

STATE OF CALIFORNIA
BOARD OF QUALIZATION

435.0584

APPEALS UNIT

In the Matter of the Petition
for Redetermination Under the
Sales and Use Tax Law of:

HEARING
DECISION AND RECOMMENDATION

Petitioner

The above-referenced matter came on regularly for hearing before Hearing Officer ANTHONY I. PICCIANO on November 13, 1989 in Hollywood California.

Appearing for the Petitioner: X-----

Appearing for the
Department of Business Taxes: X-----

X-----

Protested Item

The protested tax liability for the period January 1, 1982 through December 21, 1986 is measured by:

<u>Item</u>	<u>State, Local and County</u>	<u>LACT</u>
A. Underreported Taxable Sales	<u>\$52,050</u>	<u>\$45,873</u>
Totals	\$52,050	\$45,873

A 10 percent penalty has been imposed for failure to file a return.

Petitioner's Contentions

A. The petitioner objects to the imposition of tax on item A claiming that either; (1) he was providing a service which was non-taxable and/or; (2) the sales that he made were sales for resale and/or; (3) his sales were exempt.

The petitioner request relief from the 10 percent failure to file penalty in view of the fact that he thought he was providing a service which was non-taxable.

Summary

The petitioner is a sole proprietor of a business wherein he does production art (Colorway) for fabric designs . He also takes customers' "Colorways" and changes the colors in them to come up with new designs. He entered business in 1982 and applied for a seller's permit on July 31, 1987, wherein he described his business as an "Artist". There have been no prior audits of this petitioner.

The item which remains in dispute is the \$52,050 of taxable measure for unreported taxable sales. This figure was determined by the audit staff by using the petitioner's cash receipts for the period in Question and subtracting from these those sales which the staff auditor was able to determine were either non-taxable or exempt. Additional review of the petitioner's records revealed that he had paid taxes on certain purchases, and he received a credit of \$4898 as credit for said purchases.

The staff was provided with resale certificates by several of the petitioner's customers in 1987 but rejected them for sales made in 1986 in that they were untimely.

The audit staff inquired of the purchasers who issued resale certificates and found that the artwork sold by petitioner was consumed in the production of fabric and not resold.

The petitioner had been represented by X----- during the period of the audit, but she was not present at the hearing due to her illness. X----- had requested time to send out XYZ letters early on in the audit, and apparently did so. The petitioner indicated that he did not receive any responses to the XYZ letters, but that he was able to collect tax reimbursement on some of his sales. He paid over the money collected to the Board. He expressed concern over having received credit for tax payments made, and at his request a print-out was prepared at the hearing which indicates that he had received all credits due to him.

The petitioner's contention as to the protested items are: (1) that the sales represented by the \$52,050 were either sales which were sales for resale and are non-taxable, or (2) are payments for a service and are non-taxable, or (3) they are sales to overseas purchasers and are exempt.

X----- indicated that he does various types of art work which he sells to his customers. In some instances he provides the materials and does the work on his premises, or he might provide the materials and do the artwork on his customers premises, and lastly there are instances where the customer provides the materials and X----- does the work on the customers premises. X-----'s dealings are with "converters" which is the entity that arranges for fabric to be made, or with the

actual manufacturers, or with an agent which may be a converter for overseas manufacturers which is most often the case.

X----- felt that he was providing a non-taxable service when he produced the artwork. On that basis he did not apply for a seller's permit when he went into business. The petitioner stated that when he changed colors on a customer's "Colorway" at their place of business that was in fact an act of repair or maintenance and was therefore non-taxable. X----- indicated that prior to the audit he never collected tax from any customers. However, when he became aware of his potential tax liability, he contacted customers and he was able to find some customers who were willing to reimburse him for sales tax. He found in many instances his customers are no longer in business and as to them, he would have to bear the burden of paying taxes on those sales. X----- brought in a listing of businesses which are no longer operating. This listing indicates the amount of sales to these businesses totals \$17,950. (See Exhibit A.) He was asked if he had any documentation which would support his contention that the sales were either non-taxable or exempt from tax. He responded that he had none. X----- indicated it was common for artwork to be passed along from one party to the next and paid for on each transfer. However, for the most part, he did not know what happened to his work after he sold it. The petitioner had no documentation to support that proposition.

Analysis and Conclusion

X-----'s testimony was believable; however, documents to support his position as to the sales comprising the taxable measure were non-existent. Therefore, the outcome of this case rests for the most part with the information contained in the Board's files and audit working papers.

Revenue and Taxation Code section 6006 defines a sale to mean and include the following:

- “ (a) Any transfer of title or possession exchange, or barter, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration...
- (b) The producing, fabricating, processing, printing, or imprinting of tangible personal property for a consideration for consumers who furnish either directly or indirectly the materials used in the producing, fabricating, processing, printing, or imprinting...
- (f) A transfer for a consideration of the title or possession of tangible personal property which has been produced, fabricated, or printed to the special order of the customer, or of any publication...”

Sales and Use Tax Regulation 1526 interprets the code section above cited and provides that tax applies to fabrication which results in a new product and relieves tax liability for operations which qualify as repair or reconditioning of a product.

Sales and Use Tax Annotation 100.0080 provides that the furnishing of drawings or mock-ups to clients as tangible evidence of a design or an idea constitute taxable transfer of tangible personal property. Further, Sales and Use Tax Regulation 1525 establishes that “tax applies to the sale of tangible personal property to persons who purchase it for the purpose of use in manufacturing, producing or processing tangible personal property and not for the purpose of physically incorporating it into the manufactured article to be sold.”

The facts as they have been presented are that the petitioner produces designs either at his own place of business or at his customers place of business. The materials for the creation of those designs can either be provided by X-----, or by his customers. The design is consumed in the process of production of the fabric, but it is not incorporated into the fabric. The code section and regulation above cited provides that the fabrication of a design when said design is transferred in the form of tangible personal property is a taxable sale. When X----- is hired by a customer to change the color of a design “Colorway” on the premises of his customers, he is in fact producing a new design and therefore any change made by X----- is a taxable fabrication sale and not an exempt repair. X-----’s designs are taxable as provided in the authorities cited under which his product is by definition a manufacturing aid.

X-----’s lack of documentary support as to his sales for resale leave him in an untenable position. Every seller shall have such records, receipts, invoices, and other pertinent papers in such form as the Board may require. (Revenue and Taxation Code section 7053.) “The burden of proving that a sale of tangible personal property is not at retail is upon the seller unless the seller timely takes a certificate from the purchaser that the property is purchased for resale.” (Emphasis added.) (Sales and Use Tax Regulation 1668 (a) (1).) When a determination for tax has been issued by the Board, the taxpayer must not only prove the determination is incorrect, but also must produce evidence from which a new and better determination can be made. (See Paine v State Board of Equalization (1982) 137 Cal.App.3d 438.) In addition, taxpayer's general statements are insufficient, and are not substitutes for the required documentation. (See People v Schwartz (1947) 31 CA1.2d 59.)

X----- had the duty to maintain adequate records and has the burden of proving that sales alleged by him to be sales for resale were in fact sales for resale or were exempt sales (Sales and Use Tax Regulation 1698; Revenue and Taxation Code section 6091). He has not met that burden of proof. Exemption from taxes are to be strictly construed against the taxpayer. (See Good Humor Co. v State Board of Equalization (1957) 152 Cal.App.2d 873, 879.) In light of the lack of documentary support for X-----’s position, we cannot recommend an adjustment for any of the sales included in the measure of tax which he claimed as exempt. In addition, the fact that many of the purchasers of X-----’s products are no longer available or have refused to respond to his request for XYZ responses does not relieve X----- of his tax obligation.

Section 6592 of the Revenue and Taxation Code provides that the Board may grant relief from the penalty for failure to file a return if the failure was due to reasonable cause and occur red notwithstanding the exercise of ordinary care and the absence of willful neglect. A person seeking relief from the penalty must file with the Board a statement signed under penalty of perjury setting forth the facts upon which the claim for relief is based. We have examined the statement submitted by the petitioner (see Exhibit 8) and believe it is sufficient to recommend to the Board that relief from the penalty be granted.

Recommendation

Delete the ten percent penalty for failure to file a return. Redetermine without adjustment to the tax.

ANTHONY I. PICCIANO, HEARING OFFICER

1/31/90