

STATE OF CALIFORNIA
BOARD OF EQUALIZATION
BUSINESS TAXES APPEALS REVIEW SECTION

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

The Appeals conference in the above-referenced matter was held by Staff Counsel Michele F. Hicks on January 5, 1994 in San Diego, California.

Appearing for Petitioner: REDACTED TEXT
Attorney

REDACTED TEXT

Appearing for the
Sales and Use Tax Department: Mr. Phillip K. Klepin
District Principal Auditor

Ms. Patricia A. Hoggard
Senior Tax Auditor

Protested Item

The protested tax liability for the period January 1, 1982 through March 31, 1985 is measured by:

<u>Item</u>	<u>State, Local and County</u>
A. Taxable sales of artwork photographs not reported.	\$861,296

A 10 percent penalty has been added for failure to file returns.

Petitioner's Contentions

1. Petitioner was acting as the agent of REDACTED TEXT, when he purchased the artwork and photographs.
2. Petitioner developed and transferred an original manuscript to REDACTED TEXT which is exempt under Sales and Use Tax Regulation 1501.

Summary

During the audit period, petitioner was a writer of educational periodicals. In 1980, petitioner formed REDACTED TEXT (hereafter REDACTED TEXT), a limited partnership as a vehicle to publish REDACTED TEXT a series of educational periodicals about the characteristics and habitats of wildlife. Each REDACTED TEXT consists of a text written by petitioner, accompanied by artwork and photographs which illustrate the text.

As a result of disputes which arose between petitioner and the other partners, petitioner and the other partners decided to modify their arrangement. On May 1, 1981, the parties entered into an "Agreement Between Author and Publisher" (hereafter "Author Agreement") and a "License Agreement".

Pursuant to the Author Agreement, petitioner withdrew as a partner in REDACTED TEXT and agreed to "create and produce" REDACTED TEXT exclusively for publication by REDACTED TEXT. "Create and produced was defined as the "compilation and coordination of research, information, original artwork, photographs, and mechanical art necessary for the production of the subject books and shall not include color separations, stripping, or printing." (Paragraph 1). Petitioner had complete control over artistic design and content of all the books. (Paragraph 4). Petitioner was the original owner of copyrights on all the books. (Paragraph 5.)

Paragraph 6 of the Author's Agreement provided that as part of the acquisition of the license in the copyrights, REDACTED TEXT would pay all expenses of creation and production included by petitioner in connection with each book up to a specified budgeted amount. Funds were to be advanced to petitioner 30 percent upon assignment of a book topic, 50 percent 60 days after assignment, 20 percent upon delivery. All funds advanced by REDACTED TEXT which were not used for publication of the book for which they were advanced were to be returned to REDACTED TEXT. If funds advanced were inadequate to complete the book, REDACTED TEXT was to advance additional funds as necessary up to 25 percent of the budgeted amount. REDACTED TEXT as to be repaid all over-budget advances by deducting that amount from petitioner's royalties. With these funds, petitioner was to hire artists and make purchases as necessary. Petitioner was to provide REDACTED TEXT with copies of invoices and evidence of payment.

Paragraph 5 of the Author's Agreement states that REDACTED TEXT shall own all original artwork and photography commissioned by petitioner for the books. The purchase orders used by petitioner to purchase art state that petitioner is acting as an agent

for REDACTED TEXT. They state further that REDACTED TEXT retains ownership of all right, title, and interest in all artwork for which a full fee is paid, including copyright and all reproduction rights".

Paragraph 7 of the Author's Agreement provides that REDACTED TEXT will pay petitioner 10% of the gross receipts from the sale of the books, or five cents for each copy sold, whichever is greater, for the right to reproduce the books.

The License Agreement grants REDACTED TEXT an exclusive license to publish and distribute the individual publications in the series.

During the audit period, REDACTED TEXT published 32 REDACTED TEXT. The audit staff determined that artboards that petitioner delivered to REDACTED TEXT during this period were sales of tangible personal property. The audit staff contends that petitioner performed substantially the same functions as advertising agencies, commercial artists, and designers as discussed in Sales and Use Tax Regulation 1540. The staff determined that the purchase price of the art boards were petitioner's entire gross receipts from the sale of his books, i.e., all of his royalties.

Petitioner responds that Regulation 1540 is not applicable to petitioner because he is not an advertising agency¹. He is an author. Further, petitioner contends that the artboards he delivered were not fully complete and ready for use. He never assembled any artwork into a form that could be printed or published without substantial modifications and additions. Petitioner merely prepared designs of each page of text to suggest to REDACTED TEXT how the artwork should be reduced or increased in size to fit in a particular place on a page. REDACTED TEXT did the sizing, color separating and stripping of all artwork to make it useable. REDACTED TEXT was solely responsible for making the film and printing pages necessary to turn the work into publishable products. Finally, the artwork was purchased by REDACTED TEXT directly from the artists and illustrators and was not acquired from petitioner. Petitioner never owned or sold any of the artwork.

Analysis & Conclusions

Only the gross receipts from the sale of tangible personal property are subject to sales tax. (Revenue and Taxation Code Sections 6006(a) and 6051.) The sale of intangible property is not subject to sales tax.

¹ The audit staff states that Regulation 1543, "Publishers", is more applicable to petitioner's situation than Regulation 1540. Regulation 1543 was not enacted until July 31, 1990, after the April 30, 1990 Notice of Determination was issued. However, under Revenue and Taxation Code Section 7051, all regulations are applicable to past transactions, unless the Board elects to adopt the regulation "without retroactive effect". No such election was made with respect to Regulation 1543. Therefore it is applicable to this transaction.

Further, Sales and Use Tax Regulation 1501 provides that personal property incidental to performance of a service is not taxable. The Regulation states in part:

"... an idea may be expressed in the form of tangible personal property and that property may be transferred for a consideration from one person to another; however, the person transferring the property may still be regarded as the consumer of the property. Thus, the transfer to a publisher of an original manuscript by the author thereof for the purpose of publication is not subject to taxation."

The transfers of artwork to REDACTED TEXT are the transactions that triggered the audit staff's determination. Fundamental to this determination is a finding that there were sales of artwork by petitioner to REDACTED TEXT. The facts in this appeal do not support such a finding.

An agent is one who represents another, called the principal, in dealings with third persons. (Civil Code, Section 2295.) The facts in this appeal show that petitioner purchased the artwork as an agent for REDACTED TEXT. REDACTED TEXT paid for the artwork. The purchase orders specifically state that petitioner is purchasing the art as an agent for REDACTED TEXT and that REDACTED TEXT has ownership of all right, title, and interest in the artwork. Further, paragraph 5 of the Author's Agreement states that REDACTED TEXT shall own all original artwork and photography commissioned by petitioner for REDACTED TEXT. Petitioner never owned the artwork. He purchased it on behalf of REDACTED TEXT who owned it from the inception of its purchase from the artists.

The audit staff argues that the Author's Agreement states that all artists, designers, assistants, and others who may work for or with petitioner are his employees. Sales and Use Tax Regulation 1540 (a) (2) (B) states that a seller is not an agent for clients with respect to the acquisition of materials incorporated into items of tangible personal property prepared by its employees.

Petitioner responds that this provision was included merely to protect petitioner's copyright. Under copyright law, copyrightable materials produced by an employee may be considered to be owned by the employer.

Paragraph 5 contains the provision relied on by the staff. It states:

"5. REDACTED TEXT shall be the original owner of copyrights on all books created and produced by him, REDACTED TEXT shall not be considered an employee or subcontractor of REDACTED TEXT for purposes of determining ownership or publications. All artists, designers, assistants, and others who may work for or with REDACTED TEXT creating and producing the books which are the subject of this agreement (whether such people are legally employees, subcontractors, independent contractors, full-time, or part-time) shall be considered "Employees" of REDACTED

TEXT for purposes of this agreement regardless of who pays their fees or salaries or where their work is performed " (Emphasis added.)

This paragraph shows that an arbitrary designation of "Employees" was made regardless of actual status. The defined term and its inclusion in the paragraph dealing with copyrights, support petitioner's contention that its purpose was to protect petitioner's copyright.

As stated above, the audit staff relies on Sales and Use Tax Regulation 1540 (a) (2) (B) pertaining to tangible personal property produced by the employees of advertising agencies. We find Sales and Use Tax Regulation 1543, "Publishers", to be more applicable to the facts in this case.

Regulation 1543 (a) (1) defines an "Author" as follows: "Author means and includes any person who creates an original manuscript for the purpose of publication". Regulation 1543 (b) (1) provides:

" (A) The transfer to a publisher or an original manuscript, whether on paper or in machine-readable form, by the author or authors thereof for the purpose of publication is not subject to taxation. The transfer of any paper, tape diskette or other tangible personal property transferred as a means or expressing an idea is not taxable. However, tax applies to the sale of mere copies of an author's work.

"(B) Tax applies to charges for transfers of photographs and illustrations, whether or not the photographs or illustrations are copyrighted. Transfers of photographs or illustrations illustrating text written by the photographer or illustrator are not taxable when they are merely incidental to the editorial matter."

We conclude that the only property petitioner sold to REDACTED TEXT was his manuscripts, exempt under Regulations 1501 and 1543(b) (1), and the exclusive license to publish them, exempt as intangible personal property. The so-called artboards petitioner transferred were incidental to the sale of his manuscripts. They were not camera ready art. The Author's Agreement expressly provided that any mechanical art delivered by petitioner would not include color separations, stripping, or printing. The evidence shows that petitioner merely transferred a depiction of how he wanted his manuscript and the accompanying artwork already purchased by REDACTED TEXT directly from the artists, laid out. We conclude that no portion of petitioner's transactions with REDACTED TEXT is taxable.

Recommendation

We recommend that the determination be canceled.

Michele F. Hicks, Staff Counsel

7/12/94
DATE