STATE OF CALIFORNIA

100.0158

BOARD OF EQUALIZATION

BUSINESS TAXES APPEALS REVIEW SECTION

In the Matter of the Petition for Redetermination Under the Sales and Use Tax Law of:	)	DECISION AND RECOMMENDATION
G--- & A---, Inc.	)	No. SR -- XX-XXXXXX-010
Petitioner	)	

The Appeals conference in the above-referenced matter was held by Paul O. Smith, Staff Counsel on November 28, 19XX, at Van Nuys, California.

Appearing for Petitioner: J--- F---
Attorney At Law

Appearing for the
Sales and Use Tax Department: Ira C. Anderson, CPA
Supervising Tax Auditor

Protested Item

The protested tax liability for the period January 1, 1989 through March 31, 1992, is measured by:

Item	Amount
A. Disallowed claimed exempt sales.	$117,500

Petitioner's Contentions

1. The disallowed claimed exempt sales relate petitioner's ideas and creative process, and are not taxable.

2. The disallowed claimed exempt sales are preliminary art, and are not taxable.

Summary

During the period in issue petitioner G--- & A---, Inc., a corporation, operated a graphic design business that designed packaging for various types of products. By agreement with its clients, petitioner developed and presented the client with a selection of preliminary package design concepts. This development, which consisted of a created package shape and graphic surface (plastic) for the product, was done at petitioner's expense at no cost to the client. Upon acceptance of the design by the client, the client obtained the exclusive right, title and ownership interest in and to the preliminary package design concepts prepared by petitioner. The cost of the preliminary package design concepts were not separately stated in petitioner's invoices.

The Sales and Use Tax Department (hereinafter "Department") examined petitioner's records and determined that petitioner's contracts called for the sale of the preliminary package design concepts prepared by petitioner. On September 30, 1992, the Department issued a Notice of Determination to petitioner, inclusive of a negligence penalty and interest. On October 30, 1992, petitioner submitted a Petition for Redetermination.

Analysis and Conclusions

Sales and Use Tax Regulation 1501 provides in relevant part that "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." An idea may be expressed in the form of tangible personal property and that property may be transferred for a consideration from one person to another. Tax, however, would apply to the sale of artistic expressions in the form of paintings and sculptures even though the work of art may express an original idea. This is because the purchaser desires the tangible object itself; that is, the true object of the contract is the work of art in its physical form. (Cal. Code Regs., tit. 18, reg. 1501.)

Petitioner first argues that the disallowed claimed exempt sales relate its ideas and creative process, and are not taxable. I disagree.

The critical point of inquiry is whether the true object of petitioner's contracts are the preliminary package design concepts, or the performance of design service. Similar to an architect or engineer, petitioner's concepts and ideas were depicted in a created package shape and graphic surface (plastic). Petitioner and its client, however, clearly contemplated that petitioner would transfer title to these design concepts to the client as a representation of petitioner's concepts and ideas.

In Albers v. State Bd. of Equalization (1965) 237 Cal.App.2d 494, the court in distinguishing between the efforts of an architect and a draftsman, treated the latter as a retailer of drawings furnished to customers and the former as a consumer for sales tax purposes. The court reasoned that the sale of the draftsman's drawing of construction plans were taxable because the true object of the transaction was the drawing itself rather than the architectural or engineering services. The regulatory and case authorities stand for the proposition that if the purchaser desires concepts and ideas embodied in the form of tangible personal property, not merely as a means for conveying the concepts and ideas, but rather to use the tangible personal property, the transfer is subject to tax. (See also Culligan Water Conditioning v. State Bd. of Equalization (1976) 17 Cal.3d 86, 96; Simplicity Pattern Co. v. State Bd. of Equalization (1980) 27 Cal.3d 900, 907.)

On February 25, 1969 the Board issued a memorandum opinion in the case of Anthony J. Carsello, an industrial designer. Mr. Carsello was engaged by manufacturers of consumer goods who wished to make their products look "... as if they can perform their intended function better than competitive products ..." retained Carsello to aid in external design and to provide "shelf appeal" for their products. The Board ruled that under (then) Cal. Administrative Code Title 18, Section 1902, "Advertising Agencies, Commercial Artists and Designers", final art is an end item taxable at its selling price. Quoting Albers, supra, the Board stated that the proper construction of Mr. Carsello, and the test of whether an item is taxable, is whether an end item of tangible property is called for in the contract. As applied to Mr. Carsello, the Board found that there was support for the position that the customer was principally interested in the drawing or model. The end item was always called for by the contract, and title to it passed to the customer. After delivery the taxpayer's job was finished, but the drawing or model was used by the manufacturer to aid in the decision to go ahead with the project, and to form the artistic basis for prototypes and production models. The Board found that Mr. Carsello's models were taxable at their full sales price. An unpublished decision of the Court of Appeal upheld the Board's position in Carsello.

From the above, I am guided to the conclusion that in the performance of the contracts in issue, petitioner's primary purpose was to transfer ideas and concepts in the form of tangible personal property for use by its clients. In other words, the client purchased the item for its own use, not merely the design or specifications pictured in the item. (Cf. Albers v. State Bd. of Equalization, supra, 237 Cal.App.2d 494.)

When a transaction is regarded as a sale of tangible personal property, tax applies to the gross receipts from the furnishing thereof, without any deduction on account of the work, labor, skill, thought, time spent, or other expense of producing the property. (See e.g. Rev. & Tax. Code, 6051; Cal. Code Regs., tit. 18, reg. 1540, subd. (c); Simplicity Pattern Co. v. State Bd. of Equalization, supra 27 Cal.3d at 906.) Thus, the Department properly determined that a portion of petitioner's contracts are taxable as tangible personal property measured by the full amount

received by petitioner, without any deduction for amounts paid for any intangible (concept or idea).

Petitioner next argues that the disallowed claimed exempt sales are preliminary art, and are not taxable. I disagree.

Regulation 1540 provides in relevant part that tax does not apply to separate charges for preliminary art as defined in subdivision (b)(4)(A). Subdivision (b)(4)(A) provides that "preliminary art" means roughs, visualizations, layouts and comprehensive, title to which does not pass to the client but is prepared by a designer solely to demonstrate an idea or message for acceptance by the client before a contract is entered into. In addition, the charge for preliminary art must be billed separately to the client, or it must be separately listed on a billing, and it must be clearly identified on the billing as preliminary art.

Here, title to petitioner's preliminary art passed to its clients. Also, there was no separately stated charge for preliminary art on petitioner's billings or as a separate billing to a client. Therefore, I must conclude that the Department properly taxed the preliminary designs sold by petitioner.

At the conference the Department recommended that the negligence penalty assessed should be waived. I concur in this recommendation.

Recommendation

Waive the negligence penalty, and deny the petition in all other respects.

PAUL O. SMITH, Staff Counsel Date