OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18012066
	) CDTFA Account No. 102-294990
EDIK PARIA	) CDTFA Case ID 856320
	)
	)
	)

OPINION

Representing the Parties:

For Appellant:	Raman Zoobalan, Representative Edik Paria
For Respondent:	Chad Bacchus, Tax Counsel III Stephen Smith, Tax Counsel IV Lisa Renati, Hearing Representative
For Office of Tax Appeals:	Deborah Cumins, Business Tax Specialist III

S. BROWN, Administrative Law Judge: Pursuant to Revenue and Taxation Code (R&TC) section 6561, appellant appeals a decision issued by the respondent California Department of Tax and Fee Administration (CDTFA) in response to appellant's timely petition for redetermination of a Notice of Determination (NOD) for $58,533.30 of additional tax, a negligence penalty of $5,853.36, and applicable interest, for the period July 1, 2005, through June 30, 2013.[1] In its subsequent decision, CDTFA reduced the tax liability from $58,533.30 to $42,239.21, deleted the negligence penalty, and denied the remainder of the petitioned amount.

Office of Tax Appeals Administrative Law Judges Suzanne B. Brown, Jeffrey G. Angeja, and Andrew J. Kwee held an oral hearing for this matter in Cerritos, California, on December 18, 2019. At the conclusion of the hearing, the record was closed and this matter was submitted for decision.

[1] In his June 18, 2018 reply to CDTFA's response brief and in other letters, appellant raises issues related to an NOD issued September 8, 2014, for $10,540 in tax, plus interest and penalties, which has since gone final. As relevant here, only the NOD dated December 10, 2014, is at issue in this appeal. Therefore, we do not address appellant's contentions pertaining to the September 8, 2014 NOD.

ISSUE

Whether adjustments are warranted to the amount of disallowed claimed nontaxable labor.

FACTUAL FINDINGS

1. Appellant is a photographer and videographer who operated as a sole proprietor through April 16, 2016,[2] when he incorporated the business. Appellant originally operated without a seller's permit.
2. In October 2012, in accordance with its Statewide Outreach and Compliance Program, CDTFA visited appellant's business and determined that he was required to have a seller's permit.
3. On October 3, 2012, CDTFA issued a seller's permit to appellant with an effective start date of October 1, 2004.[3]
4. In March and August 2013, appellant filed sales and use tax returns (SUTRs) for fiscal years July 1, 2005, through June 30, 2013, on which he reported total sales of $477,268 and claimed deductions for nontaxable labor of the same amount, reporting no taxable sales.
5. CDTFA reviewed appellant's contracts with customers and determined that the contracts showed that appellant transferred tangible personal property (TPP) to clients. CDTFA also sent requests for information (on forms titled "Notice To Furnish Information") to the customers whose names and addresses could be identified. The majority of the requests for information were returned as undeliverable, but the forms that were returned all indicated that the clients had received tangible TPP[4] along with the services.

[2] Appellant closed his seller's permit on September 12, 2016, with an effective close-out date of April 16, 2016.

[3] CDTFA used a start date of October 1, 2004, because it was eight years prior to the creation date of the permit, and there is an eight-year statute of limitations for issuing an NOD in cases for which the taxpayer has not filed a return. (R&TC, § 6487(b).)

[4] The Notices to Furnish Information forms asked the customer to check one or more boxes to indicate whether: (1) appellant provided the services as well as photographs with DVD, photo albums, or frames; (2) appellant did provide services, but the customer provided his or her own DVD/flash drive; or (3) the customer did not make the purchase.

6. At appellant's request, a second round of letters was sent to his customers. CDTFA received seven responses that all indicated the customers received only services, with no transfer of TPP. However, one of those clients contacted CDTFA to say that she had been persuaded by appellant to say no TPP had been received when in fact she had received TPP. Also, CDTFA noted that three of the seven customers who responded in this second round of requests that they had not received TPP had responded differently when the initial requests were sent out. For these reasons, CDTFA found these seven responses unreliable and disregarded them.
7. CDTFA also determined that invoices established that on December 15, 2011, and December 26, 2012, appellant made bulk purchases of DVD case holders and sleeves for DVDs.[5] CDTFA regarded those purchases as further evidence that appellant was transferring photographs and videos on TPP.
8. CDTFA also found reviews on appellant's own website and on a third-party website wherein customers described how appellant provided them with TPP, such as DVDs and photo albums, as part of his sales of photographs and videos.
9. On December 10, 2014, CDTFA issued to appellant an NOD for tax of $58,533.30, and a negligence penalty of $5,853.56.
10. Appellant filed a timely petition for redetermination on December 23, 2014, asserting that, at some point during 2010, he stopped making any sales of TPP because he created a new website from which clients downloaded all photographs and videos. The petition stated in part: "Customer provides CD or DVD and taxpayer shoots over 200 pictures during the event and provides the customer with CD copy."
11. During the appeals process, CDTFA reviewed the matter and recommended that the disallowed amount be reduced to the total amount of claimed nontaxable labor for the audit period, $477,268, and that the negligence penalty be deleted. On March 29, 2016,

[5] Appellant purchased 200 DVDs and 100 DVD cases on December 15, 2011, and purchased 200 "Black Full Sleeve Double DVD C" on December 26, 2012.

CDTFA issued a Report of Field Audit – Reaudit, which reflected tax of $42,239.21, based on the calculation of an understatement of $477,268.[6]

12. Thereafter, CDTFA issued a Decision and Supplemental Decision concluding that the available evidence did not support appellant's assertion that he did not make sales of TPP. Both the Decision and Supplemental Decision deleted the negligence penalty, reduced the understatement of reported taxable sales to $477,268, and otherwise denied the petition for redetermination.

13. This timely appeal followed.

DISCUSSION

California imposes a sales tax on a retailer's retail sales in this state of TPP, measured by the retailer's gross receipts, unless the sale is specifically exempt or excluded from taxation by statute. (R&TC, § 6051.) All of a retailer's gross receipts are presumed subject to tax, unless the retailer can prove otherwise. (R&TC, § 6091.) "Gross receipts" are the total amount of the sale price without any deduction for labor, service cost or other expense, and include any services that are part of the sale. (R&TC, § 6012(a)(2), (b)(1).) Generally, the total amount for which property is sold includes any services that are part of the sale. (R&TC, § 6011(b)(1).) A "sale" is the transfer of title or possession of TPP for consideration, and means and includes a transfer for consideration of the title or possession of TPP that has been produced, fabricated, or printed to the special order of a customer. (R&TC, § 6006(a)-(f).)

A taxpayer bears the burden of proving entitlement to an exemption or exclusion and must provide some credible evidence of that entitlement. (*Paine v. State Bd. of Equalization* (1982) 137 Cal.App.3d 438, 443; *Honeywell, Inc. v. State Bd. of Equalization* (1982) 128 Cal.App.3d 739, 744.) The applicable burden of proof is by a preponderance of the evidence. (Evid. Code, § 115; *Appeal of Estate of Gillespie,* 2018-OTA-052P, at p. 4.) That is, a party must establish by documentation or other evidence that the circumstances it asserts are more likely than not to be correct. (*Concrete Pipe and Products of California, Inc. v. Construction Laborers Pension Trust for Southern California* (1993) 508 U.S. 602, 622.)

[6] The Report of Field Audit – Reaudit also recommended imposing a failure-to-file penalty of $3,448.42 (for the fiscal years ending June 30, 2006, through June 30, 2012). However, thereafter CDTFA concluded that the failure-to-file penalty was not applicable because appellant had filed returns for each fiscal year in the audit period; accordingly, on March 21, 2017, CDTFA deleted the failure-to-file penalty. Hence, this penalty was not included in appellant's liability, and thus is not at issue here.

As relevant here, tax applies to sales of photographs and photocopies, whether or not produced to the special order of the customer. (Cal. Code Regs., tit. 18, § 1528(a).) Also, the transfer of title, for a consideration, of TPP, including property on which or into which information has been recorded or incorporated, is a sale subject to tax. (Cal. Code Regs., tit. 18, § 1502(c)(1).) In addition, charges for producing, fabricating, processing, printing, imprinting or otherwise physically altering or modifying consumer-furnished TPP (cards, tapes, disks, etc.), including charges for recording or otherwise incorporating information on or into such TPP, are generally subject to tax. (Cal. Code Regs., tit. 18, § 1502(c)(2).)

However, the providing of a service that is not part of a purchase of TPP is not subject to tax. (Cal. Code Regs., tit. 18, § 1501.) In such a case, the person rendering the service is the consumer, not the retailer, of any TPP that the person uses incidentally in rendering the service. (*Ibid.*) The basic distinction in determining whether a particular transaction involves a purchase of TPP, or the transfer of TPP 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 of the service per se or the property produced by the service. (*Ibid.*) If the true object of the contract is the service per se, the transaction is not subject to tax even though some TPP is transferred. (*Ibid.*) For example, a firm which performs business advisory, record keeping, payroll and tax services for small businesses and furnishes forms, binders, and other property to its clients as an incident to the rendition of its services is the consumer and not the retailer of such TPP. (*Ibid*.) The true object of the contract between the firm and its client is the performance of a service and not the furnishing of TPP. (*Ibid*.)

Thus, the transfer of a photograph through a remote electronic wire service is not a transfer of TPP, and the charges for such service are nontaxable. (See, e.g., Business Taxes Law Guide annotation 420.0170 (11/26/91).)[7] On the other hand, when a transaction is regarded as a sale of TPP, tax applies to the gross receipts from the furnishing thereof, without any deduction on account of the work, labor, skill, thought, time spent, or other expense of producing the property. (Cal. Code Regs., tit. 18, § 1501; see also *Culligan Water Conditioning v. State Bd. Of Equalization* (1976) 17 Cal.3d 86, 96.)

[7] CDTFA's annotations do not have the force or effect of law. (See *Yamaha Corp. v. State Bd. of Equalization* (1998) 19 Cal. 4th 1, 25 [discussing the proper weight to give an annotation].)

Appellant filed SUTRs for the audit period, on an annual basis, for fiscal years ending June 30, 2005, through June 30, 2013. On those returns, appellant reported total sales of $477,268 and claimed the entire amount as nontaxable labor. CDTFA accepted appellant's reported total sales of $477,268 for the audit period, but concluded that appellant was selling photographs and videos in tangible form (i.e., as tangible photographs or on DVDs) and disallowed the entire amount of claimed nontaxable labor of $477,268. Thus, appellant has the burden of supporting his claimed exclusion for nontaxable labor.

Appellant testified that beginning in 2010, he used a website from which customers downloaded all photographs and videos, and thereafter his sales did not involve the transfer of TPP. Appellant argues that the true object of his contracts was the service of photographing and taking videos of events and that any transfer of TPP was incidental. However, this position is contradicted by extensive evidence (including appellant's contracts with his customers and appellant's own testimony) that the customers provided appellant with their own TPP, such as DVDs, and then appellant transferred the photographs onto those DVDs and returned that TPP to the customers. Appellant's transfer to clients of DVDs that contain photographs or videos falls under the provisions of California Code Regulations, title 18, section 1502(c)(1), which states that the transfer for consideration of TPP onto which information has been recorded or incorporated is a sale subject to tax. Appellant provided no documentation of any contracts with customers that did not involve the transfer of TPP. While the evidence shows that appellant offered customers an option to electronically download photos and videos, this was in addition to appellant's transfer of TPP.

Moreover, the evidence supports a conclusion that, in addition to the sales in which customers provided their own DVDs, a portion of appellant's sales included his provision of TPP such as DVDs to customers. We reach this conclusion based on evidence including customers' responses to the Notices to Furnish Information, customer reviews from websites describing appellant's transfer of TPP such as DVDs and albums, and evidence of appellant's bulk purchases of DVDs.

Appellant also contends that the nature of his business is to contract with other photographers, and photographing companies, and provide services such as taking pictures, or editing their photos for them, without any transfer of TPP. Appellant points to his testimony and declarations from owners of studios who state that appellant provided services to those studios.

However, there is no corroborating evidence, such as contracts or other documentation, establishing that appellant performed this work and included those services in the reported taxable sales on his SUTRs for the audit period. Absent such evidence, a deduction for the alleged services performed for other photographers is not warranted. In light of all evidence, we find the evidence fails to establish that appellant is entitled to any adjustment on this basis.

Appellant also points to his federal income tax returns (FITRs) and evidence that he earned income from other sources, such as his work as a valet parking attendant. While the original audit considered appellant's FITRs in calculating the understatement, the reaudit determined the $477,268 understatement based solely on the reported sales from appellant's SUTRs. CDTFA did not estimate appellant's income; it used the figures reported *by appellant* on his SUTRs. Thus, appellant's FITRs and evidence of appellant's wages from other sources is not relevant to the disputed amount here, and accordingly does not warrant any basis for adjustment.

In his briefing, appellant also argued that that audit and audit calculations were flawed because the auditor did not discuss the sample size with him and did not offer him the opportunity to agree or disagree with the sample size, the duration of the sample, or the period of the audit. Yet the audit and reaudit working papers clearly show that this audit did not involve a sample of transactions that was chosen for testing. There was no sample, and there was no specific period that was tested. CDTFA used no alternate audit methods, and there were no calculations in which CDTFA could have erred. The audit process was simple and direct; CDTFA disallowed all claimed deductions for nontaxable labor because appellant did not provide convincing documentation of any transactions that did not involve a transfer of TPP. Regarding the audit period, CDTFA is under no obligation to consult with appellant regarding the audit period. The NOD was issued within three years of the dates the returns were filed and was therefore timely. (R&TC, § 6487(b).) Hence, appellant's arguments on these points are unpersuasive.

HOLDING

No further adjustment is warranted to the disallowed deduction for nontaxable labor.

DISPOSITION

CDTFA's action in reducing the amount of claimed disallowed nontaxable labor to $477,268, deleting the negligence penalty, and otherwise denying the petition, are sustained.

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Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

We concur:

DocuSigned by:
Jeff Angeja
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Jeffrey G. Angeja
Administrative Law Judge

DocuSigned by:
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Andrew J. Kwee
Administrative Law Judge

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