STATE BOARD OF EQUALIZATION
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July 29, 2004

Mr. S--- A. S---
S--- & A---
XXX --- Boulevard, Suite XXX
--- ---, California XXXXX-XXXX

Re: E--- P---, LLC
SR -- XX-XXXXXX

Dear Mr. S---:

This responds to your May 25, 2004, letter to the Legal Department of the State Board of Equalization regarding the application of California Code of Regulations, title 18, section (Regulation) 1540 to transfers of photographs to advertising agencies by E--- P---, LLC (EP).

You write:

> "[EP] is a commercial photography studio that creates interactive and other advertising photography for use primarily in the automotive industry. EP may sometimes produce advertising photography for use other than in the automotive industry. Advertising agencies and design agencies who act on behalf of third-party automotive manufacturers and other clients contact EP for photography.[1] For ease of reference, as used herein, the 'Agency' will refer to such persons and entities who contact EP for photography. For ease of reference, as used herein, the 'Client' will refer to such persons and entities on whose behalf the Agency acts. The photography is used by the Agency and by the Client to

[1] It is rebuttably presumed that advertising agencies act as purchasing agents for their clients who are the ultimate consumers. (See Cal. Code Regs., tit. 18, § 1540, subd. (c)(1).) Thus, sales to advertising agencies are generally presumed to be retail sales. However, an advertising agency may elect not to be the purchasing agent for its client. If this election is made, the advertising agency will be the retailer of artwork it purchases and then sells to its client. (Cal. Code Regs., tit. 18, § 1540, (c)(2)(A).) If the advertising agency is purchasing property to resell to its client, the advertising agency may purchase this property for resale and provide a resale certificate to the seller. (See Cal. Code Regs., tit. 18, § 1661 [discussing sales for resale and what is needed as proof that the sale was not at retail].) Here, you have not provided me enough information as to whether the advertising agencies at issue are acting as purchasing agents for their client or not. However, for purposes of this discussion, I will assume that the advertising agencies at issue are acting as purchasing agents. Therefore, sales of tangible personal property EP makes to these advertising agencies will be at retail.

advertise and promote the goods, services or ideas of the Client. After the Agency contacts EP with a request for photography EP prepares and submits a written estimate to the Agency. The estimate sets forth the amounts for the anticipated fees, expenses, and charges in connection with the production of the requested photography. For example, a typical estimate includes estimates of amounts for items such as the production crew, insurance, studio and equipment rentals, sets and effects, location, travel, and the creative photography, license or day rate fee or fees. The fee or fees in the estimate include a copyright license for use of the photography by the Client. EP maintains the copyright ownership of all photography created by EP. If the estimate is acceptable to the Agency and to the Client, EP then proceeds with the pre-production and production of the photography. Typically the expenses or a portion thereof are required to be deposited with EP by the Agency in advance of the production.

"During production EP uses digital cameras that are usually tethered to a computer by a wire or cable. EP creates the digital photography and stores it on EP's computer hard drives. In some situations EP may use digital camera hard drives or disk storage devices, standing alone. EP then reviews the electronic photographic imagery that is created and saved in digital form. In some situations EP may then electronically manipulate the digital photographic imagery to more precisely meet the specific needs and requests of the Agency and/or the Client. During production and upon the conclusion of production EP electronically transfers the digital/electronic photographic imagery to the Agency. This is accomplished by a computer hard drive to computer hard drive transfer. The Agency supplies EP with an external computer hard drive. The electronic transfer is usually made at EP's studio or another studio that is being rented for the production. EP attaches a wire or cable from EP's computer hard drive, where the electronic photographic imagery is stored, to the Agency's computer hard drive. EP then electronically transfers the digital photographic imagery to the computer hard drive of the Agency. When the electronic transfer is completed the Agency removes and takes possession of the computer hard drive it supplied. EP does not transfer any tangible personal property containing the electronic photographic imagery, such as CD-ROMs, DVDs, or other electronic media or hard copies, to the Agency or to the Client.

"When the final transfers of the finished electronic photographic imagery are completed the production is completed. EP then issues an invoice to the Agency for the creative, photography, license or day rate fees and the expenses and other charges associated with the production. The invoice specifies the copyright license or use rights of the electronic photographic imagery that may be made by the Client. Again, we note that EP maintains the copyright ownership of the electronic photographic imagery that it creates. The invoice is typically payable in 30 days and is usually paid by the Agency."

Based on the following scenario you ask two questions, which I restate as follows:

1) Whether the transfers of photographs, as you describe in the scenario above, qualify as a nontaxable electronic transfers of artwork?

2) Whether the transfer agreement you have enclosed, if signed contemporaneously with the transfer of the artwork in the manner described in your scenario, creates a presumption that the transfer of artwork is a nontaxable transfer of electronic artwork?

Background

Sales tax is imposed on all retailers, measured by a percentage of gross receipts from their retail sales of tangible personal property in this state, unless the sale is specifically exempt by statute. (Rev. & Tax. Code, § 6051.) Although sales tax is imposed on the retailer, the retailer may collect sales tax reimbursement (usually itemized on the invoice as "sales tax") from the purchaser if the contract of sale so provides. (Civ. Code, § 1656.1.) When sales tax does not apply, use tax applies to the storage, use or other consumption of tangible personal property purchased from any retailer for storage, use or other consumption in this state, measured by a percentage of the sales price, unless that use is specifically exempt by statute. (Rev. & Tax. Code, § 6201.) "Gross receipts" (for purposes of the sales tax) and "sales price" (for purposes of the use tax) generally include all amounts received with respect to the sale or use of tangible personal property, with no deduction for the cost of materials used, labor or service costs, or other expenses of the retailer, unless there is a specific statutory exclusion. (Rev. & Tax. Code, §§ 6011, 6012.)

Analysis

Question 1:

Whether the transfers of photographs, as you describe in the scenario above, qualify as a nontaxable electronic transfers of artwork?

Answer:

Regulation 1540 explains how sales and use tax applies to advertising agencies, commercial artists, and photographers (a copy of Regulation 1540 is enclosed). Specifically, Regulation 1540, subdivision (a)(7) defines "finished art" to include photographic images. Photographs may be transferred by electronic means or in tangible form. If transferred electronically, and no tangible personal property is transferred to the customer, the transfer is not subject to tax. Regulation 1540, Subdivision (b)(2)(B) explains when a transfer of artwork electronically is not considered a transfer in tangible form (i.e., not considered a sale) in pertinent part:

> "A transfer of electronic artwork is not in tangible form if the file containing the electronic artwork is transferred through remote telecommunications (such as by modem or over the Internet), or if the file is loaded into the client's computer by the advertising agency or commercial artist, and the client does not obtain title to or possession of any tangible personal property, such as electronic media or hard copy."

In the scenario you present, the photographs are transferred to an external computer hard drive that the client gives to EP. Once the photographs are transferred onto this external hard drive, the hard drive is returned to the client. An external hard drive is designed to store data and is not a computer. (See e.g., Cal. Code Regs., tit. 18, § 1502, subd. (b)(3) [defining the term "computer" for the purpose of transfers of computer software].) Instead, an external hard drive is a form of storage media. (See e.g., 1502, subd. (b)(13) [defining "storage media" for the purpose of transfers of computer software]; a copy of which is enclosed.) For purposes of Regulation 1540, subdivision (b)(2)(B), a file is considered loaded into the client's computer when a person transfers the file directly into the permanent storage memory of the client's computer. In contrast, a file is not considered loaded into the client's computer, when the file is transferred onto portable storage media designed to be externally attached to or easily removed from a computer. (See Sales and Use Tax Annotations 120.0531 [04/10/97], 120.0661 [07/22/96], and 120.0661.175 [12/02/96]; copies of which are enclosed.)

Here, the computer external hard drive, onto which EP transfers the photographs, is electronic storage media and is not a computer. Thus, the transfer would not be considered an electronic transfer under Regulation 1540, subdivision (b)(2)(B). Instead, EP's transfers of photographs onto storage media would be considered taxable fabrication labor of the storage media. (See Rev. & Tax. Code, § 6006, subd. (b).)

Question 2:

Whether the transfer agreement you have enclosed, if signed contemporaneously with the transfer of the artwork in the manner described in your scenario, creates a presumption that the transfer of artwork is a nontaxable transfer of electronic artwork?

Answer:

I first note that EP has labeled this transfer agreement, "Technology Transfer Agreement." A technology transfer agreement is an agreement in writing that assigns a copyright or patent interest in tangible personal property for the purpose of reproducing or manufacturing it and selling it to sell to others. (See Cal. Code Regs., tit. 18, §§ 1507, subd. (a)(1) [defining "technology transfer agreement"], and 1540 subd. (b)(2)(D) [explaining how the transfer of reproduction rights to artwork under a technology transfer agreement applies to sales by commercial artists].) Here, it does not appear that EP is intending to create a technology transfer agreement. Instead, it appears that EP intends the transfer agreement to be a written statement that the artwork was transferred electronically pursuant to the instructions set forth in

Regulation 1540, subdivision (b)(2)(B). Thus, the label EP is attributing to this statement is incorrect. However, as explained above, EP's transfers of the photographs at issue do not qualify as nontaxable electronic transfers. Accordingly, EP cannot provide its clients an electronic transfer agreement to sign for these transactions. (See Cal. Code Regs., tit. 18, § subd. (b)(2)(B).)

I trust the explanation in this letter sufficiently addresses your concerns.[2] If you need further assistance, please write again.

Sincerely,

Chris A. Schutz
Tax Counsel

CAS/ef

Enclosures: Regulation 1502 [Computers, Programs, and Data Processing]
Regulation 1540 [Advertising Agencies and Commercial Artists]
Annotations 120.0531 [04/10/97], 120.0661 [07/22/96]
and 120.0661.175 [12/02/96]

cc: Torrance District Administrator (AB)
Ms. Laura Baker (MIC: 50)
Mr. Larry Bergkamp (MIC: 44)

[2] I note that Revenue and Taxation Code section 6596 sets forth the circumstances under which a taxpayer may be relieved of liability for taxes when reasonably relying on a written response to a written request for advice. In order for there to be reliance upon the written advice given, the response must erroneously conclude that the transactions at issue were not subject to tax. As explained herein, I have concluded that the transactions at issue are subject to tax. Thus, this letter should be viewed as a general discussion of the application of tax and not as advice that would qualify for relief under Section 6596.