

STATE OF CALIFORNIA
BOARD OF EQUALIZATION

435.1726

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition)
for Redetermination Under the) DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)
)
L--- M---) No. SR --- XX-XXXXXX-010
)
)
)
Petitioner)

The Appeals conference in the above-referenced matter was held by Appeals Supervising Auditor Anne Cumins on June 15, 1993 in Santa Rosa, California.

Appearing for Petitioner:

Mr. L--- M---
Petitioner

Appearing for the
Sales and Use Tax Department:

Mr. Darryl Huismann
Supervising Tax Auditor

Protested Items

The protested tax liability for the period January 1, 1988 through June 30, 1990 is measured by:

<u>Item</u>	<u>State, Local and County</u>
Disallowded deductions for nontaxable labor claimed on returns.	\$6,767

Petitioner's Contentions

1. The amounts claimed as nontaxable labor on returns did not involve the sale of tangible personal property or fabrication labor.
2. If it is determined that sales and use tax is due, interest should not be added to the liability because there was an unreasonable delay in scheduling the Appeals conference and resolving the issue.

Summary

The petitioner has operated a custom black and white photography lab since 1985. In addition, he is a professional photographer who uses both black and white and color film when he photographs people, products and events. Since he first began to operate the business, he has developed black and white film only.

During the period January 1, 1988 through June 30, 1990, the petitioner claimed deductions on sales and use tax returns for nontaxable labor. In 1991, those deductions were questioned by the Board's Return Review Section. That section issued a determination on April 9, 1991, and Mr. M--- filed a timely petition for redetermination on April 30, 1991.

Mr. M--- explained his contentions in correspondence with the Return Review Section. He covered them in greater detail at the Appeals conference. Mr. M--- stated that, during the period in question, some of his contracts were for photography and photos, as a package. On these contracts, he reported sales tax on the entire contract amount.

Other contracts were for the photography only. In these situations, Mr. M--- considered himself to be "working for hire," because his sole responsibility was to expose the film. The client could then take the film elsewhere for processing and printing or ask Mr. M--- to develop it. Mr. M--- explained that clients often asked him to develop black and white film, but that he never developed color film. He stated that the bulk of these contracts were wedding photography, which virtually always requires color film.

Mr. Huismann explained that fabrication labor is taxable. Also, he noted that a transaction which is considered a step in the process of producing tangible personal property is fabrication labor. He further stated that the photographs (tangible personal property) were the end products desired by Mr. M---'s clients. Although Mr. M--- may not have completed the process of producing the photographs, his contracts were a step in that process, and the gross receipts were taxable as fabrication labor.

As a separate issue, Mr. M--- argued that, if the sales and use tax is due, interest should not be applied to the liability. Mr. M--- conceded that he had been notified that 1) interest was accruing, 2) he had the option to pay the tax to stop the addition of interest, and 3) any overpaid tax would be refunded with interest. Since he believed that the issue would be resolved more promptly, however, he decided not to remit the tax.

Analysis and Conclusions

The Board's authority to examine returns filed by a taxpayer and to determine whether the sales or use taxes were properly reported is based on Section 6481 of the Revenue and Taxation Code (R&TC) which states, in relevant part:

"If the Board is not satisfied with the return or returns of the tax or the amount of tax, or other amount, required to be paid to the state by any person, it may compute and determine the amount required to be paid upon the basis of the facts contained in the return or returns or upon the basis of any information within its possession or that may come into its possession...."

In this case, the sole question is whether the contracts involved fabrication labor, which is considered to be a sale of tangible personal property. Regulation 1501¹, "Service Enterprises Generally," explains the distinction between service and sales of tangible personal property. The distinction centers around the "true object" of each contract. If the real object sought by the customer is the tangible personal property, the contract is considered a sale of that property.

The end products desired by Mr. M---'s clients were photographs (tangible personal property). In some situations, the photographs were not completed by Mr. M---, but his photography (the exposure of the film) was a step in the process of producing those photographs.

Regulation 1528, "Photographers, Photostat Producers, Photo Finishers and X-Ray Laboratories," states:

"(a) Photographers and Photostat Producers.

(1) GENERAL. Tax applies to sales of photographs, whether or not produced to the special order of the customer No deduction is allowable on account of expenses such as travel time, telephone calls, rental of equipment or salaries or wages paid to assistants or models, whether or not such expenses are itemized in billings to customers."

1 All regulations referred to herein are Sales and Use Tax Regulations.

Mr. M--- had read this regulation, and he stated that he remitted tax on the entire contract amount when he sold photographs as part of a "package." He argued that the contracts in question did not involve the sale of photographs. He considered himself to be working "for hire," essentially selling his talent as a photographer.

Regulation 1528 does not specifically address this issue. The explanation is found in Section 6006(b) of the Revenue and Taxation Code which defines "sale" as:

"The producing, fabricating, processing, printing, or imprinting of tangible personal property for a consideration for consumers who furnish either directly or indirectly the materials used in the producing, fabricating, processing, printing or imprinting."

Further detail regarding that definition is found in Regulation 1526, "Producing, Fabricating and Processing Property Furnished by Consumers--General Rules," paragraph (b) of which states:

"Producing, fabricating, and processing include any operation which results in the creation or production of tangible personal property or which is a step in a process or series of operations resulting in the creation or production of tangible personal property."

In addition, the Board's Pamphlet Number 68, "Tax Tips for Photographers, Photo Finishers & Film Processing Laboratories," on page 7, discusses photographers who work as independent contractors for newspapers. Although this example is not identical to the contracts in question, the key facts are substantially similar. The paragraph states:

"Newspapers will often employ photographers as independent contractors to provide them with photographs or exposed film. ... Sales tax applies to such amounts received by a photographer...where the object of the transaction is the delivery of tangible personal property, such as exposed film."

For these reasons, I have concluded that the labor involved in the petitioner's contracts was fabrication labor and was subject to the sales and use tax.

On the issue of interest, I note that interest is the time value of money to which a creditor is entitled for forbearance of its use until timely payment is made by a debtor. The legislature determines the rate of statutory interest to be charged. I am without authority to overrule this express statutory mandate. Further, as conceded by Mr. M---, he could have paid the tax and interest in full and sued for refund. This would have stopped further accrual of interest and entitled the petitioner to receive interest had petitioner prevailed on his petition.

L--- M---
SR --- XX-XXXXXX-010

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July 30, 1993
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Recommendation

Redetermine the tax without adjustment.

Anne Cumins, Appeals Supervising Auditor

Date