

STATE OF CALIFORNIA

570.0150

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:)
)
 F--- W. F---) No. SN -- XX XXXXXX-010
)
Petitioner)

The Appeals conference in the above-referenced matter was held by Senior Staff Counsel Stephen A. Ryan on July 6, 1994 in Culver City, California.

Appearing for Petitioner:

Mr. B--- C---
Attorney

Mr. J--- V---
Attorney

Appearing for the
Sales and Use Tax Department:

Mr. Gilbert Smith
Supervising Tax Auditor

Mr. Emmanuel Abaeze
Senior Tax Auditor

Protested Item

The protested tax liability for the period January 1, 1984 through December 30, 1990 is measured by:

<u>Item</u>	<u>State, Local and County</u>
B. Ex-tax price paid to purchase fine art reaudit adjustment	\$21,881,991 (4,996) \$21,876,995

A 10-percent penalty was imposed for the failure to file a use tax return, but the Department now recommends deletion.

Petitioner's Contention

No use tax is due on the cost of those paintings which were purchased on and after February 27, 1987, and placed in the Beverly Hills house/gallery because petitioner was a dealer who purchased art. His use was limited to holding the art for resale in the regular course of art dealership business.

Summary

The Board's Sales and Use Tax Department ("Department") conducted an audit of petitioner starting in January 1991. It was discovered that petitioner had purchased many pieces of fine art from out-of-state sellers without paying sales tax reimbursement or use tax. The Department imposed use tax against petitioner because he used the art in California.

Petitioner was and is an entrepreneur and "investor big time in many investments". He was a shareholder in many corporations. He was actively engaged in business in the entertainment industry. Petitioner is an heir to the --- --- department store fortune in ---. Petitioner's representatives conceded at the Appeals conference that prior to March 1987, petitioner was only a "collector" of paintings, but that he thereafter became an art dealer engaged in the business of buying and selling artwork. The Department contends that petitioner remained merely a collector throughout the audit period without becoming an art dealer who was engaged in business selling paintings.

Petitioner did not possess a seller's permit or any business license regarding purchases and sales of paintings. The paintings in question were allegedly either placed on the walls of petitioner's lavish --- --- home, or in a vault there. The home is and has been a California historical monument. Petitioner purchased it in --- for --- million, and renovated it in such a manner that these classic fine art paintings fit the atmosphere of that home. Petitioner capitalized the art costs, and took depreciation deductions, plus long term capital gains when the art was subsequently sold.

Petitioner also purchased other paintings which were placed in his homes in [1-CA], [2-CA], and [out of state]. No tax was imposed on the cost of the [out of state] paintings. Petitioner does not dispute the tax on the [1-CA] and [2-CA] paintings.

Petitioner's reason for petitioner's alleged March 1987 change in status is that he then began to use art dealer L--- R--- as an agent to purchase and sell paintings. Also, petitioner's representatives alleged that the post-February 1987 paintings acquired by petitioner were mostly of a much higher quality and price. The audit workpapers show, however, that petitioner still purchased many paintings for the same 5-figure prices, but he also made some purchases for prices in the 6 and 7-figure categories. Mr. C--- alleged that petitioner saw an opportunity to make a profit in art which was in line with petitioner's entrepreneurial attitude. Mr. C---

provided a publication from Christie's in London regarding a July 5, 19XX auction of many paintings in petitioner's "collection".

Mr. V--- conceded at the conference that the cost of the paintings located upstairs at the --- --- home in petitioner's personal quarters would be subject to tax. Although he was requested to submit a list of the assets, it was not done.

Messrs. V--- and C--- agreed at the conference that some personal use was made of each painting placed on a wall in the --- --- home, but that it was not all personal use because demonstration and display also occurred.

Petitioner submitted a declaration signed under penalty of perjury dated August 14, 1992 for the purpose of obtaining relief from the penalty for the failure to file use tax returns. His representations included: since 1987, he has been a fine art dealer who made purchases for resale to other dealers, brokers, and traders, for which no taxes were payable. He had always sought a profit from the anticipated resale of the art for the "near-term" and "long-term appreciation potential". He never had a desire to collect or retain any artwork. He had no knowledge of use taxes or seller's permit requirements.

After the conference, petitioner's representatives submitted a statement from a S--- S---, and a declaration signed under penalty of perjury from Mr. R---. Ms. S--- indicated: she had been petitioner's director of taxes from 1987 to 1992. Since petitioner had been subject to federal alternative minimum taxes, the characterization of his artwork sales income had no impact on his ultimate tax liability. Such income was shown as a line item on schedule D of his federal income tax returns.

Mr. R---' 1994 declaration consists of some facts regarding his relationship with petitioner, as well as of Mr. R---' opinions about petitioner based upon Mr. R---' 22 years in the art business. Mr. R--- described his business as a sole proprietor and as a director of C--- F--- A---, Inc. He has been a publisher, agent, distributor, gallery owner, private advisor, consultant, appraiser, and curator. Much of what he indicated concerns pre-February 27, 1987 when petitioner admittedly was not a dealer, or post-December 30, 1990 activities when the Department had already commenced this audit.

As to the relevant period from February 27, 1987 through December 30, 1990, Mr. R--- declared as follows in relevant part:

Petitioner was a dealer buying and selling fine art since sometime in 1987. He had acted as petitioner's exclusive advisor and consultant for a 10 percent commission on each sale which generated at least a 10 percent profit. Petitioner had been in business in this venture exclusively to make a profit by reselling the artwork in a "commercially reasonable period of time" and "the shortest possible period of time". "In the context of the art industry", persons like petitioner who

were regularly engaged in the business typically took a painting "off the market" for a minimum of three to five years to allow it to "mature" and to be "fresh when placed back on the market".

As relevant examples, he used two rather low-priced paintings purchased in November 1988 and sold in June of 1990, as evidence of petitioner's short-term holding period.

He and petitioner had decided to use petitioner's --- --- home as a "gallery-type location" to display and store the artwork. That California Historical Monument home was a perfect gallery for his showing of the art to thousands of other professionals in the industry, private collectors, potential purchasers, and guests who attended petitioner's charitable, political, and social functions there. He had hundreds of telephone conversations for the purpose of selling petitioner's artwork, and had written numerous marketing letters for that purpose. He submitted copies of numerous correspondence dated in the relevant period, but most do not expressly identify petitioner or his paintings. Many were general marketing letters which Mr. R--- had sent to numerous people. One undated letter allegedly sent by Mr. R--- in the spring of 1989 to numerous potential customers lists 13 paintings apparently owned by petitioner, but they had been purchased between 1984 to 1986 and most had been sold in 1988 (as early as March 1988). Mr. R--- identified the consignment of seven paintings to art dealers and galleries in the period from 1987 through 1990.

Board auditors have examined Mr. R---' records. He had collected sales tax reimbursement from petitioner on nine sales of art to petitioner from December 1986 through March 1987, but not on seven sales from April 1987 through November 1988.

Analysis and Conclusions

Absent an exemption, use tax is imposed upon a person when he makes the first storage, use, or other consumption in California of tangible personal property which had been purchased from a retailer for such storage, use, or consumption in this state (Revenue and Taxation Code sections 6201, and 6202). One typical situation when use tax is an issue rather than sales tax is when the purchase occurs outside California as happened here (Rev. & Tax. Code §§ 6051, 6010.5; and Regulation 1620). "Use" is defined to include the exercise of any right or power over the property incident to ownership, except the sale of the property in the regular course of business (Rev. & Tax. Code § 6009). No use tax is incurred when the person acquires the property for the purpose of resale in the regular course of his business and the actual use is limited to retention, demonstration, display, or a reasonable incident of the effort to market the property for purposes of sale (Levine v. State Board of Equalization (1956) 142 Cal.App.2d 760, 766-767; McConville v. State Board of Equalization (1978) 85 Cal.App.3d 156, 160; Hawley v. Johnson (1943) 58 Cal.App.2d 232; and Burroughs Corp. v. State Board of Equalization (1984) 153 Cal.App.3d 1152, 1159, and 1165; Rev. & Tax. Code § 6244(a); and Regulation 1669(a); see also Rev. & Tax. Code §6007, and Regulation 1595(b)(1), last sentence). If and when a person who made a purchase for the purpose of reselling the property in the regular course of

business (such that the seller is not liable for sales tax) then uses the property for other purposes, he or she becomes liable for use tax unless some particular exclusion applies (Rev. & Tax. Code § 6244(a); and Regs. 1668(a)(2) and 1669(a); Levine, supra; Kaiser Steel Corp. v. State Board of Equalization (1979) 24 Cal.3d 188, 192; McConville, supra; and Burroughs, supra.)

Had petitioner truly been an art dealer, he would have been the subject of certain requirements and restrictions. The evidence shows that he acted in ways which were inconsistent with, and contrary to, his alleged art dealer status. These factors do not automatically mean that he was not an art dealer, but tend to show that he was not. He did not obtain a seller's permit which was required to be held by each person engaged in or conducting business as a seller in California (Rev. & Tax. Code § 6066; also see § 6013 which defines a "business" to include any activity engaged in with the object of gain, benefit, or advantage; and § 6014 defining "seller" as every person engaged in business selling certain tangible personal property [which would include paintings]). Petitioner also did not file sales tax returns listing his gross receipts which he would have been required to do as a seller (Rev. & Tax. Code §§ 6452(b), 6453, and 6454). Petitioner apparently did not obtain a local business license for his activities at his --- --- home. He also appears to not have notified the IRS about the details of his art activities. Lastly, he impliedly represented to the IRS that the paintings were not inventory of a business because he declared the paintings to be capital assets for which depreciation deductions and capital gain treatment benefits were taken. Ms. S---'s purported excuses are unacceptable.

The evidence shows that petitioner was a nonseller consumer-investor who used, stored and consumed these paintings as assets rather than as inventory. Petitioner had hoped to make a profit by eventually selling the paintings for prices in excess of his cost. However, his activities strongly show an investor acting in an investment situation rather than as a seller in the regular course of an art dealer's business. Petitioner merely hoped to make a profit from a sale of each painting after that painting had increased/appreciated in value during an interim period when it was not held for sale or in Mr. R---' words -- was "off the market". Petitioner had no desire to immediately resell any painting because he would have incurred either a loss by a sale at or below cost, or a small profit which did not please the investment goals of a person of his stature. Petitioner needed to hold each painting "off the market" rather than as inventory in order to treat it as a depreciable asset and to allow an increase in value prior to eventual sale.

The primary purpose for petitioner's initial storage or wall hanging of each painting at his --- --- home was to retain the painting as an asset for the necessary holding period in order to allow the appreciation in value. That use was not a demonstration or display for purposes of attempting to make an immediate resale. Once a painting was held long enough to appreciate in value sufficient to satisfy petitioner, then an attempt was made to sell it for a long-term capital gain.

An investment use, storage, or consumption is a taxable event subjecting the purchaser/owner to use tax liability. The investor is not marketing or trying to sell the paintings which he just purchased. His concurrent marketing and attempting to sell other asset paintings, which he has since decided to sell after appreciation in value while held off the market, does not render him to be a seller engaged in business selling paintings. Further, petitioner has shown relatively minor marketing attempts to sell his particular paintings prior to January 1991 when the Department began its audit and petitioner thus became aware of the tax consequences of his collector's activities. The major marketing steps which he took thereafter both highlight the earlier minor marketing steps from 1987 through 1990, and that one purpose of the post-December 1990 marketing activities may have been in an attempt to show legitimate business actions.

Although not totally the same factually, this situation is somewhat similar to the retail sales of dairy cows in Kirk v. Johnson (1940) 37 Cal.App.2d 224. The seller made retail sales, rather than sales for resale, of dairy cattle to a dairyman who planned to use the cattle to produce milk for sale during a two-plus year period before selling the cattle for butchering into beef (ibid., pg 228). This was because the primary or chief purpose of the dairyman's purchase was not for resale of cattle, but for an interim taxable use to produce and sell milk for his benefit. Petitioner made a taxable intervening use of each painting while he owned and possessed it, declared it a depreciable asset, took pride in the ownership while showing it to his many guests, took depreciation deductions, and waited for it to appreciate in value before even attempting to sell it.

Recommendation

Redetermine in accordance with the reaudit report dated August 18, 1992, except for the adjustment to allow relief from the penalty as now recommended by the Department.

Stephen A. Ryan, Senior Staff Counsel

Date