

M e m o r a n d u m**515.0012**

To: Mr. Ramon Hirsig
Audit Evaluation and Planning

August 14, 1989

From: David H. Levine
Tax Counsel

Subject: --- --- ---
-- -- XX-XXXXXX

This is in response to your memorandum dated July 7, 1989 regarding the application of tax to marketing surveys and analysis provided by ---. The facts set forth below are drawn from several letters written by taxpayer's attorney, [Attorney], and a memorandum from the Van Nuys District Principal Auditor, Jack Infranca

Taxpayer conducts market research for the automotive industry. Some research projects are commissioned by single clients and are referred to as non-syndicated projects. Taxpayer and the audit staff agree that these are non-taxable services. Taxpayer also conducts what it calls syndicated projects. Although taxpayer indicates that these are pursuant to a request by members of the automotive industry to study problems common to all, it appears that taxpayer conducts these projects and then contracts to sell its results along with further consultation to the members of the automotive industry, apparently less than 35 companies. The audit considered the syndicated projects to be taxable because taxpayer does not have written contracts showing that the purchasers commissioned the projects. Mr. Infranca disagrees with this application of tax but is unsure of the proper alternative. The remainder of this opinion relates to the syndicated projects.

After taxpayer conducts the research, it produces an original report which is currently a two-volume set of binders which could be said to contain a voluminous amount of data. Each purchaser is supplied one copy of the report; there is an extra charge for additional copies. Except for the charge for additional copies, the charge to each purchaser is based on market share and other factors. Taxpayer also provides each purchaser with a three-hour presentation. [Attorney] states that these presentations involve numerous hours of preparation and that often when preparing these presentations, taxpayer's analysis yields some important points that are not reflected in the data tables contained in the report. From this statement, we conclude that the presentations generally are merely summaries which highlight the data as it relates to each purchaser. [Attorney] also states that the presentations are followed by many subsequent hours of analysis with each client for their particular situation (June 15, 1989 letter), but in another letter (April 21, 1989) states that follow-up consultations "sometimes" also occur and the purchaser may receive quarterly newsletters which are relevant to the subject of the study.

Discussion

Initially, I will comment on several assertions made by [Attorney]. He states that there will be no revenue change, except for the per-copy charges, if taxpayer failed to provide written reports to its clients because taxpayer's personnel would still need to conduct the same surveys to obtain the raw data necessary to provide its services. However, [Attorney] misses the correct question that he had posed on the previous page of his May 18, 1989 letter, that is, what is the true object of the transaction? If the purchaser's true object of the transaction is to obtain a copy of the report, then taxpayer's revenues would indeed fall significantly. That the charge for additional copies of the report is small compared to the purchase price of the initial report (\$100.00 per copy according to [Attorney]) and \$200.00 to \$450.00 according to two invoices) does not, as asserted by [Attorney] indicate that the value of the tangible property is minor. Analogous is a situation where an initial software disk is provided to a purchaser at a large fee and additional copies are provided at a far smaller price. Unless custom software, all charges are taxable.

[Attorney] refers to Annotations 515.0070 and 515.0075 and states that these most closely approximate the situation involved here. These annotations cover the providing of deposition transcripts pursuant to the provisions of the Code of Civil Procedure. That is, these annotations provide that the charge for the first copy of a deposition transcript, audio tape, or video tape provided to a party to litigation is not subject to sales tax while charges for other copies are subject to sales tax. Since the reports at issue here are not statutorily required in connection with on-going litigation, these annotations are inapposite.

Many of the other statements made by [Attorney] could also be made for other transactions which are clearly sales of tangible personal property. Of course, even if accurate, such statements do not lead to the conclusion that taxpayer's transactions are not sales of tangible personal property. Nothing has been represented to us which indicates that the transactions were severable between sales of the report and the providing of other consultation services. Rather, the consulting services appear to be an inseparable package with the report. The question is, which is incidental to the other?

Based upon the information provide to us at this time, we believe that any consulting services sold along with the report are incidental to the sale of that tangible personal property. As discussed above, it appears that the presentation is primarily a summary of the report as relates to the particular purchaser. The amount of additional consultation services appears to vary according to the purchaser, with some purchasers apparently not receiving (or desiring) additional consultation. Any such services do not seem substantial in relation to the value of the report. In reviewing the report, we believe that it is of significant value to the purchaser. It seems likely that each purchaser would desire to review the analysis as relates not only to itself but also to its competitors. [Attorney] asserts that, for example, --- participates in all of taxpayer's syndicated programs but claims to never open its copies of the reports. Not only does this seem highly doubtful to us, but it is also only one example and we believe that generally purchasers would be very interested in the report itself.

Further support for this view is that taxpayer also sells these reports to magazines. In the memo dated June 14, 1989 from Mr. Infranca, he states that a number of national magazines carrying new-car advertising subscribe to a syndicated project that identifies the particular magazines read by new-car buyers. The magazines use the information developed by this report to negotiate advertising deals with various manufacturers. As with the charges to auto manufacturers, taxpayer's charges to the magazine are also on a sliding scale based on relative position in the industry. An invoice of November 1986 shows a charge of \$9,931 to --- Magazine. Another invoice to --- of May 1987 shows a first-half payment of \$10,418. It appears that taxpayer has made no argument with respect to these reports. From the limited information we have on these reports, it seems unlikely that much consultation is involved. Rather, they appear to be sales of tangible personal property.

We assume that the reports provided to magazines are similar, even if not as extensive, as those provided to auto manufacturers. That more services may be provided as part of the sale of reports to the auto manufacturers does not change the conclusion that the included services are part of that sale.

We note that some purchasers apparently receive quarterly newsletters. If these newsletters qualify as exempt periodicals, then the portion of the purchase price attributable to these newsletters would be excluded from the measure of tax.

In summary, we do not believe that the syndicated research projects qualify as research commissioned by the prospective purchasers. In order to qualify as such, the purchasers would have to enter into a contract with taxpayer commissioning the research before the research was conducted rather than merely purchasing subscriptions, whether before or after the research is conducted. Even if the purchasers contracted in advance to purchase all issues of the report, we would likely regard the transactions as on-going subscriptions and not as contracts to commission specific research. That a magazine hires expensive professionals to produce the magazine (one of [Attorney]'s arguments) and alters the subscription price based on number of subscriptions sold or based on market share does not make sales of the magazines a service. Rather, the sales are of tangible personal property and taxable unless otherwise exempt, even if some services may be included. Based on the information provided to us, we are not convinced that the --- report is incidental to services. Rather, we believe that obtaining the report is the true object of the contract and that any services are incidental to that sale.

If you obtain further information that you wish us to review which helps us understand the true object of the parties' contracts, or if you have further questions, feel free to write again.

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cc: Mr. E. L. Sorensen, Jr.