

June 4, 1964

REDACTED TEXT

This is to inform you of our recommendation to the board in the matter of the above named taxpayers' petition for redetermination. We regret that we must recommend that the petition be denied.

After reviewing the arguments which you presented to the effect that the claimant sold intangible as well as tangible property, we are persuaded that the full amount specified in the contract of sale must be included in the gross receipts by which the sales tax is measured. The taxpayers did not sell a going business, and thus there was no element of good will which might be considered an intangible property excluded from the measure of sales tax. Also, the contract did not contain a covenant not to compete which also might be considered an intangible. Rather, the sale was of molds capable of producing a sailboat and an assignment of rights and a delegation of duties in a contract with REDACTED TEXT.

REDACTED TEXT design, of course, was a valuable element, but there is no showing that the benefits of this contract were not offset by the duties in the nature of royalty payments. The claimant and REDACTED TEXT entered an arm's length transaction for the design of the boat. We may assume, therefore, that since REDACTED TEXT was content to design a boat in return for royalty payments that the value of rights to copy REDACTED TEXT design was equal to the royalty payments which would accrue to REDACTED TEXT upon production.

Section 6012 of the California Sales and Use Tax Law (Revenue and Taxation Code), which defines the measure of sales tax, provides:

“Gross receipts’ mean the total amount of the sale or lease or rental price, as the case may be, of the retail sales of retailers, valued in money, whether received in money or otherwise, without any deduction on account of any of the following:

“(a) The cost of property sold

“(b) The cost of materials used, labor or service cost, interest paid, losses, or any other expense.

* * *

“The total amount of the sale or lease or rental price includes all of the following:

“(a) Any services that are a part of the sale.”

We believe that the various functions performed by the claimant in developing the boat molds constitute costs or services which must be considered part of the sale.

By analogy, we might point out that a sculptor must pay tax on the retail selling price of sculpture without deduction for preliminary sketches or the time spent modeling the design in clay preliminary to making the final production. The same would be true in this case. Work going into

the design and production of the molds is a cost which may not be deducted from the gross receipts of the sale. Gross receipts are not limited to materials and the labor actually involved in building the molds in question.

We note from a review of the buyers and sellers' income tax records that the purchase price set up in this audit was treated as a sale of fixed assets for income tax purposes and not as a sale of intangibles such as good will or a covenant not to compete. We believe our views are consistent with your client's interpretation of its contract of sale for income tax purposes.

You have requested an oral hearing before the board in this matter. If you disagree with our conclusions and desire such a hearing, please let us know within thirty days so that we may make the necessary arrangements. If you do not desire this hearing, please sign and return two of the enclosed copies of the waiver of board hearing forms. The third copy is for your file. Board hearings are held monthly in Sacramento.

Very truly yours,

John H. Knowles
Associate Tax Counsel

JHK:md

Enclosure

cc: San Jose – District Administrator

Attached are two copies of hearing officer's report dated May 26, 1964, which has been approved. This hearing was held in San Francisco on March 5, 1964.