

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION

100.0198

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

The preliminary hearing on the above taxpayer's petition for Redetermination was held on September 21, 1983, in West Los Angeles, California.

Hearing Officer: John B. Adamo  
Appearing for Petitioners: Mr. J--- F---, Partner  
Mr. H--- S. S---  
Attorney at Law  
Appearing for the Board: Mr. Gary Weishaup  
Tax Auditor

Protested Item

The protested tax liability for the period October 1, 1978 through September 30, 1980 is measured by:

<u>Items</u>	<u>State, Local and County</u>
A. Recorded taxable sales not reported	\$ 17,609
B. Fabrication labor claimed as exempt	\$251,087
C. Claimed labor sales disallowed due to lack of supporting documentation	\$ 90,823

Contentions of Petitioner

1. Petitioner's design work constitutes a service performed for its clients and its gross receipts derived therefrom are not subject to tax as its service is not performed in connection with the sale of tangible personal property.

2. Petitioner relied upon advice provided by Board employees in concluding that the subject transactions were not subject to tax.

Summary

Petitioner is a partnership engaged in the graphic design business. It commenced activity in October 1975.

Petitioner claims that audit items B and C relate to its design and consultation services, which it asserts are not performed in connection with the sale of tangible personal property. Petitioner explained at the preliminary hearing conducted on this matter that it produces finished art in the form of paste-ups for its clients. Petitioner then delivers a high quality photograph of the paste-up to a printer selected either by petitioner or the client. In either case, the client deals directly with the printer, and the printer's charges are not reflected on petitioner's invoices. The printer then reproduces the item desired by the clients, e.g., advertisements and annual reports. Petitioner has stated that it retains title to both the paste-ups and high quality photographs, and that these items are not delivered to its clients. During the audit period, petitioner had no title clause dealing with the paste-ups or photographs in its contracts with its clients.

Upon audit, the audit staff concluded that petitioner's design fees and related charges, e.g., delivery and messenger services, were subject to tax as services rendered in connection with the sale of tangible personal property.

At the preliminary hearing, petitioner's representative submitted a number of invoices issued by petitioner during the audit period. One such invoice (#382 to Group 1 Services) stated, in part, as follows:

“Design and Supervision fee (Art to be the property of Group 1 for unlimited use in all media for perpetuity)”	\$1,500.00
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Petitioner had previously indicated to the audit staff that it was not protesting audit item A. At the preliminary hearing, however, petitioner's representative stated that this item was related to audit items B and C and should be adjusted if petitioner's position with respect to the latter two items is found to be correct. Petitioner's representative did not specify the relationship between audit item A and items B and C.

Analysis and Conclusions

Sales and Use Tax Regulation 1540 provides in relevant part as follows:

“Generally [advertising agencies] are sellers of any of the property...which they deliver to, or cause to be delivered to, their clients or to third parties for the benefit of their client. They are also sellers of any property which they retain but title to which they transfer to their client. (subdivision (a)(2).0 (Emphasis added.)

“With respect to billings issued by advertising agencies to clients, some charges may represent the sales price of tangible personal property sold to the client by the agency and compensation for expenses incurred in, and service costs related to, the production of property. Tax applies to the total amount of the retail sale of the property.

\* \* \*

“Tax applies to charges for service rendered that represent services that are part of a sale of the property, or a labor or service cost in the production of the property. Charges for such items as supervision, consultation, research, postage, express, telephone and telegraph messages, and travel expense, if involved in the rendering of such services, are likewise taxable. (Subdivision (b)(1).)

“‘Finished art’ means the final art used for actual reproduction by photo-mechanical or other processes;...” (Subdivision (b)(4)(B).

Leases of tangible personal property are defined as sales by Revenue and Taxation Code Section 6006(g), subject to certain exceptions not relevant here. (See Sections 6006(g)(1-6) and 6006.3.) The principal tax imposed on a lease transaction is a use tax imposed on the lessee; the sales tax is imposed on the lessor when the use tax is not applicable. (Sections 6390 and 6401.) The lessor is required to collect the use tax from the lessee. (Section 6203.)

A “lease” of tangible personal property is defined in Section 6006.3 as including “rental, hire and license.” The statutory definition of “hiring” used in determining what constitutes a lease of tangible personal property is found in Civil Code Section 1925, which provides:

“Hiring is a contract by which one gives to another the temporary possession and use of property, other than money, for reward, and the latter agrees to return the same to the former at a future time.”

Petitioner’s temporary transfer of possession to various printers of the finished art which it produced for its clients constituted taxable “sales” under Section 6006(g), and petitioner was

responsible for collecting use tax from its clients measured by the lease payments, i.e., the consideration its clients paid for petitioner's services in the production of the finished art. The above emphasized portion of Regulation 1540(a)(1) specifically provides that advertising agencies "are sellers of any of the property...they deliver to, or cause to be delivered to,... third parties for the benefit of their client." The third parties in this case were the printers. The benefit derived by petitioner's clients was the completed product produced by the printers; without the finished art fabricated by petitioner, the printers could not have produced the items desired by petitioner's clients.

With respect to those transactions in which petitioner explicitly transferred title to its clients, as in the case of the above referenced invoice for Group 1 Services, petitioner was the retailer of the subject tangible personal property and is liable for sales tax measured by his gross receipts. (Section 6051; Regulation 1540(a)(1).) Our conclusion with regard to audit items B and C obviates the necessity of discussing audit item A.

Petitioner's final argument is that it acted in reliance upon advice given it by unidentified Board employees to the effect that the transactions in issue were not subject to tax. Petitioner has also submitted photocopies of two letters, dated June 27, 1978 and July 7, 1978, which it alleges it sent to the Board's legal staff, and in which it asked about various tax consequences arising out of transactions of the type in issue. These letters also state that petitioner had been told by unidentified Board employees that it was not liable for tax on the subject transactions. A search of Board files has failed to reveal any indication that these letters were received. Petitioner has stated that it never received a response.

Assuming that Board employees gave incorrect information to petitioner, that would not be a basis for relieving petitioner from liability for tax which is properly due. An erroneous interpretation by a Board employee cannot create an exemption not authorized by law. (See Market Street Railway Co. v. State Board of Equalization, 137 Cal.App.2d 87 (1955).) Moreover, estoppel is an equitable remedy and can be exercised only by a court of general jurisdiction possessing equitable powers. The Board is an administrative agency having no equitable powers. (See Standard Oil Company of California v. State Board of Equalization, 6 Cal.2d 557 (1936).) Thus the Board has no power to relieve a taxpayer of a tax liability even if all the elements of equitable estoppel exist.

Recommendation

Redetermine without adjustment.

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John B. Adamo, Hearing Officer

10/11/83  
\_\_\_\_\_  
Date