

**STATE BOARD OF EQUALIZATION**

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February 27, 1964

Dear Mr. "S"

Bob Hamlin has requested me to reply to your letter of February 17 concerning the application of sales tax to engineering and other charges as described in your letter. We shall repeat each of the four situations described by you, each followed by our answer.

1. A company contracts with an engineering firm to design and prepare a general layout of a special purpose piece of machinery based on requirements furnished by the company. The fee for this is \$1,000. Is this subject to sales tax?

Ans. The fee for the described services is not subject to sales tax.

2. After obtaining and approving the layout for the special purpose piece of machinery, the company takes the layout to a second engineering firm to prepare production drawings from which the machine can be built. The fee for this is \$500 - - is this subject to sales tax?

Ans. From the facts stated, it appears to us that the engineering firm which prepares production drawings from the layout makes a taxable sale of tangible personal property, i.e., the drawings. We might be in error in this conclusion, however, if the engineering firm preparing the drawings, in fact, contributes its engineering knowledge and skill in determining the actual content of the drawings as distinguished from merely converting the layout into a different form of physical property. We have drawn a distinction between a designer, for example, and a draftsman. The designer creates the ideas and design of a machine, building, or other object, while a draftsman merely makes a pictorial representation from data that has already been prepared by a designer or other professional person. If you wish to give us more information with regard to this problem, we shall be glad to consider it further.

3. The company contracts with an engineering firm to perform the combined services in #1 and #2 above. The charge is \$1,000 for design and \$500 for production drawing. How much, if any, is subject to sales tax?

Ans. This situation raises the question of the separability of the contract for providing the layout and the contract for providing the production drawing. If the sale of the production drawing is taxable (see our answer to situation #2), and if the contract to produce the drawing was entered into at the same time as the contract to perform the layout, of if both or part of the

same contract, the situation appears to be simply that the company contracts to furnish a production drawing for a total charge of \$1,500. The \$1,000 attributable to the design is simply one of the expenses of producing the production drawing, somewhat analogous to the case of "preliminary art" and "finished art" as these terms are defined and explained in part (d) of sales and use tax Ruling 2, copy enclosed. The principle appears to be the same in either case.

4. The company contracts with an engineering firm to design, prepare the drawings and produce a special piece of machinery. The charge for this is:

Design	\$1,000
Production Drawing	500
Machine	<u>7,500</u>
	\$9,000

How much is subject to sales tax?

Ans. Following the same reasoning explained in our answer to #3, it appears here that the total of \$9,000 is the taxable amount. The company obligates itself to produce a machine, and will receive for that machine \$9,000. Part of the cost of producing the machine is the design of \$1,000, and the production drawing for \$500, which together with the \$7,500 for the machine make the total gross receipts of \$9,000. Again if the design contract were separable in the sense that there is no contract for the finished machine until after the design work has been completed, the charge for the design work could be excluded from the measure of tax. Otherwise, it is simply an expense of the retailer of the machine and the definition of gross receipts as set out in Section 6012 of the Sales and Use Tax Law provides that there cannot be deducted from gross receipts any of the following:

"The cost of materials used, labor or service cost, interest paid, losses, or any other expense."

Very truly yours,

E. H. Stetson
Tax Counsel

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