



STATE BOARD OF EQUALIZATION

(916) 327-3400

September 1, 1989

Dear Ms. ---:

I am writing in response to your June 14, 1989 request for a legal opinion regarding the applicability of California Sales and Use Tax Law to certain television commercial encoding and monitoring services developed by ---, a newly formed Delaware corporation.

Facts

You have described the facts as follows.

"--- has been organized to enable television advertisers to more accurately and efficiently determine whether television commercials they have purchased have been broadcast at the time and in the form and market agreed to under contract. To this end, --- has obtained from the Federal Communication Commission an exclusive right to use one line of the 525 that appear on a television screen, and it has developed a device that encodes on this line a signature which is unique to each commercial. (This line appears above the visible portion of the screen.) An independent party has been contracted to do the actual encoding on the master copy of the commercial, using ---'s equipment, at a cost to the company of \$35.00 per commercial."

"--- has also developed a device that can monitor all television broadcasts in a given market and record exactly what commercials have been broadcast, the time they were broadcast and the audio and visual quality of the commercial. Once set up, these monitoring devices operate automatically, without an operator on the premises. A central computer will be used to coordinate the information captured by these monitoring devices. ----- will earn its revenues by charging its customers a fee for the monitoring of the commercials."

Once a commercial has been encoded, --- is able to monitor its broadcasts, e.g., audio and visual quality. The monitoring devices operate automatically without an operator on the premises after they are set up. A central computer coordinates the information captured by the monitoring devices. ---'s customers pay a fee for the monitoring of their commercials.

You ask whether sales tax is applicable to the \$35.00 charge to --- for encoding the signature or to ---'s fee for monitoring commercials. You have proposed the following "ruling" as to these questions:

"The sales of encoding and monitoring services are transactions the object of which is to obtain a personal service and which do not involve a sale of tangible personal property. The encoding does not constitute a fabrication within the meaning of the California sales and use tax law. Therefore, neither the encoding nor the monitoring is subject to sales tax."

Analysis

California Sales and Use Tax Law imposes a sales tax on retailers for the privilege of selling tangible personal property at retail. (Rev. & Tax. Code § 6051.) Although the legal obligation to pay sales tax is on the retailer, Civil Code Section 1656.1 provides that the retailer may seek sales tax reimbursement from the purchaser. The use tax is imposed upon the storage, use or other consumption in this state of tangible personal property purchased from any retailer. (Rev. & Tax. Code § 6201.) The legal obligation to pay use tax is on the purchaser rather than the retailer. However, the retailer is required to collect and remit the use tax provided that the retailer is engaged in business in this state. (Rev. & Tax. Code § 6203.)

The encoding procedure which you describe constitutes fabrication labor which is generally a sale (Rev. & Tax. Code § 6005 (b)). However, recent legislation provides significant sales and use tax exclusions for the motion picture industry. Specifically, Revenue and Taxation Code Section 6010.6 provides that "sale" and "purchase" do not include "the performance of any qualified production services in connection with the production of all or any part of any qualified motion picture." The definition of a qualified motion picture includes film or video tapes of television commercials. (Rev. & Tax. Code § 6010.6(b)(3).) "Qualified production services" is defined as "any fabrication performed by any person in any capacity (whether as an employee, agent, independent contractor, or otherwise) on film, tape, or other audio-visual embodiment in connection with the production of all or any part of any qualified motion picture ... " We are of the opinion that the \$35.00 for encoding is excluded from the definition of sale and purchase under Revenue and Taxation Code Section 60 10.6 (enclosed). This conclusion is consistent with your proposed ruling.

As for the monitoring service, your letter states that "--- makes no sales of tangible personal property, but in conjunction with its sale of monitoring services, it must individualize its customer's commercial by encoding a unique line of information on each commercial." "Tangible personal property" is defined as "personal property which may be seen, weighed, measured, felt, or touched, which is in any other manner perceptible to the senses. (Rev. & Tax. Code § 6016.) If there is no transfer of tangible personal property, then there is no "sale" for sales and use tax purposes and no tax is owing on the transaction.

Your letter makes no mention of how or whether --- communicates the results of its monitoring to its customers. However, in a telephone conversation with --- project manager ---, I was informed that --- will issue reports to customers either in the form of a computer printout or in the form of a data file transmitted over a communication line between computers.

The reports which are issued in the form of computer printouts fall within the definition of tangible personal property, However, --- is not considered to be a retailer of the reports if the

transfer of the reports to ---' s customers is merely incidental to the service provided by --- in monitoring he commercials. (Sales and Use Tax Reg. 1501, enclosed.)

Regulation 1501 discusses the distinction between a sale and a service as follows:

"The basic distinction in determining whether a particular transaction involves a sale of tangible personal property or the transfer of tangible personal property incidental to the performance of a service is one of the true object of the contract; that is, is the real object sought by the buyer the service per se or the property produced by the service. If the true object of the contract is the service per se, the transaction is not subject to tax even though some tangible personal property is transferred. "

Under the facts as you have presented them, the true object of ---'s contracts with its customers is the rendering of a service. ---' s production and transfer of a report to its customers is incidental to its rendering of a television commercial monitoring service. Thus, ---' s charge for the monitoring service is not subject to tax even though some tangible personal property is transferred to ---'s customers. This conclusion is consistent with your proposed ruling.

The reports which are issued by means of a data file electronically transmitted between computers do not fall within the definition of "tangible personal property." As such, fees charged in conjunction with the transmission of these reports are not subject to tax. This conclusion is consistent with your proposed ruling.

Please be aware that if --- transfers information to its customers by means of a computer tape or diskette, the transaction would be a taxable sale of tangible personal property. I would advise you to request another opinion from this office if --- transfers information to its clients in a form other than by written report or electronic transmittal.

Your letter requests a hearing if our ruling is contrary to your proposed ruling. I assume that you are not requesting a hearing since our conclusions are consistent with your proposed ruling. In any event, the Board grants hearings only on Petitions for Redetermination or on Claims for Refund.

I hope the above is helpful to you in clarifying the tax obligations of --- under California's Sales and Use Tax Law.

Yours truly,

Stella C. Levy
Tax Counsel

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Enclosure