OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

In the Matter of the Appeal of:	) OTA Case No. 18063254
	) CDTFA Account No. 101-269032
THOMAS CONGLOMERATE	) CDTFA Case ID 539093
	)
	)
	)

OPINION

Representing the Parties:

For Appellant: Jack Iyer, Representative
Dr. P. Thomas, Medical Director

For Respondent: Joseph Boniwell, Tax Counsel

S. BROWN, Administrative Law Judge: Pursuant to California Revenue and Taxation Code (R&TC) section 6561, Thomas Conglomerate (appellant) appeals a decision issued by respondent California Department of Tax and Fee Administration (CDTFA)[1] denying appellant's petition for redetermination of a June 25, 2010 Notice of Determination (NOD). The NOD is for $98,185 in tax, a failure-to-file penalty of $9,818.48, and applicable interest, for the period January 1, 2004, through December 31, 2007 (audit period).[2]

Appellant waived its right to an oral hearing; therefore, we decide the matter based on the written record.

[1] Sales taxes were formerly administered by the State Board of Equalization (BOE). In 2017, functions of BOE relevant to this case were transferred to CDTFA. (Gov. Code, § 15570.22.) For ease of reference, when this Opinion refers to acts or events that occurred before July 1, 2017, "CDTFA" shall refer to BOE; and when this Opinion refers to acts or events that occurred on or after July 1, 2017, "CDTFA" shall refer to CDTFA.

[2] Subsequently, CDTFA deleted the failure-to-file penalty, as reflected in the Notice of Redetermination CDTFA issued to appellant on June 2, 2012; hence, the penalty is no longer at issue on appeal.

ISSUE[3]

Whether adjustments are warranted to the measure of unreported taxable sales.

FACTUAL FINDINGS

1. Appellant is a corporation that operated two prenatal imaging centers, one in San Francisco and one in San Jose.
2. Appellant originally operated without a seller's permit. In 2009, in accordance with its Statewide Compliance and Outreach Program, CDTFA visited the business and determined that appellant was required to have a seller's permit. Thereafter, CDTFA issued appellant a seller's permit with an effective start date of January 1, 2004.
3. Appellant's prenatal imaging centers provided three-dimensional (3D) and four-dimensional (4D) ultrasound services to pregnant women and their families. The ultrasound services generally entailed showing expectant parents and their invited guests 3D and 4D images of the unborn child during an ultrasound session; those images were captured on photographs, or stored on CDs, and DVDs which appellant provided to customers to keep.
4. Appellant sold various bundled packages, each of which included, at a minimum, an ultrasound session and photos of the images taken during the ultrasound. For example, a basic package included one 15-to-20-minute ultrasound session, four-to-six black-and-white photos, one color photo, and a digital photo album CD. A more expensive package included two 25-to-30-minute ultrasound sessions, a video, a DVD, 12-to-16 black-and-white photos, seven color photos, a digital photo album CD, 10 issues of a pregnancy magazine, and access to a customized baby website. Customers could also separately purchase photos, CDs, and DVDs, in addition to those provided in the bundled packages.
5. As described on appellant's website (accessed March 9, 2012) and on a liability waiver form signed by appellant's customers, appellant provided elective ultrasound services that were not a replacement for a diagnostic ultrasound by a medical provider. In order to receive a prenatal ultrasound from appellant, pregnant women were required to have

[3] In April 2012, appellant submitted to CDTFA a signed request for relief of interest pursuant to R&TC section 6593.5. On appeal, CDTFA denied appellant's request for relief of interest. In the present appeal to Office of Tax Appeals (OTA), appellant did not request relief of interest, nor did appellant provide OTA with a copy of the signed request previously filed with CDTFA. Thus, interest relief is not at issue in the present appeal.

already received from a healthcare provider a medical, diagnostic ultrasound to confirm the baby's due date and screen for fetal anomalies and for any other pregnancy-related issues. Appellant's ultrasound services were not covered by medical insurance.

6. Appellant's website stated that the expectant parents would receive "keepsake videos and baby photos," and emphasized how appellant's 4D ultrasound technology would result in "clearer and beautiful photos of your baby and a realistic high-resolution quality of the video/DVD." The website also stated that patients had the option to return for a complimentary re-scan at no cost if appellant was "unable to satisfactorily obtain high quality photos or determine your baby's gender on the first visit."

7. During the audit, CDTFA found that the services appellant provided were not a medical necessity because the customers were required to have already obtained diagnostic ultrasounds from their healthcare providers. Thus, CDTFA concluded that the true object of the transactions was to provide tangible personal property (TPP) in the form of photos, albums, CDs, and DVDs.

8. Appellant did not provide business records for CDTFA's audit. Consequently, CDTFA calculated appellant's sales using the gross receipts reported on appellant's federal income tax returns, resulting in a calculation of unreported taxable sales totaling $1,172,356 for the audit period.

9. On June 25, 2010, CDTFA issued an NOD for the audit period. Appellant filed a timely petition for redetermination. CDTFA issued a Decision and Recommendation (D&R) dated May 17, 2012, a Supplemental D&R dated April 29, 2013, and a Second Supplemental D&R dated October 14, 2013 (collectively, CDTFA's decisions). CDTFA's decisions recommend that the failure-to-file penalty should be removed, but otherwise recommend that appellant's petition for redetermination should be denied.

10. This timely appeal followed.

DISCUSSION

California imposes sales tax on a retailer for its retail sales of TPP in this state, measured by the retailer's gross receipts, unless the sales are specifically exempt or excluded from tax by statute. (R&TC, § 6051.) All of the 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).) A "sale" means and includes any transfer of title or possession, exchange, or barter, conditional or otherwise, in any manner or by any means whatsoever, of TPP for a consideration. (R&TC, § 6006(a).) Generally, the total amount for which property is sold includes any services that are part of the sale. (R&TC, § 6012(b)(1).) Tax applies to sales of photographs, whether or not produced to the special order of the customer and, as relevant here, no deduction is allowable on account of expenses such as travel time, telephone calls, rental of equipment, or salaries or wages paid to assistants or models, whether or not such expenses are itemized in billings to customers. (Cal. Code Regs., tit. 18, § 1528(a).)

However, the providing of a service that is not part of a sale or purchase of TPP is not subject to tax. (Cal. Code Regs., tit. 18, § 1501.) Some transactions may involve the provision of services and the transfer of tangible personal property. 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 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*.) 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.)

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.) 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.)

Appellant contends that the sale of TPP such as CDs, DVDs, and photos was strictly incidental to the primary objective of the clinical service of elective diagnostic imaging performed by licensed sonographers and a trained physician. Appellant emphasizes that the primary purpose of its business was to supplement patient care, and states that patients and referring physicians utilized its services due to its superior technology and the specialized training of its staff for diagnosing complicated indications in prenatal care. Thus, appellant argues that pursuant to California Code of Regulations, title 18, section 1501, the true object sought by its patients was the service of prenatal ultrasound, not the incidental transfer of TPP such as CDs and DVDs. In support of its position, appellant states that only a small percentage of its patients made purchases of additional CDs and DVDs separate from ultrasound services,[4] and argues that these were its only taxable sales. Furthermore, appellant argues that it still possesses all of the blank CDs and DVDs that it has purchased since 2004.

In addition, appellant states that in January 2019 it received from CDTFA a "New Tax Guide for elective ultrasound providers." Appellant argues that the guidance in this document should not be applied retroactively to the audit period at issue.

Appellant also raises arguments concerning a CDTFA audit of appellant for the period July 2008 through June 2011. However, only the period of January 1, 2004, through December 31, 2007, is at issue in the current appeal, and thus we do not address any issues regarding the later audit period.[5]

We note that tax applies to sales of photographs and there is no deduction on account of any services included in the sale. (Cal. Code Regs., tit. 18, § 1528(a).) In the present case, the issue concerns whether appellant made sales of ultrasound photos; as with photography services,

[4] In one submission, appellant states that only 2 percent of its patients purchased additional CDs and DVDs separate from ultrasound services. In a separate submission, appellant stated that over 90 percent of its patients did not purchase additional CDs or DVDs separate from their ultrasound services.

[5] Appellant also indicates a willingness to agree to a reduced liability. However, OTA has no statutory authority to settle or compromise a tax liability. We note that CDTFA has jurisdiction over programs for settlement and offers in compromise concerning sales and use tax liabilities. (R&TC, §§ 7093.5, 7093.6.)

any ultrasound services required to obtain the photo are included in the sale of the ultrasound photo. Here, each bundled package included TPP such as photos, CDs, and DVDs, and the variations in pricing among the bundled packages depended primarily on the varying amounts and types of those items that the customers would receive. Therefore, the fact that the costs of the various packages depended primarily on the extent of the TPP provided, including the sizes of the photos and other TPP, indicates that the transfer of that property was more than incidental. Moreover, appellant's own emphasis in its marketing materials on the customer's receipt of TPP, such as photos, CDs, and DVDs, evidences that the true object of the contracts was to acquire the TPP. The relative importance of the photos and videos as part of the sale is corroborated by appellant's promise to provide a complimentary re-scan if the customer's first visit did not result in high quality photos.

The evidence does not support appellant's position that the true object of its transactions was to supplement patient care by diagnosing complicated indications in prenatal care. To the contrary, appellant's website and waiver form both made clear that appellant's elective ultrasound procedure was not a substitute for a diagnostic medical ultrasound by a healthcare provider, which was required to confirm the baby's due date and screen for fetal anomalies and for any other pregnancy-related issues. The Frequently Asked Questions page on appellant's website stated that "[t]he ultrasound used in this exam is not performed to better assess the baby for abnormalities." The fact that customers were required to first obtain a diagnostic ultrasound from a medical provider before receiving an ultrasound from appellant is evidence that obtaining appellant's ultrasound service was not the customers' real purpose when purchasing bundled packages from appellant. In addition, if the true object of the transactions was the ultrasound service, then there would be little reason for appellant's website to emphasize the quality of the photos and videos, and no need to offer a complimentary re-scan if the first visit failed to produce high-quality photos.

While appellant argues that only a small percentage of its patients made purchases of additional CDs and DVDs separate from ultrasound services, the evidence shows that all of the bundled packages necessarily included transfers of TPP such as photos, CDs, or DVDs. Given those facts, we conclude that whether customers purchased additional items separate from the package is not indicative of the true object of the contracts. Finally, appellant has not provided evidence showing that it still possesses every blank CD and DVD that it purchased since 2004,

nor would appellant's continued possession of CDs and DVDs establish that the sales were not sales of TPP.[6]

In light of all of the above, we find that the evidence establishes that the TPP was more than incidental to the services provided, and that the true object of the contracts was to obtain the TPP, such as photos, CDs, and DVDs. Accordingly, the transactions at issue were not sales of services, but taxable sales of TPP.

In addition, regarding appellant's arguments about a new guide that it received from CDTFA in January 2019, we have not received this document into the written record, nor is there any indication that any new law is being applied retroactively to the audit period at issue. We note that all of the relevant law discussed herein (i.e., regarding what constitutes services that are part of a sale) was applicable law throughout the audit period.

[6] Appellant did not provide business records for the audit, and has not established that this assertion is true, or how many CDs and DVDs appellant possesses compared to how many it purchased. Appellant did not claim a tax-paid purchases resold deduction on its sales and use tax returns for the audit period and did not file a timely claim for refund for tax-paid purchases resold. Consequently, we cannot consider whether appellant is entitled to a tax-paid purchases resold deduction for any blank CDs or DVDs. (See Cal. Code Regs., tit. 18, §§ 1528(a), 1701(a).)

HOLDING

No adjustments are warranted.

DISPOSITION

CDTFA's actions are sustained.

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Suzanne B. Brown
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Suzanne B. Brown
Administrative Law Judge

We concur:

DocuSigned by:
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Andrew J. Kwee
Administrative Law Judge

DocuSigned by:
Josh Lambert
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Josh Lambert
Administrative Law Judge

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