order to qualify for the exemption, the end result must be a production. "Production" is defined as a motion picture prepared for showing on a screen and incorporated on film or video tape. The Regulation cited also specifically states that slide films and film strips are taxable. The product that was produced by petitioner, and the subject of this audit, is not a motion picture but instead is a series of still pictures shown in sequence and coordinated with an audio tape. The petitioner argued that still shots are nontaxable by the above cited Regulation. However, in order for still shots to be nontaxable they must be incorporated in a production which meets the criteria of a motion picture. See Sales and Use Tax Regulation 1529 (b) (1) (B). Since the slides are not incorporated into a production, as defined above, their sale is not tax exempt.

We note, tax exemptions are a matter of legislative grace and must be found in the statutes (see Hotel Del Coronado Corp. v. State Board of Equalization [197.1] 15 Cal.App.3d 612) Exemptions from tax are strictly construed against the taxpayer who has the burden of proving that the statutory requirements have been satisfied (see Standard Oil Company of California v. State Board of Equalization [1974] 39 Cal.App.3d .765; and H. J. Heinz Co. v. State Board of Equalization [1962] 209 Cal.App.2d 1). Any doubt must be resolved against the right to an exemption. (Estate of Simpson (1954) 43 Cal.2d 594,602; J.C. Penney Insurance Company v. State Board of Equalization (1979) 94 Cal.App.3d 685,693.) The petitioner has not met its burden of proof in order to qualify these sales for the exemption claimed.

The petitioner's representative indicated that he was advised that if the petitioner took the next step of incorporating the modules on video tape, their sales on that media would be tax-exempt. We express no opinion as to the correctness of that advice. However, we suggest that petitioner, before- it relies on that advice, apply to the Board in writing for a legal opinion as to the accuracy of that advice in these circumstances. The petitioner's application in Writing should, meet all the requirements established for relief as outlined in Revenue and Taxation Code 6596, a reading of which we recommend to the petitioner's representative.

Recommendation

Redetermine without adjustment.

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Anthony I: Picciano, Hearing Officer

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Date

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