

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION  
APPEALS UNIT

In the Matter of the Petition for	)	HEARING
Redetermination Under the Sales	)	DECISION AND RECOMMENDATION
and Use Tax Law of:	)	
	)	
	)	
REDACTED TEXT	)	REDACTED TEXT

The above-referenced matter came on regularly for hearing before Hearing Officer W. E. Burkett on August 15, 1990, in Oakland, California.

Appearing for Petitioner: REDACTED TEXT

Appearing for the	Mr. Orval D. Millette
Department of Business Taxes:	District Principal Auditor
	Mr. Gerald R. Hill
	Senior Tax Auditor

Protested Item

The protested tax liability for the period January 1, 1983 through December 31, 1986 is measured by:

<u>Item</u>	<u>State, Local and County</u>
Purchases subject to use tax.	REDACTED TEXT

Contention of Petitioner

The measure of tax deficiency includes certain purchases of exempt intangible services.

Summary

The petitioner is a wholly own subsidiary corporation of the REDACTED TEXT. It is engaged in REDACTED TEXT. A prior audit of petitioner was conducted through December 31, 1979.

The tax deficiency is measured by audited purchases subject to use tax of REDACTED TEXT computed on the basis of a test period and projection. Petitioner has objected to the inclusion of two purchases in the test year 1986. These purchases in the combined amount of \$10,800 account for approximately \$27,000 of the measure of tax deficiency when projected for the entire audit period.

The first purchase of nine (9) Landsat images were acquired from the REDACTED TEXT for the sum of \$10,000. A copy of the sales invoice for the subject purchase is included in the audit report. This purchase is described and identified in the taxpayer's petition as follows:

“Satellite Images; Use Tax. Included in the measure of REDACTED TEXT use tax determination was the purchase of satellite images known as ‘REDACTED TEXT Landsat Images’ of Somalia from REDACTED TEXT. These images were based on Landsat images that REDACTED TEXT obtained from the U.S. Government in a digitized format on magnetic computer tape. REDACTED TEXT then manipulated the information by computer according to REDACTED TEXT specifications. This computer imaging process was used not simply to reproduce a Landsat image but rather to alter it in a manner that would emphasize information of interest to REDACTED TEXT. For example, computer imaging was used to compress or expand certain portions of the Landsat image, thereby manipulating the spatial relationships between the objects represented. The end product was not a conventional photograph, which results when a film emulsion is exposed to light rays or particles, but rather a computer graphic based upon digital information created by a satellite system. The information and services purchased by REDACTED TEXT are intangible property and services not subject to sales or use tax.”

As explained at the Appeals Hearing, REDACTED TEXT obtains the images from the U.S. Government in a digitized format on magnetic computer tape. REDACTED TEXT then reproduced from the tape a regular visual image of the earth's surface. Using computer imaging it then “enhanced” certain portions of the image to produce an image that was more useful to study to determine if the area has potential for REDACTED TEXT.

It was noted that the original collection of the earth satellite image is performed by a new light reflection process developed by a major government contractor. It is not a conventional photography process.

The second protested transaction consists of a radar mosaic acquired from REDACTED TEXT for the sum of \$800. A copy of the invoice for this purchase is also included in the audit report. The taxpayer's petition describes this protested item as follows:

“Radar Mosaic; Use Tax. Included in the measure of REDACTED TEXT use tax determination was the purchase from REDACTED TEXT of radar mosaic of the Libreville region of Gabon. These images were the result of a radar survey similar to that described above. For the same reasons, the information and services purchased by REDACTED TEXT are intangible property and services not subject to sales tax.”

This enhanced map was purchased from REDACTED TEXT who obtained the radar images prior to the order from petitioner. The procedure is described in a memorandum prepared by Geologist REDACTED TEXT dated November 23, 1988 as follows:

“RADAR IMAGES

Radar images are also improved when enhanced or mosaicked. REDACTED TEXT has proprietary radar data sets with REDACTED TEXT. Two of these sets are wholly owned by REDACTED TEXT does customer radar printing and mosaicking of individual flight strips. Their mosaics are of a higher precision than Landsat mosaics and they take a month to construct. For their services and enhancement of basic radar products (digitally plotted film positives), REDACTED TEXT receives the best possible customized product. It costs several thousands of dollars for their custom processing, dodging, printing, and mosaicking of radar films. These products are not available off-the-shelf. We are paying for these services with Service Orders.”

The petitioner has also provided a detailed description of the radar image process provided by REDACTED TEXT. It has also provided a detailed outline of the earth satellite landsat imagery process. This evidence, marked as Appeals Hearing Exhibit A, has been made a part of the petition file.

The Department of Business Taxes (DBT) has applied the tax on the basis that the purchases were of tangible personal property citing annotated letter ruling No. 420.0040. Relying on this same ruling petitioner contends that the purchases are for intangible services. This is based in part upon the claim that highly sophisticated and skilled services are required to produce the visual images.

Analysis & Conclusions

The general issue presented by this petition is whether the true object of these contracts was to obtain the services of the vendors per se or the product of those services for use by petitioner in the form of tangible personal property. (See Sales and Use Tax Regulation 1501; also see Albers v. State Board of Equalization, 237 Cal.App.2d 494.)

The petitioner and REDACTED TEXT had each made reference to annotated letter ruling No. 420.0040. This is an application of the true object test which distinguishes between aerial surveys and engineering services required to produce a precise engineering photomap (an exempt service) and the services required to produce aerial photographs and certain reproduction thereof including mosaics (a production of tangible property). In the first instance the purchaser seeks to obtain precise engineering services embodied in a map, and in the latter instance the purchaser seeks to obtain a visual representation of a certain area rather than precise engineering data. A copy of annotated letter ruling No. 420.0040 is attached hereto and incorporated herein by reference.

It is our conclusion that in each instance the true object sought by the petitioner herein was not precise engineering data produced by the vendor under this contract but rather the

enhanced visual representation in order that it could be utilized by the geologist to discover certain physical characteristics which could point to the existence of REDACTED TEXT.

It is undoubtedly true that the production of the visual representations require skilled services beyond that required to produce a photograph. However, it seems clear that the petitioner (and its geologist) did not merely desire to acquire the services per se for use. What was desired was the product of those services, the enhanced visual images for the purpose of visual inspection and review. Since the end product was physically useful to the purchaser, it was properly classified as a purchase of tangible personal property. (See Simplicity Pattern Co. Inc. v. State Board of Equalization, 27 Cal.3d 900.)

The fact that the production of images required predominantly skilled services does not provide any basis for classification of the contract as one for intangible service. This very issue was considered and rejected by our District Court of Appeals in People v. Grazer, 138 Cal.App.2d 274 in the following terms:

“To be sure, the raw materials consumed in producing that which he ordered may have cost the laboratory only a very small part of the charge made. The expense of the producer of the picture is almost entirely the cost of the skilled services of the radiologist and the technicians and the use of equipment which is generally quite costly. But the price charged for all taxable transfers is more often than not largely a charge for services rendered in connection with the tangible object transferred.”

#### Recommendation

It is recommended that the taxes be redetermined without adjustment.

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W. E. BURKETT, HEARING OFFICER

9-17-90  
DATE

W/Attachment

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION  
APPEALS UNIT

In the Matter of the Petition for	)	HEARING
Redetermination Under the Sales	)	DECISION AND RECOMMENDATION
and Use Tax Law of:	)	
	)	No. <u>REDACTED TEXT</u>
	)	
REDACTED TEXT	)	

The above-referenced matter came on regularly for hearing before Hearing Officer W. E. Burkett on August 15, 1990, in Oakland, California.

Appearing for Petitioner: REDACTED TEXT

Appearing for the  
Department of Business Taxes: REDACTED TEXT

Protested Item

The protested tax liability for the period January 1, 1980 through December 31, 1986 is measured by:

<u>Item</u>	<u>State, Local and County</u>
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A. Taxable sales to related companies. REDACTED TEXT

Contention of Petitioner

A portion of the measure of tax for this item consists of sales of services and intangible property not subject to the sales or use tax.

Summary

The petitioner is a wholly owned subsidiary corporation of the REDACTED TEXT. It is engaged in oil exploration. A prior audit has not been conducted of this permitted account.

The protested item is a part of a measure of tax deficiency computed for taxable sales to related companies based upon a projection of measure of tax deficiency computed for a test of six months in 1984 and six months in 1986. The petitioner protests the application of the sales tax to a single purchase of \$2,016 included in the test period which accounts for approximately

\$5,040 of the taxable measure. The transaction consists of radar image enhancements acquired from REDACTED TEXT and resold to a related company. The taxpayer's petition letter describes this purchase as follows:

"Radar Images; Sales Tax. Included in the measure of REDACTED TEXT sales tax determination was the purchase of second 'photographic enlargements' of a region of REDACTED TEXT from REDACTED TEXT. However, the images REDACTED TEXT purchased were not conventional aerial photographs. Prior to the 1985 merger of REDACTED TEXT and REDACTED TEXT contracted REDACTED TEXT to perform a radar survey of REDACTED TEXT. The radar survey was performed by air. REDACTED TEXT used radar emitting and receiving equipment to transmit radar signals from an airplane to the ground and then recapture those signals as they were reflected off the earth's surface. The radar information obtained is the property of REDACTED TEXT.

"The 'photographic enlargements' purchased from REDACTED TEXT were developed from the radar information obtained from the survey. REDACTED TEXT converted the radar information into visual representations using computer-assisted imaging processes. These enlargements were called 'photographic' on the invoice because the information was presented in a visual manner, but they were not the product of 'usual photographic processes' described in Cal. Anno. 420.0040. What REDACTED TEXT purchased were services and intangible property: the radar survey information digitized by computer and reformatted for visual representation. The sale of these services and intangible property is not subject to sales or use tax."

The petitioner has also presented a paper which describes the radar image collection process in detail. It has been marked as Appeals Exhibit A and made a part of the petition file.

The Department of Business Taxes representative argues that the taxes are applied because the petitioner sought to obtain property and not merely services.

#### Analysis & Conclusions

It is our conclusion that the visual radar image enhancements were properly classified as a sale of property rather than intangible services. The basis for our conclusion is the analysis set forth in the companion decision prepared by the separate use tax deficiency determined under Account No. REDACTED TEXT. It is incorporated herein by reference.

#### Recommendation

It is recommended that the taxes be redetermined without adjustment.

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W. E. BURKETT, HEARING OFFICER

9-18-90  
DATE