STATE BOARD OF EQUALIZATION

April 16, 1970

Mr. K--- L. S---
XXX --- Circle
---, CA XXXXX

SR -- XX XXXXXX

Dear Mr. S---:

Reference is made to the November 20, 1969, hearing concerning your petition for Redetermination dated August 13, 1969, with respect to tax and interest assessed for the audit period January 1, 1966, to December 31, 1968. As a result of the audit, it was determined that the taxable measure was understated in the amount of $195,355. Your petition questions the inclusion of portions of that amount in the taxable measure.

At the hearing, you advised that you are engaged in the business of designing, constructing, and installing exhibits for C--- - E---, county fairs, and various shows. Initially, you develop ideas for exhibits and then prepare preliminary designs to display these ideas. The preliminary designs are then presented to prospective clients, and when a person engages you to construct and install an exhibit as depicted in one of your preliminary designs, an appropriate lease agreement is executed. Your receipts from designing, constructing and installing exhibits during the audit period were considered to be taxable rental receipts under the law, and were included in the taxable measure. It is your position that receipts from the following aspects of your business are not taxable rental receipts and are improperly included in the taxable measure.

1. Design fees. Preliminary lay-outs, specifications, designs and/or scale models (designs) for proposed exhibits were prepared and submitted to and accepted by clients before lease agreements were executed. In most instances, designing was not included in the lease agreements, and charges therefore were billed separately prior to the execution of the lease agreements. Where designing was included in lease agreements, it was defined as such and charges therefore were separately stated. You assert that you are a commercial artist and designer for purposes of sales and use tax ruling 2, that your designs are "preliminary art" as defined in ruling 2(e), and that tax does not apply to your charges for designs since the charges were either billed separately or were separately stated.

As defined in ruling 2(e), "preliminary art" means roughs, visualizations, comprehensives and layouts prepared for acceptance by clients before a contract is entered into or approval is given for finished art. "Finished art" means the final art used for actual reproduction by photomechanical or other processes. Under the ruling, your designs were not "preliminary art" because they were not prepared preliminarily to "finished art" as defined therein, but were prepared preliminarily to your construction and installation of exhibits. Thus, your charges therefor were not exempt from tax pursuant to ruling 2(e).

Sales tax is imposed upon gross receipts from retail sales of tangible personal property, including labor and other costs of producing the property sold and all services that are part of the sale. Thus, amounts charged for labor, designing, engineering, etc., whether as a part of a quoted price or separately, constitute gross receipts and must be included in the measure of tax. If, however, before there is a contract to produce tangible personal property, drawings, visualizations, etc., are made to display ideas or for other purposes, charges for such drawings, visualizations, etc., are not taxable if title thereto is not transferred. Upon the subsequent execution of a separate contract for the production of finished property, tax applies to the gross receipts received therefrom, but not to the charges for the drawings, visualizations, etc., performed under an entirely separate agreement. (Cal. Tax Serv. Ann. 1746.40.)

Applying the principles of this annotation, your charges for designs which were prepared and submitted to and accepted by clients before lease agreements were executed are not taxable where title to the designs was not transferred to your clients. Thus, in those instances where designing was not included in the lease agreements and charges therefore were billed separately prior to the execution of the lease agreements, we are requesting our district office to delete those charges from the taxable measure upon reaudit where title to the designs was not transferred to your clients. In those instances where designing was included in the lease agreements, was defined as such, and charges therefore were separately stated, we are requesting our district office to delete those charges from the taxable measure upon reaudit where the charges were for designs which were prepared and submitted to and accepted by clients before lease agreements were executed and where title to the designs was not transferred to your clients.

2. Installation charges. Charges were made for installing exhibits and were separately stated in the lease agreements and/or billings. You assert that tax does not apply to these charges under section 6011(c).

It is true that under section 6011(c), "sales price" does not include amounts charged for labor or services rendered in installing leased property. However, under section 6011(b), "sales price" includes amounts charged for labor or services rendered in fabricating leased property. At the hearing, it was ascertained that both installation and fabrication labor were necessary at the time exhibits were installed, but the relative amounts of each were not determined. We are requesting our district office to meet with you to determine those respective amounts. Thereafter, our district office will delete the amounts charged for installation labor from the taxable measure upon reaudit.

It was also ascertained that in some lease agreements, amounts charged for installation and fabrication labor were combined with amounts for transportation or maintenance services. In those cases, we are requesting our district office to determine and deduct the amounts of the transportation or maintenance charges from total amounts prior to determining the respective amounts charged for installation and fabrication labor. The amounts charged for installation labor will then similarly be deleted from the taxable measure.

3. Transportation costs. Charges were made for transporting exhibits to other cities, and were separately stated and charged for in the lease agreements and/or billings. You assert that tax does not apply to these charges under section 6011(g).

Under section 6011(c), "sales price" includes the cost of transportation of property, except as excluded by section 6011(g). That section provides that "sales price" does not include separately stated, reasonable charges for transportation from the retailer's place of business or other point from which shipment is made directly to the purchaser, provided, that if the transportation is by facilities of the retailer, or the property is sold for a delivered price, the exclusion is applicable solely with respect to transportation which occurs after the purchase of the property is made. Ruling 58, copy enclosed, interprets these provisions of section 6011.

The application of tax with respect to separately stated transportation charges for leased property is the same as in the case of sales, and the provisions of ruling 58 apply. Thus, where lease agreements state the terms of the leases, and the transportation occurs during these terms, the transportation occurs after the sales for purposes of ruling 58, and tax does not apply to separately stated, reasonable transportation charges from the retailer's place of business or other point from which shipment is made directly to places specified by the purchasers. Accordingly, separately stated charges for transporting exhibits from C--- - E--- to county fairs pursuant to lease agreements which required you to construct and install those exhibits at dual locations were charges for transportation occurring during the terms of those lease agreements, and after the sales for purposes of ruling 58. Upon confirmation that those charges were reasonable, we are requesting our district office to delete those charges from the taxable measure upon reaudit.

With regard to the separately stated charges for return transportation of property furnished by lessees under these lease agreements, we are requesting our district office to delete those charges from the taxable measure upon reaudit also. That property was the property of your lessees at all times and was not part of the property you were obligated to provide under the lease agreements. As those charges were unrelated to your leases of exhibits, they are not taxable as part of the "sales price" as defined in section 6011.

With regard to the remaining separately state charges for transporting exhibits, we are requesting our district office to determine the taxability of those charges upon reaudit pursuant to the applicable provisions of ruling 58. Those charges which are not taxable thereunder will also be deleted from the taxable measure.

4. Maintenance charges. Due to the length of the 1958 C--- - E---, you agreed to supply janitorial services for some of your lessees as a convenience to them. Charges for such services were referred to as maintenance charges in the lease agreements and/or billings. You assert that since your lessees were not obligated to contract for these services, tax does not apply to these charges.

In view of the fact that you contracted to maintain some of the C--- - E--- exhibits (B---- C---, F--- C---, M--- C---) but not others (A--- C---), we have concluded that your services in this regard were available to your lessees at their option. Thus, we agree that tax does not apply to those charges. To the extent that such charges were included in the taxable measure, we are requesting our district office to delete them upon reaudit.

5. Prize monies. Included in some lease agreements was a provision assigning any prize monies received by your lessees for their exhibits to you as a "bonus" consideration. As participation awards rather than prize monies were given to your lessees for their exhibits at the 1968 C--- - E---, some of those lease agreements similarly included a provision assigning the participation award to you. You assert that these assignments constituted assignments of intangible bonuses which were in addition to the definite prices for your services, and that any consideration received by you in the form of prize monies or participation awards was thus separate from and did not affect the agreed prices for your services.

As the lease agreements provided that any prize monies or participation awards paid to you were additional consideration for your services in connection with the exhibits, we would regard any prize monies or participation awards received by you as receipts from your leases of the exhibits. Pursuant to section 6011, "sales price" means the total amount for which property is leased, and such receipts were part of those total amounts for which your exhibits were leased. The fact that any realization of such amounts was contingent upon subsequent events does not compel a different conclusion.

Other prize monies were received by you for exhibits which you entered in shows on your own initiative, without any lease agreements or consideration from other persons. You assert that tax does not apply to these prize monies.

We agree that tax does not apply to prize monies awarded to you under these circumstances. To the extent that such prize monies were included in the taxable measure, we are requesting our district office to delete them upon reaudit.

6. Miscellaneous items:

1966

A. Repairs, including installation of translites furnished by K--- C--- and painting, to the C---'s existing case display at the Capitol.

As this was a repair operation, we are requesting our district office to determine the taxability of this item pursuant to ruling 26, (now regulation 1546).

B. Sale of exhibit to the United States Bureau of R---.

This item has already been deleted from the taxable measure as an exempt sale to the United States.

C. July 15, 1965, contract with the O--- Chamber of Commerce for A--- C--- exhibit shown at the 1966 --- County Fair.

As this contract was entered into prior to August 1, 1965, the date the new lease became operative, and is exempt from that law under the "Grandfathers Clause," we are requesting our district office to determine the taxability of the contract by applying the lease law as it existed prior to August 1, 1965.

1967

A. Services, refurbishing (cleaning and painting) and changing translites for K--- C---'s case display at the Capitol.

We are requesting our district office to determine the taxability of this item pursuant to ruling 26 (see 6-1966-A, supra).

B. Judging fee received from D--- C--- Fair.

We are requesting our district office to delete this item, receipts for services, from the taxable measure.

C. Services, refurbishing existing décor and display structures in International Bazaar area for 1967 California State Fair.

We are requesting our district office to determine the taxability of this item pursuant to ruling 26. As a result of the hearing, it appeared that the work performed by you under this

contract was in the nature of a repair operation rather than the fabrication of new exhibits. However, the value of the parts and materials used therein was not established at that time.

D. Services, refurbishing existing hanging flower displays on Front Mall, California State Fair.

We are also requesting our district office to determine the taxability of this item pursuant to ruling 26 (see 6-1967-C, supra).

1968

A. Construction of permanent storage room in rear of A--- C--- exhibit space at C--- - E---.

We are requesting our district office to review the agreement relating to the construction of this room and to ascertain the degree of its permanence. A retailer who constructs temporary fair exhibits is required to pay tax on his gross receipts therefrom, without deduction for charges for construction and assembly. (Ann. Nos. 1255,47 and 1273.60.) If it is concluded that this room was a temporary construction, the sales price will remain in the taxable measure. If it is concluded that this room was a permanent construction, however, a construction attached to and now a part of the building, the sales price will not be included in the taxable measure since the room would be an improvement to realty. In this case, you will be regarded as the consumer of materials used in constructing the room.

B. Maintenance (janitorial) services for exhibit not constructed or installed by you.

As these services were not connected with your leases of exhibits, we are requesting our district office to delete this item from the taxable measure.

C. Services in C--- Building, N--- O--- Show, cleaning building and cleaning beams.

This item consists of that portion of receipts received from a N--- O--- Show agreement which you attributed to charges for cleaning glass, changing lights, etc. We are requesting our district office to review this agreement with you. If these services were available at the lessee's option, to the extent that it can be ascertained that this portion of those receipts was attributable to such cleaning, we are requesting our district office to delete the appropriate amount from the taxable measure.

In conclusion, we are recommending that a reaudit be conducted as hereinabove set forth. Thereafter, if you are in agreement with the results thereof, the matter will be presented to the board for final action. If you are not in agreement with the results thereof, you may again avail yourself of the board's hearing procedure if you so desire.

We are enclosing herewith the copies of the lease agreements and billings which you submitted for our review.

Very truly yours,

J. Kenneth McManigal
Tax Counsel

JKM:smb
Enclosures

bc: --- – District Admin.

Attached are two copies of hearing report dated 4-10-70, which have been approved, also attached are the work papers.