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April 16, 1986

Mr. C--- D---
I--- A--- of
G--- C--- (IAGC)
XXXX XXth Avenue
Suite XXX
---, Colorado XXXXX

Dear Mr. D---:

This is in response to IAGC's letter to Mr. Glenn Bystrom, the Board's Principal Auditor, concerning the application of the Sales and Use Tax Law to certain commissioned geophysical surveys.

The geophysical surveys in question were described in your letter as follows:

"A client needing geophysical information will contact a geophysical service company and contract the company's services. A client most often relies on a geophysical service company to supply information resulting from:

- i. field data acquisition; and/or
- ii. seismic processing.

The client may use the same geophysical service company for both of these services, or may utilize different companies for each. Therefore, an exclusive geophysical contract may include any of the following fact patterns:

Acquisition Only Contract: In consultation with the client, the geophysical company determines the proper methodology and precise location of the seismic survey ("line") that it will perform for the client. The geophysical company then utilizes its own personnel and equipment to gather the geophysical information in the field.

To successfully gather the information, the field crew must make many discretionary professional decisions in the field. These decisions vary from contract to contract but generally include:

- i. determining the proper method to overcome physical sources of impedance to the line, such as rivers, cliffs, roads, or wind. Such barriers can introduce anomalous and ambiguous information into the line; therefore, an incorrect decision in this area reduces the quality of information generated.
- ii. determining the best arrays in order to generate the best information. The layout of a geophysical line entails arranging hundreds of geophones in arrays. Appropriate arrangement of the geophones is essential to generating quality geophysical information. These arrays must vary to take into account the terrain and surface geology of the area.
- iii. making changes in the amount of energy introduced into the earth during the survey such as the number of vibrator sweeps, the number of vibrator units used the number of pounds of explosives, and the depth of the shotholes, among other decisions requiring judgement.
- iv. making other suggestions regarding changes to originally agreed recording parameters in order to minimize problems encountered in the field or maximize good results previously produced.

The information generated in shooting the line is embodied in the form of an obervor's (sic) report, a survey report and magnetic tapes. As noted above, this information is solely the property of the client, and is delivered to him when completed. This group of information can be delivered in pieces, i.e., reports first followed by tapes or vise (sic) versa, but all of the information must be delivered to the client in order for any of the information to be usable; the contractor retains none of it.

Seismic Processing Only Contract: Once the field work has been completed, the information generated in the field must be refined using sophisticated geophysical processing techniques.

After consulting with the client on his geological objectives, the geophysical processor determines an initial geophysical processing sequence. This sequence varies depending on such things as the location of the fieldwork, quality of the data and the geological structures in which the client is interested. This sequence includes a series of steps, the goal of which is to enhance the meaningful information by increasing the ratio of signal to noise in the data. (Signal is the information which is useful in determining the subsurface structure of the earth; noise is unavoidable but useless static which is introduced by the field seismic operation.)

To successfully process a line, the seismic processor must make many discretionary decisions and tests. These decisions vary from line to line but generally include:

- i. testing to determine the velocities that most appropriately reflect the speed at which the signal was reflected through the earth;
- ii. selectively editing the information to enhance the appropriate velocities to improve the signal to noise ration;
- iii. determining appropriate elevation corrections and parameters for surface consistent statics in order to apply the static corrections; and
- iv. utilize special processing analysis and signal processing techniques in an iterative fashion to enhance the signal and further discriminate against noise.

The information delivered to a client consists of a seismic section which contains a reporting of the seismic processing sequence used, a surface elevation map and a representation of the subsurface structure of the earth beneath the place where the line was shot. The original field information received from the client is also returned to the client. The information produced by the seismic processor is solely the property of the client and is delivered to him when completed; the contractor retains none of the information.

Field Acquisition and Seismic Processing Contract: Under this contract, a geophysical service company conducts the field acquisition and seismic processing services for the client on a given line. In this case, the information generated by the company's field crew is sent directly to the geophysical company's seismic processing center. When the seismic processing is completed, the client receives all of the information generated in an acquisition only contract and a seismic processing only contract, as outlined above."

At the outset we note that the conclusions reached below assume that California has jurisdiction for sales and use tax purposes, i.e., either the sales occurred in California or the property in question was used here.

It is our opinion that where there is a single contract commissioning a geophysical survey and the product of the service is delivered to the customer in written report form, the object of the transaction is professional engineering services. The basis for this opinion is that we view charges for design and engineering to be nontaxable services, even though some incidental tangible personal property in the form of a written report, drawing or specification is transferred to the customer. In such cases, the written report merely expresses ideas and information which were produced by the engineering services, the true object of the contract.

Since 1972, it has been the Board's position to regard as a sale of tangible personal property and not a service the transfer of punched cards, tapes, discs, or other machine readable source media on which information or data has been recorded (Reg. 1502, anno. 420.0040). Under such circumstances, the information produced by the service is considered to be integrated into a functionally usable piece of tangible personal property with specific physical properties. Thus, when a survey contract requires only the delivery of a magnetic tape to the customer, the object of the contract is no longer the contractor's engineering ideas, analysis or data interpretation, but instead, the true object is the acquisition of a functionally usable piece of tangible personal property. Therefore, a sale of tangible personal property occurs when the survey contractor transfers data tapes to the customer, regardless of whether the contract is exclusive or nonexclusive, and tax applies to the total charges for the data tapes, notwithstanding the large service element required to gather the data and to fabricate the tapes. However, where an exclusive contract for a custom geophysical survey requires the contractor to furnish the customer both a written interpretive report and magnetic data tapes, nontaxable services are performed. We regard the buyer's primary object in this situation to be the interpretive report and not the magnetic tapes, since the tapes are only used as a medium of transferring engineering information and such use is incidental to the performance of the contractor's service in providing the written report.

Applying the foregoing principles to the "Acquisition Only Contract" in question herein, we are of the opinion that the true object of that contract is the provision of a service, not a sale of tangible personal property. In reaching this conclusion, we note the apparently extensive involvement of licensed professional engineers in the field work which resulted in creation of the "observer's report", "survey report:", and tapes.

Regarding the "Seismic Processing Only" contract, we are likewise persuaded that the true object of the contract is the provision of services rather than a sale of tangible personal property. In our view, this contract calls for the development, through computer manipulations, of original data from raw data furnished by the customer. Such manipulations constitute "processing of customer-furnished information" as defined in Regulation 1502(d)(5), and charges therefore as well as charges for the incidental tangible personal property transferred in connection therewith are not subject to tax.

Finally, with respect to the "Field Acquisition and Seismic Processing Contract", it is our conclusion, again, that the true object of the contract is the provision of services, not the sale of tangible personal property. It follows, neither the gross receipts from nor sales price of these contracts are taxable.

Sincerely,

E. Leslie Sorensen, Jr.
Tax Counsel

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Mr. C--- D---

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April 16, 1986
120.2810

cc: Mr. Joseph A Vinatieri
Mr. Glenn Bystrom