



STATE BOARD OF EQUALIZATION

STATE OF CALIFORNIA
BOARD OF EQUALIZATION
APPEALS UNIT

In the Matter of the Petition)	HEARING
for Redetermination Under the)	DECISION AND RECOMMENDATION
Sales and Use Tax Law of:)	
)	
)	
)	
Petitioner)	No. --- --- ---

The above-referenced matter came on regularly for hearing before Hearing Officer H. L. Cohen on November 14, 1989, in Hollywood, California.

Appearing for Petitioner:

Appearing for the Department of Business Taxes:

Hr. J. Cohen
District Principal Auditor
Hollywood District

Hr. J. Sheehy
Supervising Tax
Auditor Hollywood District

Mr. R. Delgado
Tax Auditor
Hollywood District

Protested Items

The protested tax liability for the period January 1, 1985 through December 31, 1987 is measured by:

<u>Item</u>	<u>State, Local, County & LACT</u>
A. Fees claimed as exempt, disallowed	\$106,479
C. Labor charges claimed as exempt, disallowed	<u>60,890</u>
Total	\$167,369

Contentions

Petitioner contends that fees and labor charges are for art direction and set design and are not taxable because they are charges for services.

Summary

Petitioner is the sole proprietor of a business engaged in designing sets used in motion pictures and television commercials. The last prior audit was for the period through September 30, 1983.

Petitioner provides art direction and set design and also subcontracts for the construction of sets. In billing sales tax reimbursement and in reporting sales tax, petitioner deducts separately itemized design fees and labor charges from receipts under contracts with advertising agencies. The set subcontractors bill sales tax reimbursement to petitioner and report their own sales tax. Charges for fees and labor were regarded by the auditor as related to the sale of tangible personal property (the sets) and thus subject to tax. In those cases where no sets were furnished, the charges were regarded as pure service charges and no tax was applied.

Petitioner's description of its activities on a typical job is as follows:

"PHASE I RESEARCH AND DEVELOPEMENT [sic]

"Art director developes [sic] estimated budget based on story boards provided by production company and bids given by subcontractors to fabricate and decorate set. Production company finalizes budget with ad agency and client.

"Art director researches books, magazines, video tapes, etc. for examples of similar settings as are required. He then does rough sketches to communicate his concepts to the director, producer and client who must approve then. [sic]

"Art director then renders final drawings and specifications which, after approval, are used to communicate his ideas to subcontractors. These drawings are retained by the art director, that is title to drawings and/or designs remain with art director.

"Art director determines what other props and decorations will be needed to create his concepts and orders those from outside companies, ie. neon lighting, scenic backdrops, graphics, models, or special effects.

"PHASE II CONSTRUCTION

"Set construction company builds the set on their premises according to the sketches provided by the art director. If necessary the art director will visit the set construction company to communicate ideas on how he wants the set to look.

"Set decorator locates and selects furnishings and props and arranges timely delivery to the stage for proper placement on the set.

"PHASE III PRELIGHT

"Set construction company delivers set to stage and reassembles it, making any modifications as per director.

"Art director works with director to develop [sic] proper lighting, camera angles, [sic] and shooting schedule.

"Set decorator arranges furnishing and props.

"PHASE IV SHOOT

"Art director consults with director and camera man on placement.

"Set construction company provides a small crew on stand by to modify or repair the set during the shoot.

"Set decorator places hand props and needed for each shot.

"PHASE V STRIKE

"Set construction company crew tears down and disposes of the set.

"Set decorator's assistants package and return rented props.

"Art director is usually beginning the next phase of another shoot at this point, since most commercials or packages require several different sets."

Petitioner contends that it provides only services to its customers. These services include acting as the customer's disbursing agent in paying the set construction contractor. What petitioner's customers seek are the art direction service which petitioner provides. Petitioner submitted letters from four customers attesting to this and stating that petitioner does not control the employees of the set contractor. Petitioner cites Business Taxes Law Guide, Annotation 515.0440 (February 27, 1964) as support for treating petitioner's art direction separately from the set construction by the set contractor.

Petitioner also contends that the true object of his contracts is the service; therefore, under Sales and Use Tax Regulation 1501 and General Business Systems, Inc. v. State Board of Equalization, 162 Cal.App.3d 501, tax does not apply to the charges in question here.

Analysis and Conclusions

Section 6051 of the Revenue and Taxation Code imposes the sales tax on retailers based on the gross receipts from the retail sale in this state of tangible personal property. Section 6012 defines "gross receipts" to include charges for services related to the sale of tangible personal property. Petitioner's contracts are for the design and furnishing of sets. There is nothing in the contracts designating petitioner as merely a disbursing agent. Petitioner, not his customers, contracts with the set construction firms. It is immaterial whether petitioner furnishes the sets through his own personal efforts or by subcontracting. The sets are tangible personal property which petitioner sells at retail. Charges for services, such as design, which are related to the sales are a part of gross receipts which are subject to tax.

Sales and Use Tax Regulation 1501 provides that the basic distinction in determining whether a particular transaction involves a sale of tangible personal property or the transfer of such property incidental to the performance of a service is one of the true object of the contract; that is, is the true object of the contract the service per se or the property produced by the service. Here, if the customers wanted only petitioner's design efforts, they could have contracted directly with the set constructors. They did not; they contracted with petitioner for both the designs and the sets. The true objects of the contracts were custom-designed sets.

Annotation 515.0440, which was cited by petitioner supports our view. It specifically deals with a consumer who contracts separately for a design from one person and property fabricated to the design from another person. As we stated above in reaching our conclusion, petitioner, not the customer, contracted with the set builder.

In the General Business Systems case, the customer contracted for the design of a custom computer program, which is an intellectual concept which had to be transferred in some tangible form. The court held that the form in which the program was transferred did not affect the application of tax. The customer wanted the idea, not the punchcards. In petitioner's case, the customer wants the set.

Recommendation

Deny petition.

H. L. Conen,
Hearing Officer
Date 12/13/90