

STATE OF CALIFORNIA

295.0725

BOARD OF EQUALIZATION

BUSINESS TAXES APPEALS REVIEW SECTION

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

The Appeals conference in the above-referenced matter was held by Staff Counsel Elizabeth Abreu on June 2, 1994 in Sacramento, California.

Appearing for Petitioner: A--- G---, President
 A--- S--- T---
 C---

Appearing for the Kevin Hanks
Sales and Use Tax Department: Senior Tax Auditor

Protested Item

The protested tax liability for the period January 1, 1990 through December 31, 1992 is measured by:

<u>Item</u>	<u>State, Local and County</u>
Taxable labor claimed as nontaxable	\$173,405

Petitioner's Contentions

1. Charges for standby and strike labor are nontaxable repair and reconditioning charges.
2. Art direction services are nontaxable services which are not a part of the sale of tangible personal property.
3. Setup charges are nontaxable charges for installation labor.

Summary

Petitioner is a partnership which designs, constructs, and sells or rents sets (scenery) used in filming television commercials. Petitioner constructs only temporary sets. Its specialty is the fronts of buildings. Petitioner constructs each set at its facilities one wall at a time. Because film studio stages are often rented and rent is expensive, it would be too costly to assemble a set for the first time at the studio, only to discover mistakes. Therefore, petitioner assembles the set at its facilities and obtains approval before transporting it to the studio. Petitioner then disassembles the set, transports the set in its own trucks, and reassembles the set at the studio.

Petitioner's charges for some of its sets include charges for setup, standby, and strike labor and for transportation and art direction. Petitioner contends that these charges are separately stated on its invoices and that art direction and setup, strike, and standby labor are optional services.

Setup labor is the labor which reassembles the sets at the studio. Standby labor is labor provided by petitioner's personnel who stand by a set during filming to perform reconditioning, repair, and possibly fabrication labor of the set as needed. It may involve moving a wall or door of the set or making other minor changes. Strike labor is the labor which disassembles the set.

According to petitioner, an art director is responsible for the overall look of a set before the set is built. After it is built, the art director must make sure the set will look good on film and decide what types of props are needed. Finally, an art director watches a monitor while a commercial is being filmed and is responsible for making changes that may be needed. Art directors are paid by the project, not by the hour. In some projects, there may be assistant art directors.

The auditor determined that the labor and art direction are services that are part of the sale of each set and therefore are taxable. Although not entirely clear, it appears that the Sales and Use Tax Department also believes that these services may not be optional. In addition, the auditor determined that the transportation costs are taxable.

At the Appeals conference, petitioner's representative stated that petitioner will probably concede the transportation charges but will dispute the remaining charges. Since we have

heard nothing further from petitioner on the transportation charges, we assume that these charges are not in dispute and therefore we will regard them as taxable.

With respect to the remaining charges, petitioner contends that they are optional, nontaxable services not related to the sale or lease of tangible personal property. In addition, petitioner asserts that setup labor is installation labor because the set must be anchored to prevent it from falling down. Petitioner also argues that when one of the partners is hired as an art director, that partner is hired in that capacity only, i.e., the partner, not the partnership, is hired as an art director. Petitioner admitted, however, that the charges for the art director are included on the same invoice as charges for the set.

Analysis and Conclusion

Revenue and Taxation Code section 6051 imposes a sales tax on all retailers from retail sales in this state of tangible personal property. Sales tax is measured by "gross receipts" which means the total amount of the sale or lease price of the retail sales of retailers and includes charges for services that are a part of the sale of tangible personal property. (Rev. & Tax. Code § 6012(a) and (b)(1).) Gross receipts do not include the price received for labor or services used in installing the property sold. (Rev. & Tax. Code § 6012(c)(3).)

The issue of whether charges for standby and strike labor are taxable was raised in an Appeals conference for another taxpayer. In that case, the Sales and Use Tax Department subsequently agreed that if these services were optional, the services represented mostly repair or reconditioning labor and therefore should not be taxable. Therefore, with respect to these charges, the only issue in the present case is whether the services were optional (nontaxable) or mandatory (taxable). Mandatory services are taxable because they are considered a part of the sale of tangible personal property. (See Sales and Use Tax Annotation 295.1690.)

The auditor scheduled 96 invoices from the audit period with a breakdown of the charges for the different services in issue. Less than 15 percent of the transactions included charges for standby labor and less than a third included charges for strike labor. Since the majority of the transactions did not include these services, we conclude that these services were optional in all transactions. Therefore, charges for standby and strike labor should be excluded from the measure of tax in the audit.

With respect to art direction, the evidence indicates that the partnership, not the partners, was the contracting party since charges for the art director were on the same invoices as the charges for the set. Even if such charges were on a separate invoice, our conclusion that the partnership was the contracting party would remain the same because there is no evidence that each partner ran a separate business with separate books and records for art direction.

With respect to the art direction services provided during the filming of the commercials, we conclude that such services are not part of the sale of the sets. Rather, they are

services related to the filming of the commercials and therefore are nontaxable if optional.¹ Since less than a quarter of the invoices listed in the auditor's schedule included charges for art direction, we also conclude that these charges were optional.

These conclusions, however, do not end our inquiry because art direction also included services relating to the construction of the sets. Charges for designing tangible personal property are subject to tax when the person designing the property also produces it and the design contract is not separable from the contract to produce the tangible personal property. (See paragraph (4) of Sales and Use Tax Annotation 515.0440.) Thus, we recommend that this item be reaudited and that petitioner provide the auditor with documents and other information upon which the auditor can make a reasonable allocation between taxable services performed prior to filming and nontaxable services provided during the filming of the commercial.

The final issue is whether setup charges are taxable. Petitioner contends that such charges are for installation. However, the sets are transported in knockdown condition; thus, most, if not all, of petitioner's charges are for reassembling the sets by putting the parts together. In addition, charges for positioning property in the place desired by the customer, as opposed to actually installing it, do not qualify for the installation exclusion. (See Sales and Use Tax Annotation 295.1680.) It may be that some of these charges were for attaching the sets to the realty through bolts, nails, or other means. However, we believe that this would be a minor portion of such charges. Thus, unless there is another basis for excluding these charges, they remain taxable in full until petitioner presents evidence showing what amount, if any, of the charges are for installation labor.

Sales and Use Tax Annotation 435.0140 provides:

"435.0140 Reassembling Tangible Personal Property That Has Been Previously Assembled. When tangible personal property is manufactured and completely assembled at the retailer's plant, then disassembled for shipment and reassembled at the buyer's place of business, the reassembling constitutes a reconditioning of the property rather than fabrication. Accordingly, separately stated charges for such reassembly are not subject to tax if title to the tangible property passed to the buyer prior to its reassembly and if the buyer was not required to hire the seller to do the reassembly. 11/14/67."

Petitioner has not demonstrated that title passed prior to assembly. California Commercial Code section 2401(1) and (2) provides that unless otherwise explicitly agreed, title passes to the buyer at the time and place at which the seller completes his performance with reference to physical delivery of the goods. If the contract requires delivery at destination, title passes on tender there. California Commercial Code section 2503, which relates to the manner of the seller's tender of

¹ Tax generally does not apply to services provided by directors. See Sales and Use Tax Regulation 1529(a)(4).

delivery, provides that the manner, time, and place for tender are determined by the agreement.

In this case, once the customer made final approval of the set, petitioner was required to make physical delivery to the studio and reassemble the component parts of the set. Because there is no evidence that title was to pass at a prior time, title could only pass once petitioner made physical delivery of the sets. However, because the customer contracted for a reassembled set, reassembly was a necessary condition for petitioner to make proper tender of delivery. Therefore, delivery was not complete simply because the sets were transported to their appropriate destination. It was only after the reassembly at the studio that petitioner completed "tender of delivery" and title was then transferred. For this reason, the reassembly labor is includable in the measure of tax.

Since we conclude that the setup charges are taxable because title passed after reassembly, we do not need to address the optional versus mandatory issue.

Recommendation

Delete standby and strike labor from the audit. Reaudit to determine the proper allocation of taxable and nontaxable art direction services provided by petitioner in accordance with the views expressed herein. Allocate a portion of the setup labor as nontaxable installation labor upon proof by petitioner of the amount of installation labor, if any. Redetermine without further adjustment.

Elizabeth Abreu, Staff Counsel

Date
