515.0012.680

2/7/95

STATE OF CALIFORNIA

BOARD OF EQUALIZATION

APPEALS SECTION

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of: [redacted]	)	DECISION AND RECOMMENDATION
Petitioner [redacted]	)	No. [redacted]

The Appeals conference in the above-referenced matter was held by Paul O. Smith, Staff Counsel on June 8, 1995, at [redacted] California.

Appearing for Petitioner: [redacted]

Appearing for the Sales and Use Tax Department: Scott A. Lambert, CPA
Supervising Tax Auditor

Type of Business: Sale and lease of music and sound reinforcement equipment.

Protested Item

The protested tax liability for the period October 1, 1990 to December 31, 1993, is measured by:

Item	Amount
Taxable sales and taxable leases not reported based on actual examination of invoices for the period October 1, 1990 to December 31, 1992, and estimated for the calendar 1993.	[redacted]

Petitioner's Contentions

Petitioner contends that its charge for engineers or operators furnished with the rental of a sound systems is the charge for a nontaxable service.

Summary

During the period in issue petitioner [redacted], a [redacted] corporation, engaged in the sale and lease of sound systems, and sound equipment such as JBL horns, tweeter speakers, microphones and stands, and amplifiers. In 1993, the petitioner closed its warehouse in [redacted] California. The Sales and Use Tax Department (hereinafter "Department") audited petitioner's records and determined that in some of petitioner's rentals, petitioner agreed to furnished the engineer or operator (hereinafter "sound engineer") along with the equipment. The Department made the determination that the sound engineer's services were mandatory, irrespective whether the charges for the equipment rental and the sound engineer's service were billed lump sum or separately stated. Relying on Sales and Use Tax Annotation 330.3480, the Department determined that the gross receipts from the sound engineer's services were includible in taxable rental receipts.

On January 1, 1987, [redacted] (hereinafter [redacted]") and [redacted] dba [redacted] (hereinafter [redacted]), entered into a sound agreement. (See Petit. File, p.81.) The agreement provided, among other things, that [redacted] would furnish to [redacted] a fully-energized sound engineering system, the service of a sound engineer, and the tools necessary to perform such services. The agreement required the sound engineer furnished to maintain and supervise the sound system, and to be present at each performance and rehearsal. The sound engineer was required to personally operate the sound system. Any sound engineer rendering service was to be mutually acceptable to petitioner and [redacted]. Further, all personnel provided by [redacted] were deemed to be [redacted] employees, but were instructed to follow and comply with all of [redacted] rules, requests and instructions in connection with the use of the sound system. [redacted] paid [redacted] a weekly rental of $2,550 from which it paid its expenses, including compensation to the sound engineer. (See Petit. File, p.73.) On February 27, 1989, the agreement was assigned to petitioner. (See Petit. File, p.77.) Petitioner states that this agreement supports its contention

that its sound engineers should be exempt as a service, and not taxable as part of its rental charge. In support of its contention, petitioner relies on the cases Entremont v. Whitesell (1939) 13 Cal.2d 290, and Northbrook v. Coastal Rescue Systems Corp. (1986) 182 Cal.App.3d 763.

On June 6, 1994, the Department issued a Notice of Determination to petitioner, inclusive of interest and a negligence penalty. On June 29, 1994, petitioner submitted a Petition for Redetermination stating therein that numerous nontaxable items such as rental receipts, and out-of-sales were included in the taxable measure. On September 3, 1994, an office conference resulted in the exclusion of some of the items from the taxable measure. On October 12, 1994, the Department prepared a revised audit report to reflect the agreed upon adjustments. Petitioner contends that the taxable measure remains overstated because its charge for sound engineers furnished with the rental of a sound systems is the charge for a nontaxable service.

At the conference, petitioner stated there were adjustments amounting to [redacted] that the parties had agreed to at the office conference on September 3, 1994, and only $2,000 has been removed from the taxable measure. (See Petit. File, at p.105). After review of petitioner's exhibit, the Department now concedes that petitioner is entitled to a reduction in the taxable measure of [redacted]. This is the difference between [redacted] and [redacted], as reflected in Exhibit A. Petitioner also submitted a listing of customers to whom it will send XYZ letters. The petitioner was given until July 24, 1995, to submit its XYZ responses to the Department for verification. To date no XYZ letters have been submitted.

The Department points out that petitioner has never provided any records for 1993, and therefore a projection using prior period records was used to determine the taxable measure for this year. The Department also questioned why the auditor, in determining the taxable measure for 1993, eliminated sales over $25,000. Petitioner states that the purpose of this adjustment was to eliminate non-recurring sales, since petitioner closed its only facility in California in 1993. In a letter dated July 7, 1995 (Petit. File, p.113), the Department states that the auditor's reasoning for eliminating sales over $25,000 has no merit. After recalculating the 1993 sales, the Department's recomputation would result in an increase in taxable measure of [redacted]

Analysis and Conclusions

Revenue and Taxation Code[1] Section 6051 imposes the sales tax upon the gross receipts of any retailer from the sale of tangible personal property. Section 6012 provides in relevant part that the term "gross receipts" means the total amount of the sale, of the retail sale of retailers, valued in money, without any deduction for the cost of labor, or any other expense. (Rev. & Tax. Code, § 6012, subd. (a)(2).) The total amount of the sale or lease or rental includes any services that are part of such sale or lease or rental. (Rev. & Tax. Code, § 6012, subd. (b)(1).) Section 6091 provides in relevant part that it shall be presumed that all gross receipts are subject to the tax until the contrary is established.

Here, the Department made the determination that the sound engineer's services were mandatory because such services were indispensable in the operation of petitioner's sound systems. Relying on Annotation 330.3480, the Department determined that the gross receipts from the sound engineer's services were includible in taxable rental receipts. However, subsequent to the audit of petitioner, Annotation 330.3480 was deleted because it did not correctly state the long standing rule that a lease with a mandatory operator is not a lease at all. In a true lease the chief characteristic is the giving up of possession to the lessee, so that the lessee and not the owner uses and controls the rented property. (Cal. Code Regs., tit. 18, reg. 1660, subd. (a); see also Entremont v. Whitesell, supra, 13 Cal.2d at 294, citing California Civil Code §§ 1925, 1955; Northbrook v. Coastal Rescue Systems Corp., supra, 182 Cal.App.3d at 767-769.)

The [redacted] agreement here required petitioner to provide a sound engineer, who would maintain and supervise the sound system and be present at each performance and rehearsal. The sound engineer was also required to be available to personally operate the sound system. Effectively, the sound engineer had complete control of the sound system. Considering the sophistication of these sound systems, I cannot perceive of petitioner leasing the system to [redacted] without a qualified sound engineer. Upon review of the agreement, I conclude that petitioner did not intend for [redacted] to have possession or use of the sound system apart from the sound engineer. I also

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[1] Unless otherwise specified, all section references are to the Revenue and Taxation Code as in effect for the year in issue.

conclude that at no time did [redacted] have possession and control of the sound system, or temporary possession of it within the meaning of Civil Code sections 1925, and 1955. Although [redacted] might have given some directions to the sound engineer, the agreement shows that possession of the sound system remained with petitioner. Thus, as I read the [redacted] agreement, it is not a true rental agreement at all.

Under the circumstances here, petitioner is the consumer of the sound system used in the [redacted] agreement. Accordingly, the charges by petitioner to [redacted] for use of the sound system and sound engineer are not subject to tax. Tax, if applicable, would apply to the sale of the sound system to petitioner by a retailer or to petitioner's use of the property, measured by the purchase price, when the property is purchased from a retailer in California under a resale certificate or from a retailer at an out-of-state location. (Cal. Code Regs., tit. 18, reg. 1660, subd. (e)(4).) Here, the only agreement submitted for my review was the [redacted] agreement. Thus, this finding only applies to the [redacted] agreement. If petitioner has similar agreements, it can submit them for consideration in a petition for reconsideration. In order to determine the reduction in the taxable measure relating to the agreement, a reaudit is hereby recommended.

As stated above, under the [redacted] agreement petitioner received weekly rental payments of $2,550. Upon review of the audit workpapers (Schedule 12A), I find that petitioner received varying amounts from [redacted] (see e.g., Audit Workpapers, Schedule 12A, p.20). However, I cannot determine the exact amounts that relate to the [redacted] Agreement. Therefore, I recommend a reaudit of [redacted] invoices in order to make this determination.

Section 6006, subdivision (g) defines the term "sale" as "Any lease of tangible personal property in any manner or by any means whatsoever, for a consideration", except a lease of property not relevant here. Section 6010, subdivision (e) provides a similar definition for a purchase. (See also Cal. Code Regs., tit. 18, reg. 1660, subd. (b)(1).) In the case of a lease that is a sale and purchase the tax is measured by the rentals payable. Generally, the applicable tax is a use tax, that the lessor must collect from the lessee at the time of the rental payments. (Cal. Code Regs., tit. 18, reg. 1660, subd. (c)(1).) Thus, petitioner's lease of sound equipment such as JBL horns, tweeter speakers, microphones and stands, etc., unless

exempt under some other section, are subject to the use tax, measured by the rentals payable.

With respect to the increase of the determination of [redacted] for 1993, section 6563 provides in relevant part that the Department may increase the amount of the determination before it becomes final, providing it is asserted by the Department at or before the hearing. (Rev. & Tax. Code, § 6563, subd. (a).) However, such increase must be asserted by the Department to the petitioner.

Recommendation

Reduce the taxable measure by [redacted] as reflected in Exhibit A, conduct a reaudit to determine the nontaxable portion of the material relating to the [redacted] Agreement, and deny the petition in all other respects.

PAUL SMITH, Staff Counsel

February 7, 1996
Date

JA

W/Exhibit A