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August 22, 1994

**REDACTED TEXT**

This is in reply to your June 28, 1994 letter regarding the application of sales tax to charges to create trial exhibits. You provided the following facts:

“Our client is engaged in the business of creating demonstrative exhibits for attorneys to use in trial presentation. The services provided by our client are the production of videos, computer animation, charts and illustrations, scanning and coding documents and other visual aids onto a laser disk for access and display during the trial. It should be noted that these exhibits are produced for a single use in a specific case.

“The work is billed based on the time spent by video producers, artists, art directors, graphic consultants and project managers, in producing the exhibits. Charges are also billed for expenses related to the project. These charges include materials incorporated into the exhibits as well as other expenses such as mileage, transportation, charges for copies, and meals.”

Given this information, you ask whether we believe that your client provides a nontaxable service pursuant to Sales and Use Tax Regulation 1501, Service Enterprises Generally.

No, although your client probably expends significant labor to create the exhibits, we believe that under the test provided in Regulation 1501, the true object of the contract between your client and its customer is the tangible personal property the client transfers to its customer.

The sales tax is imposed upon all retailers at the applicable rate of the gross receipts of the retailer from the sale of all tangible personal property sold at retail in this state. (Rev. & Tax. Code § 6051.) The law defines “gross receipts” to mean the total amount of the sale price of the retail sales of retailers, without any deduction on account of the cost of the property sold, the cost of the materials used, labor or service cost, or any other expense. (Rev. & Tax. Code § 6012.) Therefore, all expenses your client incurs in producing the tangible personal property such as expenses for mileage, transportation, copies, and meals, are includible in the gross receipts of your client’s sale.

You note your client pays sales tax reimbursement on its purchase of all materials your client uses in performing its work. Sales tax properly applies to sales to your client of tangible personal property the client uses or otherwise consumes in producing the tangible personal property your client sells. Tax does not apply to sales of tangible personal property to your client when your client either sells that very same tangible personal property to its customer prior to use or physically incorporates that tangible personal property into the tangible personal property your client sells to its customer.

For example, let us assume your client contracts to furnish its customer with a poster size photograph of a building for \$60. Your client purchases a 5" x 7" picture of the building for \$10. Your client contracts with a photography laboratory to make the poster size print, and the laboratory charges your client \$15.

Under those facts, the sale of the 5" x 7" picture to your client is a retail sale, and sales tax applies to the \$10 charge. Your client would use the photograph as a manufacturing aid to produce the poster. As explained in Sales and Use Tax Regulation 1540, Advertising Agencies, Commercial Artists and Designers, at subdivision (e), "A photograph, for example, does not become an ingredient or component part of property sold merely because the image of the photograph is reproduced as part of the property sold. A photograph or art is regarded as having been used when a reproduction is made from the photograph or art." See also Business Taxes Law Guide Annotations 385.0400 and 385.0420. Your client may issue a resale certificate to the photography laboratory to purchase the larger print extax, because the larger print is the very same tangible personal property the client provides to its customer. If the laboratory were to charge sales tax reimbursement to your client, your client would be eligible to take a "tax paid purchase resold deduction" in accordance with Sales and Use Tax Regulation 1701, "Tax-Paid Purchases Resold." Under these facts, sales tax applies to your client's entire \$60 charge for the poster with no deduction for the cost of the 5" x 7" picture, the charge by the photography laboratory, nor any other expenses.

We hope this answers your questions; however, if you need further information, feel free to write again.

Very truly yours,

Ronald L. Dick  
Senior Tax Counsel

RLD:plh

cc: Out-of-State Chicago Area Office - OHA