



CDTFA
CALIFORNIA DEPARTMENT OF
TAX AND FEE ADMINISTRATION

Advertising Agencies

Preface

This publication is designed to help you understand how sales and use tax applies in your business operations. If you cannot find the information you are looking for in this booklet, please see our website at www.cdtfa.ca.gov, or contact our Customer Service Center. Customer service representatives are available to answer your questions Monday through Friday between 7:30 a.m. and 5:00 p.m. (Pacific time), except state holidays.

For general information about sales and use taxes, the obligations of seller's permit holders, and filing sales and use tax returns, please see [publication 73](#), *Your California Seller's Permit*. It includes information on obtaining a permit; using a resale certificate; collecting and reporting sales and use taxes; buying, selling, and discontinuing a business; and keeping records. Information on obtaining this and other publications begins on [page 41](#).

We welcome your suggestions for improving this or any other publication. If you would like to comment, please provide your comments or suggestions directly to:

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Please note: This publication summarizes the law and applicable regulations in effect when the publication was written, as noted on the back cover. However, changes in the law or in regulations may have occurred since that time. If there is a conflict between the text in this publication and the law, decisions will be based on the law and not on this publication.

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Introduction—Sales Tax Basics for Advertising Agencies

As an advertising agency, you develop and implement ideas to promote a client's products and services. The way sales tax applies to your charges depends on 1) your business relationship with the client; 2) the product you provide to the client; 3) whether the product you provide is produced in-house, and 4) your billing method. You may act as the agent of your client on some jobs and act as a retailer on other jobs. You may also act as an agent with respect to the acquisition of some products for your client and as a retailer of other products on the same job. Some of your sales will be taxable and others will not. This chapter discusses the rules that apply when you purchase products and services on behalf of your clients and helps you determine when you are regarded as a retailer and how tax applies to your sales as a retailer. The next chapter explains what sales are generally nontaxable. Specific information about your sales as a retailer is provided in the other chapters.

Services and products

Advertising agencies provide both services and tangible products to their clients. As an agency, your services include such things as planning, media placement, market research, advertising, radio spots, and public relations. Your products include such items as print ads, brochures, logos, posters, artwork, video productions, and website design. When you sell tangible products, tax will generally apply to your sale of the products as well as any charges for services associated with the production of the products. When you sell services only, your charges are generally not taxable.

Depending on the business relationship between you and your client, you may qualify as a retailer in some cases subject to the general sales and use tax laws and an agent in other cases. The following information will help you understand when you are an agent of your client and when you are considered the retailer.

Business relationship

■ Acting as an agent

An agent represents its client in dealings with third parties. For purposes of the sales and use tax, the state presumes an advertising agency acts as an agent of its client in dealings with third parties such as artists, printers, or video and audio producers. As an agent, you are not regarded as purchasing the product on your own behalf, nor are you considered to be selling the product to your client. Accordingly, your transfer of products to your client is not taxable when these three elements apply:

- You buy the product from a third party,
- You buy the product on behalf of your client, and
- You separately state on your invoice to your client the amount you paid for the product.

Generally, you will pay an amount for tax to the third party at the time of purchase (you should not furnish a resale certificate to the third party). If you buy a product without paying tax, for example, from an out-of-state retailer who did not collect California tax, you must report and pay use tax on the purchase price. As an alternative, your client may elect to report use tax on the purchase. (See [page 38](#).)



Example: Your client is holding a sales presentation to promote a new product line. You contract with the client for the production of brochures to be given to attendees at the presentation. You hire a printer to design and produce the brochures on behalf of your client. The printer designs and produces the brochures in-house and delivers the printed brochures directly to you or to your client when the job is done. The printer invoices you a lump-sum amount of \$10,000 plus tax at 7.75 percent. In turn, you invoice your client \$11,775, which includes a separate charge of \$10,775 for the brochures and an additional charge of \$1,000 for your agency fee.

Since the state presumes you are the agent of your client and you separately stated the actual amount paid to the printer on your invoice to the client, your charges are not subject to tax. As an agent of your client, you are neither the purchaser nor the retailer of the brochures.

■ Acting as a retailer

You are a retailer in relation to your client and your sale or use of your products may be taxable when any one of the following circumstances applies:

- You choose (elect) to act as a retailer by written notification to your client,
- You do not separately state the amount you paid to the supplier when billing your client,
- You sell products that you or your employees have made in-house, or
- You furnish a resale certificate to your supplier, in which case you are presumed to have purchased the product on your own behalf for resale to your client.

Your sales of products to your clients, as a retailer, are taxable unless they qualify for a specific exemption or exclusion.

Example: You contract with your client to design and produce a logo. You do not choose to act as a retailer. You hire an artist to design the logo and produce the finished art. The artist's charge for designing the logo and providing the finished art is \$5,000, plus the applicable tax. You transfer the finished art to your client on a CD and charge your client \$7,500 plus the tax paid to the artist. Your invoice separately states the \$5,000 plus tax you paid to the artist on your client's behalf and a \$2,500 agency fee. Since the law presumes you are an agent of your client, your charges are not taxable.

If, however, you bill your client a lump sum amount of \$7,500, you are considered the retailer of the artwork and your entire charge is taxable. You may, however, claim a tax-paid purchases resold credit on your sales and use tax return for the tax paid to the artist. (See [page 38](#).)

■ Choice to act as a retailer

To choose retailer status when providing products to your client, you must have a written statement in your master agreement, job order, or invoice stating that you are a retailer of the products you are selling to the client. The statement should use the following or similar language:

"[Name of advertising agency] will not be acting as an agent of [client's name] for purposes of this transaction."

If you elect this option, generally you may issue a resale certificate when you buy any property you plan to resell to your client.

■ No separate statement

You are considered a retailer if you transfer to your client items you have purchased from a supplier and you do not separately state the amount paid to the supplier on your client invoice. For example, you purchase brochures for a client and pay the printer \$700 and sales tax of \$54.25, at the rate of 7.75 percent. You charge your client a lump-sum amount of \$1,000, which includes your cost of the printed brochures plus a markup for your services rendered.

Your entire charge is taxable. If your lump-sum charge includes charges for both products and nontaxable services, such as a consulting fee, you will need to calculate the selling price of the property as described below. (Please note: You are generally allowed a credit on your sales and use tax return for any tax you paid to the printer. For more information on tax-paid purchases resold, please see [page 38](#).)

■ Items created in-house

You are the retailer of any item you create in-house and tax is generally due on the stated selling price, except for certain sales of artwork. When you create and sell property as a retailer, you should purchase the materials that become an ingredient or component of the property you will sell to your client for resale. To make a purchase for resale, you must issue a timely, signed resale certificate to the vendor. If you do pay tax on your purchase, you may generally claim a tax-paid purchases resold credit, provided you make no use of the property before you resell it (see [page 38](#)). For information on the rules that apply to sales and purchases of intermediate production aids and special printing aids, see [pages 13-16](#).

Sale of printed matter

When you contract with your client for the sale of printed matter, in most cases, you are not only the retailer of the printed matter, you may also be the retailer of the intermediate production aids and special printing aids used during the production of the printed matter. If you make sales of printed matter purchased from a printer or print broker for resale to your client, you should read the chapter beginning on [page 25](#) for an explanation of the special rules that apply to sales of printed matter and the aids used in the printing process. [Pages 13-24](#) discuss the rules that apply to the sale or use of production aids, special printing aids, and artwork in general.

■ Issue a resale certificate

You are presumed to have purchased items on your own behalf for resale to your client when you issue a resale certificate to your supplier. In this case, you are acting as a retailer, not as an agent of your client. Normally, charges on the transfer and sale of products and other property to your client are taxable. However, there are some exceptions to this general rule:

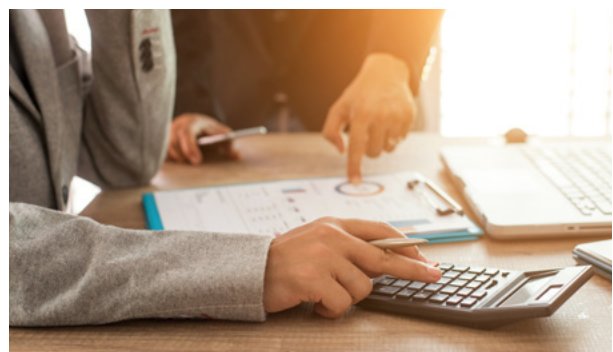
- Some transfers or sales may not be taxable because of legal exemptions or exclusions.
- Tax may apply to only a portion of your charge for certain sales of artwork.

Please note: If you mistakenly issue a resale certificate to your supplier, you may overcome the presumption that you are a retailer if you can show that you issued the resale certificate in error, and that you did not collect an amount for tax from your client on the sale.

Calculation of the taxable selling price

In general, you should separately state and tax the selling price of the products you sell as a retailer. If you do not separately state the selling price, you must calculate a taxable selling price for the product. When calculating tax on your charges for items other than artwork (see discussion beginning on [page 19](#) for how to calculate tax on your charges for artwork), you must include the following components in the taxable selling price:

- Direct labor, including commissions, fees and other charges exclusively related to the creation of the item being sold;
- The cost of property that becomes a component part of the item being sold;
- The cost of any intermediate production or special printing aids, for example, the cost of a printing plate used to produce newsletters; and
- A reasonable markup.



Sales of taxable labor, services, and products in general

In California, sales or use tax applies to retail sales of tangible products sold and delivered for use in this state. However, when you sell and deliver products outside the state, sales tax generally does not apply. Tax also applies to your sale of capital assets used in the course of your business, such as processing or printing equipment, fixtures, computers, and furniture whether the sales are incidental or sold when you sell your business. If a lump-sum sale of your business includes these or similar capital assets, you must report and remit sales tax based on their fair market value.

■ Monthly agency or retainer fees

When an advertising agency charges the client a monthly agency or retainer fee, and the agreement or contract stipulates that any transfer or sale of tangible products will be billed separately, the agency or retainer fee is not taxable. If you are considered a retailer and the monthly agency or retainer fee is for both services and the sale of tangible products, the fee will be prorated and the portion of the fee that is related to the sale of tangible products will be subject to tax.

Charges for taxable labor and related expenses

Your labor and overhead charges may be taxable depending on the product and service you provide to your client or others on your client's behalf. The following sections explain which charges are taxable.

■ Fabrication labor

Charges for labor to create or produce a new product (such as finished art, mechanical assemblies, illustrations, brochures, printed matter, prints, or printing aids) are generally taxable. Tax applies whether you supply the materials or use materials supplied by your client to create or produce the product.

Common examples of fabrication labor relating to sales of artwork and related products include:

- Printing brochures
- Creating special printing aids
- Creating finished art or intermediate production aids

For more information on fabrication labor, you may obtain a copy of [Regulation 1526, Producing, Fabricating, and Processing Property Furnished by Consumers—General Rules](#), and [publication 108, Labor Charges](#).

■ Taxable digital fabrication labor

Charges for labor you perform to create or produce digital artwork are taxable when the product you sell to your client is:

- An item in a tangible form, such as an image or transparency; or
- A digital image delivered on storage media, such as a disk, DVD, CD, or flash memory card, whether the media is furnished by you or your client.

Typical taxable fabrication labor for digital images and such products includes:

- Scanning images or artwork and saving them on digital storage media
- Making prints or slides from digital images provided by clients
- Producing finished art from intermediate production aids
- Editing (cropping, retouching, or otherwise modifying) a digital image when you deliver the image on a storage media such as a CD or DVD

Although you may separately state charges for your computer-related fabrication labor and charges for the storage media itself, all charges are taxable.

Example: A client brings you a photograph and asks that you edit and modify the image to add a special background and remove any imperfections. The client plans to use the image in their production of advertising brochures. You scan the photograph and save a copy on your computer. You edit the scanned image to remove any imperfections and save a copy to a CD. Then, you add the requested background and save a copy of the edited image to another CD. You provide both CDs to your client. Your charges to your client for scanning, editing, and retouching the photograph are taxable. Whether or not you separately state your charges for the editing, scanning, and retouching, your total charges are taxable since you performed fabrication labor in connection with the sale of a tangible product.

■ Charges for overhead and project-related expenses

Your charges to clients that represent your expenses for creating artwork and other tangible products that you sell are taxable. These expenses may include:

- Setup charges, model fees, and overtime charges
- Equipment and computer rental
- Travel expenses
- Prop construction or rental
- Technicians, assistants, or graphic artists' salaries or fees

When you rent equipment from a California vendor, tax will normally apply to the rental fees you pay to that vendor. You may not issue a resale certificate to avoid paying tax on those rental charges.

Please note: If you charge a client for overhead and project-related expenses, but do not deliver a tangible product to your client, tax does not apply to your charges. For more information on how tax applies to products delivered electronically, please [see page 7](#).



Sales That Are Generally Nontaxable

This chapter includes information on your sales as a retailer that generally are not taxable, such as sales for resale, sales to the U.S. government, sales in interstate and foreign commerce, electronic transfers of artwork, repair labor, and certain other transactions.

Sales for resale

You are not responsible for sales tax on sales you make to others who will resell the items they purchase in the regular course of their business. You must obtain a valid resale certificate from the purchaser at the time of the sale and retain that certificate in your records. The purchaser must sell the item as is or physically incorporate it into another product they sell.

Example: Your city has a new professional sports team. The team contracts with your firm to develop a promotional campaign. As part of the campaign, you design and produce T-shirts with the new team logo on the front and the team schedule on the back. Although team management will be giving some of the T-shirts away at promotional events, they plan to sell most of the T-shirts through the team store. If your client provides a timely, completed resale certificate, your sale of the T-shirts is not taxable. The team should pay sales tax on the sale of the T-shirts sold in their store and report use tax on the cost of the T-shirts given away.

Example: As part of the same promotional campaign, you produce 50,000 wallet cards with the team logo and schedule. The team distributes the cards free of charge at various promotional events. Your client cannot issue a resale certificate for the purchase of these cards since the team does not intend to resell the cards.

Please note: Photographs, artwork, or other property used in the creation of (for example, image is reproduced), but not incorporated into, finished art or printed matter are considered intermediate production aids or special printing aids. Generally, your sale of the aids will be taxable. For instance, in the examples above you may have sold a silk screen or other tangible printing aid in connection with your sale of the shirts and cards. In both examples, the sale of the aids will be taxable. For more information regarding intermediate production aids and special printing aids, see discussion beginning on [page 13](#).

Sales to the U.S. government

Sales tax generally does not apply to sales made to the U.S. government or its agencies, or to sales made to certain U.S. government-related corporations. Sales tax also does not apply to sales made to certain instrumentalities of the federal government. Examples include sales to:

- Amtrak (National Railroad Passenger Corporation)
- Federal reserve banks, federal credit unions, federal land banks, and federal home loan banks
- The American National Red Cross, including its chapters and branches

For more information, you may obtain a copy of [Regulation 1614](#), *Sales to the United States and Its Instrumentalities*, and [publication 102](#), *Sales to the United States Government*. If you need help determining whether the exemption applies to a specific client, you may call our Customer Service Center for assistance (see [page 41](#)).

Sales in interstate and foreign commerce

■ Sales tax

The sale of artwork, development and fabrication services, or other tangible goods or services to clients who live outside California is generally not taxable, provided you ship the items:

- Directly to a client at a destination outside the state, and you
- Use your own business vehicles, the U.S. Mail, or a common carrier to deliver the items.

Items delivered to the California office of an out-of-state client are not eligible for this exemption. This holds true even if the products are ultimately delivered into the client's courier pack for shipment to the client's out-of-state location by common carrier.

■ Sales of intermediate production aids, special printing aids, and similar products used in this state

Advertising agencies commonly use products within this state to produce finished art or similar items they will ship out of state. A common example is the use of a tangible, intermediate production aid to create finished art or a special printing aid when you sell both the artwork and the aid to an out-of-state client. Your sale of the artwork is an exempt sale in interstate commerce when the artwork is delivered outside the state. Your sale of the intermediate production aid used to create the artwork is generally a taxable sale because you use the aid in-state before shipping it to your client. In contrast, your sale of an unused production aid that you ship directly to a client located outside the state is not taxable. To claim an exemption for interstate and foreign commerce, you must retain records of delivery or shipment, such as shipping invoices, postage receipts, or other shipping documentation showing the location and method of delivery. For more information regarding the sale or use of production aids and special printing aids, see [pages 13-16](#).

■ Use tax

If you ship an item to a California resident at an out-of-state or foreign address, you should collect use tax on your sale unless you get a written statement signed by the purchaser confirming that the item is being purchased for out-of-state use for more than 90 days. The statewide use tax rate is the same as the sales tax rate.

For example, you might create artwork for a San Francisco resident who asks you to ship the artwork to Reno, Nevada. Unless that client gives you a signed, dated, written statement that says she will use the artwork in Nevada for more than 90 days after its purchase date, you must collect use tax on the sale.

Please note: A district use tax may also apply to your client's purchase if the property is purchased for use in a city or county with a district tax in effect.

Sales in interstate and foreign commerce are discussed in detail in [Regulation 1620](#), *Interstate and Foreign Commerce*, and [publication 101](#), *Sales Delivered Outside California*. Information about the tax rates in effect in a specific city or county is available by selecting [California City & County Sales & Use Tax Rates](#), or from our website at www.cdtfa.ca.gov, select *Tax & Fee Rates*, then select *Sales and Use Tax Rates*.

Products delivered electronically

Tax applies to your sale of tangible products, including artwork, photographs, production aids, and other such products. However, if you transfer your product electronically and do not include any tangible product, tax does not apply. This is true whether you transfer the product by the "load and leave" method or remotely (for example, by email or file transfer protocol [FTP]). Please note that sales tax will apply if you provide your client with a copy of the electronically transferred product in any sort of tangible form such as a copy of the product on a CD or other storage media or a tangible print, copy, or transparency of the product. In addition, your itemized charges to your client for tangible, intermediate production aids, or special printing aids used in California to produce your product are generally taxable even though you may deliver the finished product electronically. For more information regarding intermediate production aids and special printing aids, see [pages 13-16](#) and [pages 25-30](#).

You should document any electronic transfer of a product so that you can show why tax does not apply to that transaction. For instance, if you electronically transmit an image to a customer by email, you should print out a copy of the transmittal email and retain that copy in your records. If you transfer an image by FTP or download it to your customer's computer directly from your computer, a CD, or another storage media that you keep (the "load and

leave” method), you should document the transfer in your records.

One way to do that is to place a document in your project file listing the customer’s name and the date, place, and method of the transfer and noting that you did not provide the customer with any tangible products in addition to the electronically transferred image. You should have your customer sign and date the document at the time of the transfer. We suggest you use language such as the following for your documentation:

“This electronic image was loaded into the computer of [client’s name] by [advertising agency’s name], and [advertising agency’s name] did not transfer any tangible personal property containing the image, such as electronic media or prints, to [client’s name].”

As you read the rest of this publication, please remember this exclusion for electronic transfers of products.

Inserts for newspapers and periodicals

Tax does not apply to your charges for printed advertising inserts provided to clients for inclusion in newspapers and periodicals qualifying for exemption under [Regulation 1590, Newspapers and Periodicals](#). This includes handbills, circulars, flyers, order forms, reply envelopes, maps, or the like—when such items are inserted in or attached to the newspapers or periodicals when distributed. However, tax will apply to your charges for any intermediate production aids and special printing aids transferred or used in a tangible form as part of the production of the inserts.

Printed sales messages

Sales of printed sales messages are not taxable if they meet all of the following three conditions. The material must be:

- Printed to the special order of the purchaser;
- Mailed or delivered by the seller, the seller’s agent, or by a mailing house acting as an agent of the purchaser through the U.S. Mail or by contract or common carrier; and
- Received by the recipient at no cost where the recipient becomes the owner of the printed material.

Example: A local museum engages you to design brochures announcing each new exhibit. You are responsible for having the brochures printed and shipped to a mailing house for distribution to the museum membership, at no charge. This transaction qualifies as a sale of printed sales messages, since the material is printed to the special order of the museum and the museum does not take possession of the brochures. Instead, the mailing house delivers the brochures by U.S. Mail to the membership at no charge to the members.

Example: For one of the exhibits, the museum asks you to have extra brochures printed. These brochures are shipped to the museum for free distribution to visitors. The sale of these brochures does not qualify for the printed sales message exemption since the museum has taken possession prior to distribution. Consequently, the selling price of these brochures to the museum is taxable.



Please note: Tax will generally apply to your purchase of items used to produce the printed sales messages (for example, items that do not become a component part of the printed matter). Tax will also generally apply to your charges for any tangible intermediate production aids and special printing aides used in California to produce the printed sales messages. Sales of printed sales messages must be supported by complete, timely exemption certificates. For more information about printed sales messages, you may see [Regulation 1541.5, Printed Sales Messages](#).

Delivery and shipping charges

■ Nontaxable delivery charges

Tax does not apply to delivery or shipping charges for nontaxable sales. Delivery charges for the shipment of taxable merchandise are generally not taxable if they are stated separately at actual cost on your invoice, and you ship the merchandise directly to the purchaser using the U.S. Mail, an independent contract carrier, or a common carrier, rather than your own vehicles.

If you charge your client more than your actual (not average) cost of delivery, the excess amount is taxable. For example, if you charge \$12.50 for shipping, but the delivery service charges you only \$10.00, tax would apply to \$2.50 of your delivery charge.

It is important that you use terms such as “delivery,” “shipping,” or “postage” on your invoice to identify delivery charges.

■ Taxable charges related to delivery

Other charges related to delivery, including charges for “handling,” are generally taxable, even if a postage or shipping amount is listed on the package.

■ Combined charges

If you combine a nontaxable charge for delivery and a taxable charge for handling in a single amount, for example, “shipping and handling,” you must ensure that you properly apply tax. As noted earlier, the portion of the charge that represents handling is generally taxable. The portion representing delivery is not taxable, provided it does not exceed your delivery cost (see previous entry on nontaxable delivery charges), and you do both of the following:

- Ship the merchandise directly to the purchaser using the U.S. Mail, an independent contract carrier, or a common carrier.
- Record the actual delivery, postage, or shipping cost in your books.

Cash on Delivery (C.O.D.) fees

Generally, tax applies to C.O.D. fees you charge your client on a taxable C.O.D. sale. However, if the C.O.D. fee is not included on your invoice, and the delivery carrier collects the fee from your client and retains it, the fee is not taxable.

More information on delivery charges is contained in [Regulation 1628, Transportation Charges](#), [Regulation 1632, C.O.D. Fees](#), and [publication 100, Shipping and Delivery Charges](#).

Repair labor and nontaxable services

Your itemized charges for repairing or reconditioning an item to restore it to its original condition are not taxable. Examples include charges for:

- Airbrushing a client’s print to restore or repair it
- Retouching a client’s print to restore or repair it
- Other film or print processing charges that restore an item to its original condition

Example: A client brings you a print that is scratched and torn. She asks you to repair the print and retouch it so that the scratches and tears are less visible. Your itemized charges for labor to perform these services would be considered nontaxable repair labor. However, if your client asks you to produce copies of the print after it has been restored, tax would generally apply to your charge for the copies.

If you provide services that do not create or produce artwork or other products you sell, your itemized charges for those services are not taxable. This may include charges for:

- Services you provide or expenses incurred when you do not deliver any resulting tangible product to your client
- Electronically transferring artwork to your client (see [page 7](#))



Other nontaxable services

Tax generally does not apply to an advertising agency's separately stated charges for:

- Media commissions for advertising placement. The commissions may be paid by the media (newspaper, magazine, radio, television, or cable network) on which the advertising is placed, by another advertising agency, or by your client.
- Commissions or fees received from suppliers such as premium manufacturers (or distributors) or direct-by-mail suppliers.
- Consultation and concept development related to client discussions and development of ideas, except when such consultation and development result in tangible preliminary art sold to the client (see [page 17](#)).
- Research and account planning that entail consumer research and the application of that research to your client's business or industry.
- Quality control supervision for proofing and review of printing or other products from outside suppliers purchased on behalf of your client.
- Charges for the formulation and writing of copy.

Charges for these services are generally not taxable, even if you transfer product to the client that you incidentally produce in connection with the service. For example, you contract with your client to perform consumer research. Under the contract, you provide a report detailing the findings of your research. There is no tax due on the transfer of the report since it is incidental to the services provided. However, charges for additional copies of the report are taxable.

To ensure charges for these services are not considered part of a taxable sale, you should separately state them on your client billings. Otherwise, the charges could be considered part of the selling price of products you are providing to your client. For example, you plan an advertising campaign for a client. As part of the campaign, you design a brochure highlighting your client's business services. You print the brochures and charge your client \$15,000 for the planning services and brochures. On your invoice, you should separately state the charge for the planning to ensure it is not taxed as part of the selling price of the brochures.

Please note: As explained on [pages 21-23](#), when you make a lump-sum charge for artwork, you may need to calculate the retail-selling price of certain products by marking up the combined cost of the labor, materials, production aids, and overhead. Charges for the nontaxable services described previously should not be included in this calculation.

■ Website design

Generally, the design, creation, or hosting of a website is not taxable because the product you provide is electronic, not tangible. Similarly, the posting of artwork on a website is not taxable if the posting does not involve the transfer of a tangible product. However, if you deliver a tangible product to your client, whether on computer media or in printed copy, your charges for creating the website may be taxable. For example, you contract with your client to design a webpage for a new product. Your charges include a charge for designing the webpage, HTML production, high-level programming, database management, and the creation and posting of images of the new product. Whether your services are billed on an hourly basis or a flat fee, as long as you do not transfer any tangible product to the client, such as a backup copy, your charges are not taxable.

■ Creative art services for a qualified motion picture

"Creative art services" provide ideas, concepts, looks, or messages in connection with the production, distribution, or exploitation of a "qualified motion picture." A qualified motion picture is a film or video production created for commercial purposes, including TV commercials and movie trailers. It does not include a production created for private noncommercial use, such as wedding or graduation videos. Your charges for creative art services are not taxable. See [page 35](#) for more specific information.

■ Audio productions

Audio productions may include sound commercials for radio or Internet advertising, advertising jingles, and sampler CDs or tapes that are provided to prospective clients. Generally, a recording that is made for the actual broadcast of the audio advertising is considered a “master tape.” The taxable charge for the sale of a master tape is limited to the sales price of the unprocessed recording media on which the production is recorded. If a master tape is used to produce sample CDs, tapes, or other media that will be distributed to potential clients, tax applies to the entire charge for producing the samples.

Example: Your client sells self-help books and CDs. To advertise the business, you have a 30-second radio spot produced, as well as an Internet spot that includes a sample lecture from your client’s self-help CDs. You also have the sample lecture produced on CDs that will be included in advertising materials mailed to prospective clients. For the radio and Internet spots, tax applies only to the cost of the unprocessed media on which the spots are recorded. Tax applies, however, to the entire charge for producing the sample CDs.

■ Digital prepress instruction

“Digital prepress instruction” is the creation of original information in electronic form by combining more than one computer program into specific, original instructions or information necessary to prepare and link files for the output of an image to film, plate, or direct to press. Since digital prepress instruction is generated from proprietary software for digital output specifically for printing purposes, it has very limited uses. Provided the files are prepared to the special order of the client, it qualifies as a custom computer program and the charges associated with the creation of the digital prepress files are nontaxable. However, digital prepress instruction is not considered a custom computer program if it is a “canned” or prewritten computer program, which is held or existing for general or repeated sale or lease, even if the digital prepress instruction was initially developed on a custom basis or for in-house use. The sale of canned or prewritten digital prepress instruction in tangible form is taxable.

For information about custom computer programs in general, you should read [Regulation 1502, Computers, Programs, and Data Processing](#). For more information about digital prepress instruction and the sale of printed matter, see discussion beginning on [page 28](#).



Sale and Use of Production Aids and Special Printing Aids

This chapter includes information on the sale and purchase of property used in the creation and production of preliminary art, finished art, and special printing aids, including the presumptions that apply. You should read this chapter and the four chapters that follow if you contract with your client for the production and sale of artwork (for example, prints and images), special printing aids, or printed matter and are the retailer, not the agent of your client. Please see the first chapter if you are unsure as to whether you are acting as an agent or retailer. See discussion beginning on [page 17](#) for more information regarding the sale or use of preliminary art and finished art; how tax applies to the sale of printed matter purchased from a printer or print broker for resale to your client; technology transfer agreements, and the application of tax to services performed for the motion picture industry. As you read this chapter and the following chapters, please remember the exclusion for electronic transfers of products.

Preliminary production aids

A preliminary production aid is property used in the process of creating preliminary art and generally includes such items as scans, layouts, visualizations, artwork, illustrations, proofs, images, etc. Unlike intermediate production aids and special printing aids, preliminary production aids are *not* presumed sold to the client prior to use. As such, you should pay tax on your purchase of tangible items developed and used to produce your preliminary designs. As discussed on [page 17](#), preliminary art is produced solely for demonstrating an idea, concept, look, or message for acceptance by the client prior to their approval for you to produce finished art.

Although not generally the case, there may be times in which you contract with your client for the sale of the preliminary production aids prior to their use. Assuming you hold title to the aids or are contractually permitted to sublease the aids to your client, you may generally sell or sublease the aids to your client prior to use. However, to do so, your contract or sales agreement must include a specific title clause transferring title to the aids to your client prior to use. Or, you must have an explicit sublease agreement with your client subleasing the aids to the client prior to the use of the aids. If your contract or agreement contains such a clause or sublease agreement, you should separately state the taxable selling price of the aids from your nontaxable charge for your conceptual services and preliminary designs.

When selling the preliminary production aids to your client prior to use, you may generally issue a resale certificate for your purchase or lease of the preliminary production aids, or for the components or ingredients incorporated into the aids when produced in-house. If you paid an amount for tax on your purchase of the aids or their components, you may generally take a tax paid purchases resold deduction on your return.

Intermediate production aids

An intermediate production aid is property used in the process of creating finished art or special printing aids, and includes such items as artwork, illustrations, photographic images, scans, and photo engravings. Intermediate production aids do not include items used to produce preliminary designs/art.

When you are acting as a retailer, not an agent of your client, and you use intermediate production aids in the creation of finished art or special printing aids, it is presumed that the intermediate production aids are resold to your client prior to any use. This is true whether you separately state the charge for the intermediate production aid or not, unless you choose to retain title to the aids rather than sell them to the client (see discussion beginning on [page 15](#) on how to rebut the presumption). As is the case with the sales of finished art and special printing aids, tax will generally apply to your sale of a tangible intermediate production aid. Even if your client issues a resale certificate for its purchase of the finished art or special printing aids, or the sale of these items is otherwise nontaxable, except in certain cases, your sale of the tangible intermediate production aid is taxable.

Example: Your firm is hired to create artwork for your client's cover page of its annual report. Your contract separately states your charges for the creation of the preliminary designs. You do not transfer title or permanent possession of the preliminary designs to your client. Once your client approves the concept, you purchase an illustration that will be reproduced in your final design, along with all rights to the illustration, from an outside party. The illustration is sent to you electronically. You electronically/digitally reproduce the illustration in your final design and email the final design to your client. You do not provide anything tangible to your client.

Although your sale of an illustration (tangible product), which is used in California and sold to your client prior to use would generally be taxable, this is not the case in this example. Your sale of both the illustration (intermediate production aid) and the final design are nontaxable since they were transferred electronically and no tangible products were used or provided to the client.

Special printing aids

A special printing aid is reusable property used in the printing process solely for a specific client. Examples include silk screens, dies for cutting or embossing, lithographic plates, film, color separations, some intermediate production aids, etc. As with intermediate production aids, the person selling the printed matter is regarded as selling the special printing aids used to produce the printed matter along with the printed matter, prior to any use, unless title to the special printing aids is explicitly retained by the person.

Example: Your firm is hired to develop advertising for a homebuilder. One brochure illustration will feature a model home set in a forest landscape. To create the illustration, you hire a freelance photographer to take a picture of the model home. You also purchase a photograph of a forest landscape. You digitally combine the two images and an outside printer makes a reusable printing plate from the combined image. The photographs of the model home and landscape are intermediate production aids used to create the printing plate. The printing plate is a special printing aid because it is used solely to print your client's brochures.

Whether you perform the printing in-house or purchase printed matter from a printer for resale to your client, the special rules applicable to the sale of printed matter also apply to you. For more information about how tax applies when you purchase printed matter from a printer for resale to your client along with the special printing aids, see discussion beginning on [page 25](#). For more information about how tax applies when you perform the printing in-house, please refer to [Regulation 1541](#), *Printing and Related Arts*.

■ Sold to the client prior to use

Since intermediate production aids and special printing aids are presumed sold to your client prior to use unless you explicitly retain title to the aids (see [page 15](#)), the sales price of the aid is considered included in the selling price of the final product. As such, you may generally purchase intermediate production aids or special printing aids for resale to your client by issuing a timely resale certificate to your supplier for these items or for items that will become an ingredient or component part of the aids. (See [page 16](#) for an exception to this rule.)

Example: You contract with your client for the production of artwork that will be reproduced in brochures to be given to visitors at your client’s new housing development. You purchase two illustrations from a graphic artist, including all rights to the illustrations, and use the illustrations to create finished art. The illustrations are provided to you on a CD. The artist charges you \$5,000 and, since you issued a resale certificate to the artist, you were not charged an amount for tax. In turn, you charge your client \$7,000, plus tax for the finished art.

As a retailer, assuming you sell the illustrations to your client prior to use (for example, you do not include a statement in your contract to the contrary), their selling price is included in the \$7,000 charge. The illustrations are intermediate production aids sold with the finished art.

In some instances, you may use a tangible aid to create an item whose sale is nontaxable. For example, you may use a special printing aid to produce printed matter in-house that you will ship to a client outside the state. Although the sale of the tangible special printing aid may be included in the selling price of the printed matter, the aid is used in California. Accordingly, you must generally report tax on the sale of the aid to your client. When the printing is done in-house, the taxable selling price is the amount you paid for the aid or for the production of the aid. This is true whether you separately state the selling price of the aids on your invoice or not.

Example: Your homebuilder client has a new subdivision in Arizona and asks that you produce brochures to promote sales of the homes in the subdivision. The production of the brochures requires a new printing plate (tangible product) costing \$1,300. You mail all the brochures to the homebuilder’s office in Arizona. The sale of the brochures qualifies as a nontaxable interstate sale. However, since the printing plate is sold to the client prior to use and is used in California, sales tax applies to the sale of the printing plate. You charge your client \$25,000 for the printing of the brochures, which includes the sale of the printing plate. Assuming you paid no tax when you purchased the printing plate, you must report tax on your cost of \$1,300. If you paid tax at the time of purchase, no further tax is due on the sale of the special printing aid.

Please note: When you purchase printed matter from a printer rather than produce the printing in-house, the rules that apply to your sale of special printing aids may differ from the rules that apply to a printer. Using the example above, if you had a printer print the brochures *and* your invoice to your client separately stated the selling price of the aids, tax would generally be due on the stated selling price as long as it is not less than your cost. In this case, you would be considered a print broker, not a printer and tax would be measured differently in relation to the aids. For more information about the sale of printed matter by a print broker, see discussion beginning on [page 25](#). For more information regarding how tax applies when you produce the printing in-house, please refer to [Regulation 1541, Printing and Related Arts](#).

■ How to rebut the presumption

When you hold title to an aid, if you do not wish to sell the aid to your client, you must include specific language in your contract or invoice stating that fact. That is, your contract must include a statement that the aid is not being sold to the client as part of the sale of the finished art or printed matter and you do not intend to pass title to the aid to your client. For example, you may include the following or a similar statement in your invoice or contract:

“The intermediate production aids [special printing aids] are not being sold to my client as part of the sale of the finished art [printed matter], and the selling price of the finished art [printed matter] does not include the transfer of title to the intermediate production aids [special printing aids].”

If you retain title to the aids, you should not purchase the intermediate production aids or special printing aids for resale. If you are producing the aids in-house, you should pay tax on your purchase of the components incorporated into the aids.

Remember, when acting as an agent, you may not issue a resale certificate for property you purchase on behalf

of your client. When you issue a resale certificate, the law presumes you are buying the property for resale to your client. As an agent, you never obtain title to the property and thus are neither the seller nor consumer of intermediate production aids or special printing aids. In this case, the aids are sold by the vendor directly to your client.

■ Client is reselling the aids to their customer

At times, your client will purchase products from you for resale to their customer. When your client is purchasing finished art or printed matter from you and intends to resell the items, generally the client may also purchase the intermediate production aids or special printing aids for resale. However, to do so, the client must have an existing obligation to resell the aids to their customer prior to the time the aids are used. Unless your client is a printer or print broker, it would be unusual for them to purchase special printing aids for resale to their customer.

Please note: You will not be regarded as selling the aids for resale to your client unless you separately state the selling price of the aids or their components on your invoice and you accept a timely and valid resale certificate from your client stating that the aids are purchased for resale. Additionally, as discussed in the following section, you must have the right to sell or sublease the aids to your client.

For more information regarding your sale or use of intermediate production aids and special printing aids as part of your sale of printed matter, please see [pages 25-28](#). If you sell finished art or other intermediate production aids to your clients for resale to their customers, you may read [Regulation 1541, Printing and Related Arts](#). The special rules applicable to special printing aids also apply to intermediate production aids.

■ Temporary transfers of production aids and special printing aids

The rule that intermediate production aids and special printing aids are resold to your client prior to use does not apply if you purchased the aids from a third party and do not have a right to resell or sublease the intermediate production aids or special printing aids to your client. This is frequently the case when you acquire artwork that is copyrighted from artists and photographers. They may transfer a tangible copy of the image, whether in hard copy or on digital media, and certain rights for copying and reproducing the image. However, artists and photographers generally do not transfer the right for you to either resell or sublease the image to your client. Accordingly, you cannot sell or lease the image to your client, and should pay any tax due to the artist or photographer or, if appropriate, report use tax on your purchase.

Example: You contract with a photographer to provide a river landscape to be used in an annual report you are creating for your homebuilder client. The photographer temporarily transfers a slide with the river landscape image to you, along with rights to copy the image subject to the copyright. You do not receive the right to sell or sublease the slide to your client, either temporarily or permanently. In this case, you cannot issue a resale certificate to the photographer and should pay any tax due on the transaction to the photographer or, if subject to use tax, self-report the tax. This is true even though you may have chosen to act as a retailer rather than an agent of your client. Tax would also apply to your charges for the production of the annual report shipped to your client in California without any deduction for the amount paid to the photographer or upon which use tax applied.

For more information about sales and leases of artwork and reproduction rights, see [pages 17-24](#). For an explanation of when charges for the right to use and reproduce artwork are not taxable, see [pages 31-34](#).

Sale and Use of Artwork

Artwork, whether in the form of drawings, photographs, or three-dimensional objects, is a key element in advertising. Frequently, your charges for the transfer or use of artwork are only partially taxable, either because part of your charges are related to preliminary art, or because the artwork sold or leased is part of a technology transfer agreement. At times, your charges may also include a taxable charge for the right to reproduce artwork produced by you or an outside party. This chapter discusses the special rules that apply to the sale or use of artwork. It also discusses taxable reproduction rights. For information on how tax applies generally to retail sales, see first chapter.

Artwork

Artwork includes illustrations, drawings, paintings, diagrams, color images, photographs, sculptures, and hand lettering. The artwork can be created by hand or electronically. As an advertising agency, you normally buy, create, or sell artwork for commercial use; that is, for use in activities such as advertising, promotion, publicity, marketing, publishing, corporate communications, packaging, news reporting, product development, merchandising, commercial display, etc. How tax applies to your charges for artwork will generally depend on the type of artwork, as well as your billing methods.

■ Type of artwork

Preliminary art vs. finished art

When concept or design services are provided in conjunction with furnishing artwork, the job usually results in the creation of “preliminary art,” as well as “finished art.”

- Preliminary art is the product of your concept or design services. It is artwork used to convey original ideas, concepts, looks, or messages to a client for review and acceptance before preparation of the final artwork. Typically, preliminary art is not suitable for reproduction purposes. Preliminary art includes sketches, roughs, visualizations, layouts, comprehensives, contact sheets, low-resolution images, direct positive prints, printed copies of rough digital layouts, and proof prints from film or slides. Tax does not apply to charges for creating preliminary art provided certain conditions are met. Instead, tax applies to the purchase of items used to develop the preliminary art.
- Finished art is the actual product sold or leased to a client for reproduction or display. Examples include finished designs, photographs, transparencies, high-quality inkjet prints, and high-resolution digital or printed images. Finished art may also include charts, graphs, or illustrations prepared for a client’s sales meeting. Charges for finished art are generally taxable based on the value of the finished art, as explained later in this chapter (but remember the electronic transmission exception—see [page 7](#)). Except for technology transfer agreements (see [pages 31-34](#)), charges for reproductions rights sold with the tangible artwork are also taxable.




Example: Your firm is engaged by a microbrewery to design labels for the different products it brews. Your client asks you to design a label for one of its seasonal brews: Autumn Smoke. You sketch several different designs and present them to the client. The client selects a design showing smoking hops and barley spilling out of a cornucopia. You redraw the image and present it to your client for approval of the color scheme. The client requests a few color changes, after which you create and provide the client with a full-color drawing that will be used in making the printing plates. The initial sketch and redrawn image are preliminary art since the client has not given final acceptance. The drawings were done prior to the client's approval to move ahead with the production of the finished art. The full-color drawing produced after receiving the client's approval to produce the final product is finished art.

Example: The owner of a small clothing boutique approaches your firm about a new logo it can use for its signage, stationery, and advertising. The owner has a limited budget and cannot afford the usual design services. To cut the costs, the owner accepts an existing design that was rejected by a prospective client, subject to some minor changes. Since the owner accepts an existing design, your contract is for finished art only.

How does tax apply?

■ Basics

The following table provides a basic illustration of how the tax rules apply to charges for artwork you sell to your clients. It is provided as an introduction only. Be sure to read the rest of this section to determine how tax applies to your charges. Also, please keep in mind the exclusion from tax for the electronic transfer of products.

Selling Artwork Created In-House		
	Service or Product	How Tax Applies to Charges
Preliminary Art	Development of Ideas, Concepts, Looks, or Messages for a Client  Sketches, Comps, Proofs, or Other Preliminary Work for Client Review and Approval	Charges are not taxable unless you permanently transfer possession or ownership of the sketches, comps, proofs, or other preliminary work products to your client.
Finished Art	Finished Art	Charges are generally taxable, based on the value of the artwork.

Preliminary art

Your itemized charges for concept and design services that create preliminary art are not taxable when all of the following conditions apply:

- You create the preliminary art at the direction of your client,
- The preliminary art is intended to convey ideas, concepts, looks, or messages,

- You present the preliminary art to your client for acceptance or approval purposes only,
- You retain ownership and permanent possession of the preliminary art used to convey the idea or concept. However, you may temporarily transfer it for review purposes directly to your client or to another advertising agency, a graphic design firm, another commercial artist, or another party involved in the design process, and
- Nothing in your contract transfers title to the preliminary art or the right to permanent possession to your client. However, you may transfer to your client the ownership of the intellectual property embodied in the art (ideas, concepts, designs, etc.), or agree not to use the preliminary art for any other client.

If you permanently transfer possession or ownership of some of the preliminary art products to your client, tax applies to your itemized charge for preliminary art in proportion to the amount of art you transfer in a tangible format. In other words, if your client keeps or owns all of the products of your creative work, your full charge for that work is taxable. If the client keeps or owns 50 percent of the products, 50 percent of your charge is taxable.

Example: Your microbrewery client requests a label design for its Nice 'n Spicy Winter Holiday Ale. You provide color sketches for six different designs, which constitute preliminary art. Your client selects one for further development and asks if he can keep three of the sketches. The client likes their holiday feel and wants to frame and display them in the reception area of the brewery. You separately charge \$3,000 for creating the six sketches. Since the client is keeping three of the sketches, tax applies to \$1,500.

Please note: You are the consumer of supplies and materials you use to create nontaxable preliminary art, including film, paper, paint, art supplies, chemicals, internegatives, ink, etc. You must pay tax to your supplier at the time of purchase or, when applicable, pay use tax on those items when you file your sales and use tax return.

Charging for preliminary art

As explained previously, itemized charges for preliminary art are not taxable unless you transfer ownership or permanent possession of all or some of the tangible preliminary art prepared in-house to your client. If you itemize your charges in your invoice or contract, be sure to identify charges for preliminary art as “design charges,” “preliminary art,” “concept development,” or another description that clearly indicates the charges are for the development and creation of preliminary designs, not for finished art. If you prefer not to itemize your charges for preliminary art, you may bill your client one lump-sum amount for preliminary and finished art. For lump-sum billing options, see [page 21](#).

Finished art

As explained on [page 17](#), finished art is the final product you provide to a client for reproduction or display purposes. Typically, finished art is delivered to clients in one of the following forms:

- A tangible drawing, whether done by hand or by computer
- An exposed piece of film (for example, a transparency, slide, film positive, or film negative)
- Camera-ready mechanical assembly
- A digital file on storage media, such as a CD, DVD, flash memory, or removable disk
- A digital file you electronically transfer to your client by modem or in person from a CD or other electronic storage media that you keep (not taxable, see [page 7](#))
- A three-dimensional object, such as a sculpture

Tax generally applies to your charges for the retail value of the tangible finished art you sell, license, or lease. This holds true whether your client keeps the finished art (a sale), a copy of the finished art (licensed copy), or returns it to you after reproducing it (a lease). The amount of tax due will depend on the value of the art, which in turn can vary depending on how you bill your client (see “Alternative billing methods,” on [page 20](#)).

Please note: These rules also apply to a commercial artist that makes a taxable sale of finished art to you directly or to you as an agent of your client. If you are working with the artist to develop the concepts or designs used in the artwork, a portion of the artist’s charges may not be taxable. That is, a portion may be for preliminary art.

Alternative billing methods

Your charges for artwork may cover all of the steps in the creative process, from your initial concept to the final production of the product qualifying as finished art. As explained in the following sections, when this is the case, you can itemize your bills or charge your client a lump-sum amount.

The table below provides a quick guide to how tax applies to different billing methods. Be sure to read the explanation for each method in the text rather than base your tax decisions on this table alone.

Type of bill	How tax applies (see text)	See explanation
Itemized bill: Separate charges for preliminary art/conceptual services and finished art.	Tax applies to charge for finished art sold in a tangible form.	Page 21
Lump-sum bill method 1: Value of finished art is 25% of total charge. (Can only be used in certain circumstances.)	Tax applies to 25% of total charge for preliminary art/conceptual services and tangible finished art. Tax will also apply to your charge, if any, for the right to reproduce the art (for example, copyrighted artwork).	Page 21
Lump-sum bill method 2: Value of finished art based on its retail value.	Tax applies to the retail value of the tangible finished art based on the actual cost of production, markup, and any taxable reproduction rights.	Page 22



As you read the following sections, please keep in mind that charges related to copyrighted artwork generally include an amount for the right to reproduce the artwork. The sale or use of copyrighted artwork typically involves two elements: (1) the actual artwork sold, licensed, or leased and (2) the copyright interest transferred that permits the use of the artwork as specified. When determining the amount of tax due on your sale or lease of tangible finished art, you should include any taxable charges for the right to reproduce the artwork.

■ Itemized bill

When you itemize charges for conceptual services/preliminary art and finished art, your charges for the preliminary art are generally not taxable and your charges for the tangible finished art are generally taxable. The charge for the finished art should reasonably reflect the cost of creating the artwork plus a markup for profit. As noted earlier, be sure to describe charges for preliminary art as “design charges,” “preliminary art,” “concept development,” or another description that clearly indicates the charges are for the development and creation of preliminary designs and not finished art.

■ Lump-sum bill combining charges for preliminary and finished art

There are two options for determining the value of artwork when you bill a lump-sum amount that combines only charges for preliminary and finished art. In the first, 25 percent of your charge is for finished art and the remainder is considered a nontaxable charge for preliminary art. In the second, tax is based on the retail value of the finished art. The methods are described below and on the following pages.

Method 1, “75/25”: Tax based on 25 percent of lump-sum charge

If your lump-sum charge to your client includes only charges for producing artwork, from concept to finished art, you may use the “75/25” billing method. Charges for producing the artwork include the cost of any intermediate production aids, which may be part of the lump-sum charge unless separately itemized on the billing invoice. Under method 1, sales tax applies to 25 percent of your total charge. The other 75 percent of your charge is considered nontaxable conceptual services and preliminary art.

To use this method, your lump-sum charge should include only charges that are related to the creation of preliminary and finished art. You should not use the “75/25” tax method if:

- Your lump-sum charge includes any charges not related to the creation of preliminary and finished art (*example*: a combined lump-sum charge for research and artwork).
- Your bill lists separate charges for any conceptual services or other nontaxable charges related to the creation of the artwork in addition to a combined charge that represents preliminary art and finished art.
- Your lump-sum charge includes a charge for the reproduction rights associated with the right to reproduce the finished art. The reproduction rights in this case are not a cost associated with the creation of the finished art, unlike the case with an intermediate production aid (see below).
- Your cost for intermediate production aids to produce the finished art, including any taxable reproduction rights associated with the use of the intermediate production aids (for example, license to use or right to reproduce), is more than 25 percent of your lump-sum charge when a charge for these items is included in the lump-sum amount.

Example: You charge your microbrewery client \$5,000 for the Autumn Smoke label design. The charges are only for the creation of the preliminary and finished art, which includes the cost of an intermediate production aid purchased from an outside party for \$550. Since the amount includes no charges for other services or products unrelated to the creation of the artwork and the cost of the aid is less than 25 percent of the lump-sum charge, you may use the “75/25” billing method. That is, you would report tax on only \$1,250 of the total charge (\$5,000 x 25 percent). If the charge associated with the intermediate production aid were separately itemized, tax would generally apply to the itemized charge in addition to 25 percent of the lump-sum amount.

Example: You are hired to develop tangible artwork your client will use in its upcoming advertising campaign. Your in-house art department develops various concepts and designs for use in the advertising materials. You present the concepts and preliminary designs to your client and receive approval to go forward with the creation of the final design. You transfer a copy of the final design to your client on a CD. You do not sell the artwork (final design) to your client, but you do grant your client the right to reproduce the artwork in its advertising materials. You charge your client a lump-sum amount of \$5,000, which includes your charge for the right to reproduce the artwork in their advertising materials. Your transaction does *not* qualify as a technology transfer agreement (see [page 31](#)). Because your lump-sum charge includes an amount for the right to reproduce the final design, you should remove and separately state your charge for the reproduction rights from your lump-sum charge for the artwork prior to using the “75/25” method; or you should use the “actual basis” method to calculate the retail value of the finished art.

As stated previously, you may use the “75/25” presumption only when your lump-sum charge includes an amount for conceptual services (creation of preliminary designs) and the creation of the finished art. The reproduction rights included in your lump-sum charge are not associated with the creation of the finished art; rather they represent a charge for the right to reproduce the artwork after its creation.

Method 2, “Actual Basis”: Tax based on retail value of finished art

When you cannot use the “75/25” method of calculating tax on a lump-sum amount or you choose not to, you should use the “actual basis” method. In this method, tax applies to the retail value of the tangible finished art. You should calculate the retail value of the finished art by adding all of the following:

- Cost of direct labor to create the finished art. This includes expenses such as amounts you pay to third parties or employees, models, or technician fees. The cost of direct labor also includes the value of your labor. It does not include travel expenses such as airfare, car rentals, or meals and lodging.
- Cost of items you purchased, which are physically incorporated into the finished art.
- Cost of any intermediate production aids, such as color separations or scans, used to make the finished art, including any taxable reproduction rights associated with the use of the aids.
- A reasonable markup based on your operations.

The difference between the calculated value of the finished art and your total charge is presumed to be the nontaxable charge for your conceptual services and preliminary art. Remember, if you also make a charge for the right to reproduce the *finished art*, you should include your charge for the reproduction rights when billing your client. Unless your contract with your client qualifies as a technology transfer agreement, your charge for the right to reproduce the finished art will generally be taxable (see [page 23](#)).

Example: Your travel agent client hires you to produce brochures that will advertise its new package deal for travel to Africa. Your staff photographer will travel to Africa and take photographs of various tourists on safari. Given the client approves your concept, selected images will be reproduced in brochures the client will provide to their travel agencies. The photographer takes 100 photographs during the visit, which illustrate happy tourists of various ages on safari. The film for the shoot was purchased in California before the trip and was processed in California upon the photographer's return.

Your client reviews all the photographs and selects ten separate photographs for further enhancement and reproduction in the brochures. The remaining photographs are retained by you. The client purchases all rights to the ten photographs. You bill your client a combined charge of \$8,200 for your concept development and finished photographs, which includes the photographer's time, preliminary and finished art charges, production aids, and a reasonable markup. You provide no separate selling price for the ten photographs. To determine the taxable selling price of the final images you compile the following costs:

Cost of the staff photographer (five days at \$1,500/day)	\$7,500.00
Film and processing costs	200.00
Enhancement of selected images/aid	500.00
Total combined charge	<u>\$8,200.00</u>
Taxable finished art ¹	\$1,270.00
15% markup (\$1,270.00 x 0.15 ²)	190.50
Value of finished art (taxable, plus markup)	<u>\$1,460.50</u>

¹ Taxable amount includes photographer and film/development costs at 10%, plus enhancement (10 of the 100 photographs purchased by client, resulting in 10% of the total costs for the photographer and film/processing being taxable. (($\$7,500 + \$200 = \$7,700$)($\$7,700 \times 10\%$) + $\$500 = \$1,270$)).

² Markup of 15 percent is shown for example purposes only.

■ Sales for resale

Occasionally you may create artwork in-house and sell it to a client who wants to buy it for resale. You may make a nontaxable sale for resale if you transfer title to the artwork to the client and the client:

- Gives you a timely, complete resale certificate, and
- Intends to sell the artwork as is or physically incorporate it into another product that will be sold.

■ Reproduction rights

Graphic artists, commercial photographers, and other advertising agencies may sell, license, or lease, artwork such as illustrations, photographic images, paintings, so forth and make a charge for the right to reproduce but not sell the artwork. The charge may be identified as a charge for reproduction rights or as a "copyright interest," "license to use, (limited time or limited purpose)" "license," "advance royalty," or "royalty contract." Generally, charges for reproduction rights in connection with the transfer of tangible finished art such as an illustration or photographic image are taxable when your client intends to reproduce the artwork, but not sell the product on which it is reproduced.

Example: You hire a commercial artist to develop illustrations for your client’s letterhead. You are acting as the agent of your client. The commercial artist provides conceptual design services with no transfer of title or possession of the preliminary designs. Once your client provides approval to proceed with the final design, the commercial artist produces the final illustration that will be reproduced on the client’s letterhead. A copy of the illustration is transferred to you on a CD. The commercial artist makes a charge for the right to reproduce but not sell the final illustration. The commercial artist’s billing to your client includes the following charges.

Concept development and preliminary designs	\$2,200.00
Final illustration	500.00
Reproduction rights	1,500.00
Tax (\$2,000.00 x 0.0775)	155.00
Total	<u>\$4,355.00</u>

Since you acted as the agent of your client and the client will reproduce the illustration in its company letterhead, the transaction does not qualify as a technology transfer agreement. Accordingly, the charge for the reproduction rights is taxable along with the charge for a copy of the final illustration transferred in a tangible format. Because the artist retained title and permanent possession of the preliminary designs, the charge for the concept development is not taxable. For information regarding when reproduction rights are not taxable, see [page 32](#).



Sale of Printed Matter

An advertising agency may act as an agent of its client, or choose to act as a retailer, when purchasing printed matter. Occasionally, an agency may produce the printed matter in-house. This chapter discusses the rules that apply to the sale of printed matter purchased from a printer for resale. You should read this chapter if you contract with your clients for the production of printed matter, and you purchase the printed matter from a printer for resale to your client. For information on the rules that apply to the production and sale of printed matter in general, please see [Regulation 1541, Printing and Related Arts](#). For information about how tax applies to your purchases of items as an agent of your client, please see first chapter.

Printed matter purchased for resale

When you purchase printed matter from a printer, the printer is presumed to have made a taxable retail sale of the printed matter, unless you issue a timely and valid resale certificate. The printer is also generally presumed to be selling any special printing aids used during the printing process, as part of the sale of the printed matter. Normally, the printer's sales of the special printing aids are taxable.

The fact that the printer may sell the printed matter to you for resale to your client does not necessarily mean that the aids are also sold to you for resale. For you to purchase the aids for resale to your client, you must intend to resell the aids prior to the time the printer uses the aids. That is, along with your contract with your client for the sale of the printed matter, you must also have a contract with your client for the sale of the special printing aids. The contract must be entered into before the printer begins production of the printed matter. If this is not the case, you should not purchase the special printing aids for resale.

■ Special printing aids defined

As discussed on [page 14](#), special printing aids are reusable manufacturing aids, which are used by a printer during the printing process and are of unique utility to a particular customer. Special printing aids include electrotypes, stereotypes, photo engravings, silk screens, steel dies, cutting dies, lithographic plates, film, single or multicolor separation negatives, and flats. Special printing aids may also include items such as artwork, illustrations, and photographic images used to create other special printing aids or finished art (intermediate production aids).

■ Printer and print broker defined

A printer is a person engaged in the printing process. A print broker is a person who contracts to sell printed matter but who does not actually engage in the printing process to produce the printed matter that will be sold. Instead, a print broker purchases printed matter from a printer or another print broker for resale to its customers.

■ Issuance of a resale certificate

When you issue a resale certificate for the purchase of special printing aids, you are generally liable for tax on your sale of the special printing aids to your client even if the sale of the printed matter produced with the special printing aids is not taxable (for example, a sale in interstate commerce). This holds true unless your sale is to the U.S. government or a print broker who issues you a timely resale certificate for their purchase of the printed matter and aids.

Advertising agency's sale of printed matter and special printing aids

An advertising agency that purchases special printing aids for resale from a printer who uses the aids to produce the printed matter is presumed to have resold the aids to its client prior to any use, along with the printed matter, when the following conditions are met:

- The agency acquires title to the aids,
- The agency has an existing obligation for the sale of the aids to its client at the time the aids are purchased, and

- The agency does not include a statement in its contract with its client or in their sales invoice that it is retaining title to the aids.

However, even though you may issue the printer a resale certificate for both the purchase of the special printing aids and the printed matter, the sale of the aids to you will generally be taxable unless:

- The printer separately states the charge for the special printing aids on its sales invoice, and
- The printer's charge for the aids is at least the amount the printer paid for the aids or their components.

■ Existing obligation to sell special printing aids

You cannot purchase special printing aids from a printer for resale unless you have an existing obligation to resell those particular aids to your client prior to the printer's use. If you do not have an existing obligation, the printer will use the aids on your behalf before you can resell them to your client. The fact that you have an existing obligation to resell the aids prior to use may be demonstrated by a purchase order, invoice, or other agreement as long as the agreement was in place before the special printing aids were used in the printing process. The same is true when your client is a print broker purchasing the aids from you for resale to their customer.

■ Sales to the U.S. government

When you issue a resale certificate for your purchase of special printing aids and the printed matter produced with the aids for resale to the U.S. government, your sale of the special printing aids and the printed matter is exempt from tax. See [page 6](#) for more information concerning sales to the U.S. government. You may also find additional information in [Regulation 1614, Sales to the United States and Its Instrumentalities](#).

■ Nontaxable sales of printed matter

When your sale of printed matter is not taxable, even though you may issue a resale certificate for your purchase of the special printing aids and the printed matter produced with the aids, your sale of the special printing aids is generally taxable. This is true even though your sale of printed matter may qualify as a nontaxable sale in interstate commerce, an exempt sale of qualifying newspapers, periodicals, or printed sales messages, or a nontaxable sale for resale.

If you separately state your charge for the aids, assuming your separately stated price for the special printing aids is not less than the amount the printer charged you for the aids, tax will be due on your separately stated charge. If your charge is less than the amount the printer charged you, or you do not make a separate charge for the aids, tax will be due on the amount you paid the printer for the aids.



Example: You are hired to produce brochures for your client’s advertising campaign to kick off a new housing development. You choose to be the retailer, not the agent of your client, and include the proper statement in your contract. Your contract with the client also includes the sale of the special printing aids. The brochures will be delivered by the U.S. Postal Service to locations in the surrounding area at no cost to the recipients (printed sales messages).

You hire a photographer to photograph several of the model homes. The photographer charges you \$1,000 for the photographs, plus tax, and transfers all rights to the photographs to you. You develop some preliminary designs using the photographs and present them to your client. Your client approves one of your designs and gives approval for you to produce the brochures. You reproduce one of the images as part of your final design. You retain title and possession of all preliminary matter but do not retain title to the aids used to produce the final design.

You hire a printer and transfer the necessary files to the printer. You issue a resale certificate for your purchase of the printing aids. The printer produces a printing plate from the files and prints the brochures. The printer also delivers the brochures to the mailing house for mailing. The printer invoices you a separate charge of \$1,500 for the printing aids and \$5,000 for the printing of the brochures. You are also charged \$550 for the mailing of the brochures. Your invoice to your client shows the following charges:

Preliminary concepts and design	\$2,500.00
Illustration and layout (finished art)	500.00
Printing plate	1,600.00
Postage and delivery	550.00
Printing of brochures	5,500.00
Print supervision	300.00
Sales tax (\$2,100.00 at 0.0725 ¹)	152.25
Total	<u>\$11,102.25</u>

¹ Tax rate of 7.25 percent used for illustration purposes only.

Given the brochures qualify as printed sales messages, your charge for the printing of the brochures is nontaxable. Since the print supervision is for a third-party transaction, your charge is nontaxable. Your charge for the concepts and design is also nontaxable. Since the itemized mailing charge is at cost, your charge for this is also nontaxable. The only taxable charges are your charges for the illustration and layout (intermediate production aid) and the printing plate (special printing aid).

■ Sales of special printing aids for resale

Occasionally, your client may ask to purchase both the printed matter and the special printing aids for resale to their customer. Unless your client is a print broker and, in fact, will resell the special printing aids to their customer prior to the printer’s use of the aids, you should not accept a resale certificate from your client for their purchase of the aids. Even though your client may purchase the printed matter for resale to their customer, tax will generally apply to your sale of the special printing aids used in California, as discussed on [page 28](#).

Please note: A person never purchases special printing aids for resale when the printed matter produced with the aids is sold to several purchasers. For example, a person purchasing newspapers for individual sale cannot purchase special printing aids for resale because the individual purchasers of the newspaper are not also purchasing the special printing aids. A person purchasing newspapers for sale to the general public is not purchasing special printing aids for resale to the general public.

■ Taxable sales of printed matter

When your sale of printed matter is taxable, your sale of the special printing aids purchased for resale to your client is also taxable. Tax applies to your entire charge for the printed matter and the aids whether or not the charge for the special printing aids is separately stated on your sales invoice. If you make a separate charge for the aids, the separate charge is subject to tax along with the charge for the printed matter. If you do not make a separate charge for the special printing aids, your taxable charge for the printed matter includes the sale of the aids, and no further tax is due on your sale of the aids.

Example: Using the example on [page 27](#), instead of mailing the brochures to area residents, your client asks that you have the brochures sent to the model homes. Instead of separately itemizing all your charges on your invoice, you decide to bill your client a lump-sum amount for the printing and the aids, which includes your in-house production of the finished art. Your invoice to your client shows the following charges:

Preliminary concepts and design	\$2,500.00
Printing of brochures (including the applicable tax)	8,000.00
Print supervision	300.00
Mailing to Shady Acres Subdivision	550.00
Travel to assist photographer	300.00
Total	<u>\$11,650.00</u>

The brochures do not qualify as printed sales messages because they are mailed to the homebuilder, not to recipients in the area at no charge. You are the retailer, not the agent of your client, since you elected retailer status by making the required statement in your contract. Since the mailing charge is itemized on the invoice at the actual cost, the charge is nontaxable. Because you retained title and possession of the preliminary designs, your charge is nontaxable. Your charges for the print supervision and travel are also nontaxable since the travel is related to the preliminary concepts and the print supervision is related to a third-party transaction. Although you did not make a separate charge for the aids, these charges are included in your taxable charge for the printing, and no further tax is due in relation to the sale of the aids.

■ Sale of the printed matter is partially taxable

Occasionally, you may sell printed matter, a portion of which is taxable and a portion of which is not. For example, you may contract with your client for the production of printed sales messages. You deliver some of the printed matter as required for the sale to be exempt from tax (see [page 9](#)). You also deliver a small quantity directly to your client. When you make a sale of printed matter that is split between taxable and nontaxable, your sale of the special printing aids is fully taxable.

Similar to your sales of printed matter that are fully taxable, if you separately state the taxable selling price of the special printing aids on your sales invoice and the price is not less than the separately stated amount the printer charged you for the aids, tax will be due on your charge.

If you do not make a separate charge, the taxable portion of the sale of the printed matter is regarded as including the taxable sale of the special printing aids, as long as the sale price of the taxable portion of the printed matter is at least equal to the separately stated amount the printer charged you for the aids. If so, no further tax is due on the sale of the aids. If the taxable portion of your sale of the printed matter is less than the separately stated amount the printer charged you for the special printing aids, you owe tax on the difference.

■ Digital prepress instruction

“Digital prepress instruction” converts electronic files produced by different computer programs into specific, original instructions or information necessary to prepare and link files for the output of an image to film, plate, or

press. Digital prepress instruction qualifies as a custom computer program, and the charges associated with the creation of the digital prepress files are not taxable provided the files are prepared to the special order of the client. The development of digital prepress instruction generally involves the following four steps/processes:

- First step—image capture: The images needed for the print job are captured in a digital format. Hard copies of artwork such as an image or illustration are scanned to capture the image. Programs used to perform this first step are usually tied to the hardware used in capturing the image such as Agfa Fotolook or Epson LaserSoft Silverfast Ai.
- Second step—image manipulation: Once the image is captured, it must be reviewed and adjusted for output. If the image is a photograph, the main objective is generally that the image matches the color desired by the client and this is accomplished with paint software such as Adobe's Photoshop. If it is an illustration or other such graphic file, the image is manipulated to the desired output by software such as Adobe's Illustrator.
- Third step—page layout: Text, graphics, and photographs are combined in a single file and positioned for output. Page layout software such as QuarkXpress or PageMaker allow these elements to be imported and positioned, resulting in what is commonly called the mechanical, mechanical assembly, or finished art.
- Fourth step—output: The page layout file is sent to "print" to a specific high-resolution device through a postscript driver. The postscript driver converts the page layout program along with the graphics and photographs to postscript code. Postscript code is a page description language developed to describe an image for printing.

The postscript code is sent to a control device such as a Raster Imaging Processor that interprets the postscript code into device specific language. An object or display list is created in the processor's memory to control certain options of the printing device and then converted (for example, rasterized) to a single file using the parameters of the destination printing press. The resulting electronic file is digital prepress instruction, which will be used to prepare film or plates or the file will be sent direct to press for printing.

The same person may perform all four steps or more than one person may perform one or more of the steps. For example, you, or another person on your behalf, may perform the first three steps only and the file generated by the first three steps will be sent to a printer or prepress house for conversion into postscript code and creation of the digital prepress instruction. Alternately, you may produce the digital prepress instruction in-house and provide the necessary files to a printer who will use the files to prepare film or printing plates. Whatever the case, it is important to remember that the fourth step must be performed in order to create digital prepress instruction.

Please note: Persons who provide digital prepress instruction are consumers of any items used in the creation of the digital prepress instruction. Accordingly, the purchases of items used in creating the digital prepress instruction or the use of production aids that are not sold by the provider of digital prepress instruction prior to use (for example, intermediate production aids and separations) are generally subject to tax.



Example: You create a page layout file, which includes original artwork with a desktop publishing program. You convert the file into a form readable by a plate maker for use in the printing of your client’s product. Your charges for the time and material used for the file conversion that results in the specific instructions or information necessary to prepare and link files for output to film, plate, or direct to press are charges for digital prepress instruction and are not taxable. This holds true even when you transfer the digital prepress instruction in a tangible form such as a CD or tape.

However, your purchases of materials used in the process of creating the digital prepress instruction would be subject to tax. Tax would also apply to your *purchase* of any tangible intermediate production aids, or their ingredients and components if produced in-house, unless the aids were sold to your client prior to use. For example, if you had used a *tangible* intermediate production aid in your creation of your artwork rather than creating it with a desktop publishing program, and the aid was sold to your client prior to use, tax would generally apply to your sale of the aid. This is true even though your charges for the conversion of the file into digital prepress instruction may have qualified as nontaxable.

Example: Using the previous example, even though you have the ability to perform the processes necessary to create digital prepress instruction, you choose to forward the files containing the artwork to a printer for completion of your client’s print job. If you do not perform the last step/process, you have not created digital prepress instruction. When you perform the first three steps/processes and transfer a page layout file to the printer, you have made a sale of a mechanical or finished art that, if transferred in a tangible form, is subject to tax as discussed on [page 13](#). Once the printer receives the page layout file, the printer will generally send the page layout file to “print” and begin the process of creating digital prepress instruction.

Related charges that are not for digital prepress instruction

Fabrication labor—Charges for scanning artwork, creating original artwork by computer, or manipulating scanned images are considered charges for fabrication labor and are generally taxable when the output of this labor is transferred in a tangible form to the client or another party. In essence, you are producing an intermediate production aid that will be used in the production of a special printing aid.

Proof art—As part of the digital prepress process, you, or the printer on your behalf, may provide proofs to your client for review and acceptance prior to printing the final product. Charges for proof art delivered to your client or another person on behalf of your client are taxable.

Film or printing plates—Charges for film or plates are charges for special printing aids and tax applies as discussed previously. Such charges are not for digital prepress instruction even though the film or plates may be prepared from the electronic digital prepress file.



Technology Transfer Agreements

This chapter is intended for advertising agencies that are transferring or licensing rights to finished art for reproduction on items that will be sold. If your sale or lease of artwork does not include the transfer of reproduction rights or any assignment or licensing of copyright for reproducing artwork on items that will be sold, the information in this chapter does not apply to your transaction. See section beginning on [page 17](#). You may also wish to obtain a copy of [Regulation 1540](#), Advertising Agencies and Commercial Artists, and [Regulation 1541](#), Printing and Related Arts.

“Technology transfer agreements,” defined

When you sell, license, lease, or otherwise assign a copyright interest in artwork or other like property, your arrangement with your client may qualify as a “technology transfer agreement” (TTA). A TTA, as it relates to artwork you sell or lease to clients, must meet all the following conditions. It must:

- Be in writing.
- Assign a copyright interest in the product (finished art) being sold or leased (often indicated by language such as “copyright,” “reproduction right,” “use for limited time or purpose,” “license,” “license fee,” “advance royalty,” or “royalty contract”).
- Show the buyer’s clear intent to reproduce and sell merchandise subject to the copyright interest.

If one or more of these conditions is not met, the agreement is not a TTA.

■ Examples

The following examples illustrate when a transaction does and does not qualify as a TTA.

Transactions that qualify as technology transfer agreements

Example: You obtain artwork as an agent of your client from a third party (commercial artist) under a written contract that allows your client to reproduce the image on boxes of software it sells.

Example: You provide copyrighted finished art illustrating a landscape to a calendar publisher under a written contract. The contract permits the publisher to reproduce the image in wall calendars the publisher will sell to retail stores.

Example: You acquire copyrighted artwork under a written contract that allows you to reproduce the images in advertising materials you will sell to your client for distribution at an advertising seminar. You have the materials printed by a third party. Your master contract with your client reflects your retailer status.

Each of these agreements/contracts qualify as a TTA: they are in writing, they assign a copyright interest, and the buyer will reproduce the images on, or incorporate into, products that are for sale and subject to the copyright interest.

Transactions that do not qualify as technology transfer agreements

Example: Same fact pattern as presented in the previous example except your master contract does not include the necessary language to document your status as a retailer and no other circumstances have occurred under which you would be regarded a retailer. Since you are presumed to be the agent of your client and your client will not be selling the advertising materials, your contract does not qualify as a technology transfer agreement.

Example: A corporation hires you to design a company logo for its annual report. Your contract authorizes your client to reproduce the logo in the annual report, which is distributed free to shareholders.

Example: A client purchases some of your illustrations to reproduce in a series of roadside billboard advertisements promoting its products.

These agreements/contracts do not qualify as technology transfer agreements because the buyer will not reproduce the images on or incorporate into products that are for sale and subject to the copyright interest. These contracts are likely covered by the rules that apply to sales of artwork in general.

If your transaction does not meet the conditions for a TTA or fit any of the examples of a TTA, it does not qualify as a TTA. Please return to [page 17](#) for more information regarding sales and transfers of artwork in general.

Applying tax to a technology transfer agreement

As is the case for copyrighted artwork in general, when you sell, license, or lease artwork as part of a technology transfer agreement, the transaction generally involves two elements. Each element has value. The elements are:

- The actual artwork or image you sell, license, or lease.
- The copyright interest you transfer to your client that permits the client to use the artwork as specified in the agreement.

Unlike copyrighted artwork in general, under a technology transfer agreement, tax applies to the fair market value of the artwork itself but not to the value of the copyright interest. If you transfer artwork in a tangible format to your client, such as a print, slide, negative, transparency, or digital image on a CD, you must determine its taxable value in one of the ways explained on the table on [page 33](#). However, if you transfer a digital image in any of the ways listed below, and you do not transfer any tangible products to your client, tax will not apply to your charges for the artwork.

- Remote, electronic transfer to your client (see [page 7](#)).
- “Load and leave” electronic transfer (see [page 7](#)).
- Temporary transfers of the finished art on a digital storage media provided your client returns the media to you within a 30-day billing cycle (or within a longer period if necessary to allow the client sufficient time to copy the digital file).

Example: You acquire artwork from a commercial artist that you will reproduce in materials you will sell to your client. You make the necessary statement in your contract for you to act as a retailer, not an agent of your client. The artist indicates in their written contract that reproduction rights are being sold. The rights being sold allow you to reproduce the artwork in materials you will sell to your client. You are not allowed to resell or sublease the artwork or the licensed copy of the artwork. The artist transfers some of the artwork to you in digital files on CDs. Other artwork is transferred on paper or art board. You must return all of the artwork to the artist after downloading or scanning the images into your computer within 30 days.

All transfers of artwork in this example are being made pursuant to a technology transfer agreement. Therefore, no tax is due on the fair retail value (artist’s charge) of the artwork temporarily transferred to you by CD. Tax is due, however, on the artist’s charge for the temporary transfers made on paper or art board. The charges for the right to reproduce the artwork would not be taxable.

Please note: If the artwork transferred to you on CD was not returned by you as required by your agreement, the artist’s charges to you for the artwork could be taxable in the same manner as the artwork transferred on paper or art board. For information regarding how to determine the tax due on charges for artwork sold, leased, or licensed under a TTA, see [page 33](#).

The following table shows how to determine the tax due on your charges for finished art (artwork) you sell, license, or lease under a technology transfer agreement.

Applying tax: technology transfer agreements	
Written contract terms	The taxable fair market value is
Includes a charge for the sale or lease of the artwork and a separate charge for the reproduction rights.	The separately stated sale or lease price for the artwork.
Charges are lump sum.	1) The price at which you have sold or leased, or offered for sale or lease, that artwork or similar artwork to an unrelated third party, when either of the following is true: <ul style="list-style-type: none"> • You did not transfer reproduction rights. • You transferred reproduction rights and separately stated the selling price of the artwork. 2) If you cannot determine a separate price based on prior sale or lease price, 200 percent of the combined cost of materials and labor used to produce or acquire the artwork. See “Establishing the cost of labor and materials” below.

■ Establishing the cost of labor and materials

Materials

The cost of materials includes your cost for items used in producing the artwork or incorporated into it. Cost of materials also includes the cost of any tangible product transferred as part of the TTA. Examples include:

- For an image provided on digital media: (1) your cost for the blank diskette, flash memory, removable disk, DVD, or CD; and (2) your cost for leasing any equipment or props for the development or creation of the specific image (for example, photo shoot).
- For finished art in a tangible form, for example, a transparency: (1) your cost for paper, ink, and chemicals incorporated into the final print or transparency; and (2) your costs for any production aids used, including any taxable reproduction rights associated with the production aids.

Labor

The cost of labor includes any costs to you for the labor used to create the artwork, such as labor you purchased from a third party or work performed by your own employees. This includes costs for work performed by people who create the artwork as well as those who share in its creation.

The cost of labor does not include any of the following:

- The value of your own labor if you are a sole proprietor
- Travel expenses such as airfare and car rental
- Meals and lodging expenses

Example: You contract with a manufacturer to develop a product logo that will be reproduced on the manufacturer's product and packaging. Your written contract is lump sum and you have no similar sale or lease price upon which to determine the fair retail value of the artwork. The contract price is \$40,000. The transaction is a TTA because there is a transfer of reproduction rights and the manufacturer will reproduce the image on property subject to the copyright interest that will be sold. You will permanently transfer the logo to the manufacturer.

Your records indicate that your in-house art department spent 50 employee hours creating the finished art/logo. The average labor cost for the in-house art department is \$35/hour per employee. The records also indicate that the materials used to transfer both a hard copy and digital copy of the finished art cost approximately \$10. The measure of tax for the sale of the finished art transferred is computed as follows:

Labor: \$35/hour x 50	\$ 1,750.00
Materials	10.00
Total for materials and labor	\$1,760.00
Taxable total (\$1,760 x 200 percent)	\$3,520.00
Tax (\$3,520 x 0.0775)	272.80
	272.80
Contract Price	\$40,000.00
Tax due	272.80
Total	\$40,272.80

■ Licensing arrangement may be a lease

If your licensing agreement requires your client to return the tangible property on which you transferred the artwork, the transaction is considered a lease. Tax applies as for any other TTA (see special exception for transfers on digital media, [page 32](#)).

A client may want to give you a resale certificate for a lease transaction (see below). However, the temporary transfer of artwork under a lease does not qualify as a nontaxable sale for resale unless you are authorizing the client to sublease the artwork to a third party in the same form you are providing it. If you are not authorizing that kind of subleasing, you should not accept a resale certificate.

■ Sales for resale

Artwork sold under a TTA will normally not qualify as a sale for resale, since your client will use the artwork to create or produce other products to sell. In addition, your client cannot pass ownership or possession of the artwork to another person unless you specifically allow the client that right.

If you accept a resale certificate from your client under a technology transfer agreement transaction, be sure the TTA states that the specific artwork is being purchased for resale in the regular course of business before any use, and that you have given your client the right to transfer ownership or possession of the artwork to a third party.

For more information, see [publication 103](#), *Sales for Resale*, and [Regulation 1668](#), *Sales for Resale*.

Creative Art Services for the Motion Picture Industry

This chapter addresses the special rules that apply to advertising agencies that work in the motion picture industry. For more information, you may order a copy of [Regulation 1529](#), Motion Pictures.

“Creative art services” and “qualified motion pictures,” defined

Creative art services are services performed only to convey ideas, concepts, looks, or messages, as opposed to services that create artwork your client will reproduce or display. Sales tax does not apply to your charges for “creative art services” provided in connection with the production, distribution, or exploitation of a “qualified motion picture.”

Qualified motion pictures may be for any purpose including entertainment, commercial, advertising, promotional, industrial, or educational. They include:

- Motion pictures produced for display at theaters, amusement parks, or on commercial carriers; television shows including closed circuit and broadcast; commercials; trailers; television spots; specials; featurettes; “promos;” “sneaks;” corporate training and sales presentations; video press kits; music videos; and special effects, titles, and credits on film, tape, or other motion picture media, including digital media.
- Original and adapted versions including productions adapted to another language or medium.
- Motion pictures produced for the federal government or its instrumentalities, foreign governments, and state and local governments and their political subdivisions.

Films and videos created for family use, such as wedding videos, do not qualify as motion pictures.

Your creation of visualizations, drawings, sketches, renderings, illustrations, layouts, comprehensives, photographs, negatives, transparencies, prints, scans, laser graphics, visual prototypes, electronic imagery, and other preliminary designs can qualify as creative art services as long as the client will not reproduce or display your work. However, qualifying creative art services do not include services for the preparation of finished art. The fact that your client is a motion picture studio does not necessarily mean all of your charges qualify as creative art services.

■ Applying tax

Unlike conceptual services in which you may create and transfer permanent possession of your preliminary designs to your clients, resulting in a taxable sale, when you provide qualifying creative art services, you are performing nontaxable services rather than selling tangible products. This is true even if you transfer the product of the creative art services to your client. Because you perform nontaxable services, you are considered the consumer of the tangible items used in providing the creative art services, such as CDs, transparencies, paper, etc. Your purchases of those items do not qualify as nontaxable purchases for resale. If your client later reproduces or displays the products of your services, the client owes use tax based on the amount paid to you for the creative art services.

Example: You contract with a movie studio to create a rendering of a horse during the filming of a feature film. The renderings are intended to convey your ideas about possible ways to advertise the film. As part of your contract, you provide the client your preliminary designs. Although the movie studio may not return the designs, your activities qualify as creative art services since you are transferring the designs only to convey ideas and concepts and the movie studio will not reproduce or display them. The transfer of the designs is not a taxable sale, and you are the consumer of the paper, production aids, and related items used in producing the designs.

Example: You contract with a movie studio to create preliminary color schemes for molds that may be used in the production of animal figurines. The studio is considering using various figurines to advertise and promote a movie soon to be released at theaters. The studio asks you to create renderings and molds in various color schemes, with a deer sitting, standing, running, etc. You do not have a contract for the production of molds the studio may actually reproduce and use in their advertising. The rendering and molds are solely to convey your ideas for varying color schemes.

You produce renderings and preliminary molds in varying colors and send all the renderings and molds to the studio for their consideration. Under your agreement, the studio retains your renderings and molds, but does not enter into a contract with you for any further development of your ideas. Your services qualify as creative art services and tax does not apply to your charges to the studio for your work. However, you must pay tax on your cost of any items used to produce your preliminary designs, including items that are incorporated into your preliminary designs.

Example: The studio executive you worked with on your last job liked your work so much he asks you to attend his daughter's wedding reception and produce drawings and renderings of the wedding party. If he likes the drawings, he may have you produce items that will be displayed in his office. You prepare the drawings and send them to the executive for approval. He decides to keep all the drawings, but does not ask you to produce a final version of any of the drawings. Your charges to the studio executive are subject to tax. Although he may work for the studio, you did not perform creative art services. Since he kept all your drawings, you have made a taxable sale of the preliminary designs.

For more information regarding the sale of preliminary art in general, you should read the chapter beginning on [page 17](#).



Applying Tax to Your Purchases

This chapter addresses purchases commonly made by advertising agencies. It includes information on purchases of services, production aids, special printing aids, finished art, and other like items. For more information, you may obtain a copy of [Regulation 1540](#), Advertising Agencies and Commercial Artists.

Purchases for resale

You may issue a resale certificate to your vendor when you buy items you will resell rather than use. This allows you to make the purchase without paying tax until you sell the product. You may issue a resale certificate to purchase:

- Products you sell to clients as is.
- Products that become a tangible part of products you sell to your clients.
- Intermediate production aids and special printing aids sold to the client prior to use.
- Digital storage media (DVDs, CDs, flash memory, diskettes, removable disks) you sell to clients rather than retain in your business.
- Fabrication labor.
- Packaging supplies you use to wrap property you sell.
- Items you use exclusively for demonstration and display while you hold them for sale in the course of your business.

For general information on purchases for resale, see [publication 103](#), *Sales for Resale* or [Regulation 1668](#), *Sales for Resale*. For information on purchases for resale of photographs, production aids, or other photographic materials, see [publication 68](#), *Photographers, Photo Finishers, and Film Processing*.

Taxable purchases

Some of your purchases are taxable. If you know a purchase is taxable at the time you make it, you should not issue a resale certificate to your vendor. If you buy from an out-of-state vendor who does not collect California tax, or you buy merchandise for resale but use it before you sell it, you must report and pay use tax with your sales and use tax return. To do that, list the cost of your purchase under "Purchases subject to use tax" on the return for the reporting period in which you used the item. The rate for use tax is the same as the rate for sales tax in the location where you used the item.

Tax applies to amounts you pay for:

- Materials and supplies that *do not* become a tangible part of products you sell.
- Materials and supplies that become a tangible part of nontaxable preliminary art (see [page 19](#)).
- Items you use for demonstration and display unless you will also offer them for sale.
- Items you use for donations, gifts, or other personal use (donations to charitable organizations may not be taxable; please call our Customer Service Center for guidance).
- Equipment you use in your business rather than sell, such as office supplies, furniture, props, lighting, backdrops, film and print processing equipment, computers, order forms, printers, etc.
- Property from out-of-state vendors that would be taxable if you made them in California (see "Purchases from out-of-state retailers," [page 38](#)). This includes purchases made by phone, mail order, or over the Internet.
- You should also pay tax on charges for leasing or renting equipment provided the owner of the equipment charges you an amount for tax.

For more information on use tax, see [publication 110](#), *California Use Tax Basics*, and [Regulation 1685](#), *Payment of Tax by Purchasers*.

■ Tax-paid purchases resold before use

If you pay an amount for tax when you buy an item then later sell it before using it, you may claim a deduction on your sales and use tax return, under “Cost of tax-paid purchases resold prior to use.”

Example: You pay an amount for tax when you buy a stack of CDs you intend to use in your business. You pay \$20.00 plus tax for 50 CDs. Later, you sell ten of those blank, unused CDs to a client in a taxable transaction. You would report the amount you charged for the CDs in “gross receipts” on your sales and use tax return and take a \$4 tax-paid purchases resold deduction for their purchase price (10 CDs = 20 percent of total 50 CDs purchased; $\$20.00 \times 20 \text{ percent} = \4.00).

■ Purchases from out-of-state retailers

Purchases on your own behalf

Tax applies to out-of-state purchases the same way it does to purchases within California: a purchase that is taxable in California is taxable when you make it from an out-of-state vendor. In general, you will owe use tax if you purchase merchandise from an out-of-state retailer without paying California tax and use the merchandise in California for a purpose other than resale. You must report the tax on your sales and use tax return. Some out-of-state retailers are authorized to collect and pay California use tax. If your sales receipt indicates that the retailer collected the correct amount of California use tax on your purchase, you do not need to report that purchase on your return. However, if the retailer did not collect enough tax, you would owe any additional tax that should have been charged.

If you purchase artwork, photographs, intermediate production aids, special printing aids, or other such products from vendors located outside of California for resale to your client prior to use, no use tax is due on your purchase. Instead, you will owe tax on your sale of the items to your client. For more information on how tax applies to the purchase of items presumed sold to your client prior to use, you should read the chapters beginning on [pages 13 and 25](#).

Purchases as an agent of your client

When you purchase products from out-of-state retailers as the agent of your client, the vendor is regarded as making the sale directly to your client. Accordingly, your client would generally be liable for any use tax due on its purchases. However, because of the unique circumstances surrounding the transactions between an agency and its client, it is the agency that is liable for any use tax due on purchases of products as an agent of the client. Your liability for the use tax is not extinguished unless the client has, in fact, already self-reported and paid the use tax.

Credit for payment of another state's tax

If you were required to pay, and did pay, another state's sales tax on a purchase on which you will owe California use tax, you may claim a credit against your use tax liability by doing the following:

- Report the amount of the purchase under “Purchases subject to use tax.”
- Deduct the amount of tax paid under “Sales and use taxes imposed by other states” on your return. You may claim a deduction up to the amount of California use tax due on the purchase.

You may not claim this deduction as a credit against your sales tax liability.

General Tax Reporting Requirements

This chapter provides general information on how to report your sales and purchases on your sales and use tax return. It also includes information on invoicing clients, applying tax to credit sales, and claiming deductions and exemptions on your return. For more information, please refer to [publication 73](#), Your California Seller's Permit.

Including an amount for tax in your charges

You are responsible for paying sales tax on all your taxable sales. However, you can collect tax from your clients equal to the amount you will owe on each sale. This is called "sales tax reimbursement." You may add the tax amount to your taxable charges, being sure to itemize it on your invoices or receipts. Or, you may include it in your charges. If you choose the latter method, you must either post a visible sign stating, "All prices of taxable items and services include sales tax reimbursement calculated to the nearest mill," or include a similar statement on your sales invoices or receipts.

Tax due with your return

You must report all of your sales on your sales and use tax return, including nontaxable sales. The tax due with each return is based on your total gross receipts for the period less deductions for allowable nontaxable sales and other adjustments. You may not deduct any expenses related to your sales—such as travel expenses, model fees, phone charges, equipment rentals, etc. Some common exemptions and deductions are noted below.

Common deductions and exemptions

Common deductions and exemptions include:

- Sales for resale (see [page 6](#))
- Tax-paid purchases resold prior to use (see [page 38](#))
- Repair labor and nontaxable services (see [page 9](#))
- Preliminary art/conceptual services (see [pages 18-19](#))
- Certain sales in interstate and foreign commerce (see [page 6](#))
- Sales to the U.S. government (see [page 6](#))
- Cash discounts on taxable sales

Bad debts

If you paid tax on a sale and then were not able to collect payment, you may claim a deduction for the bad debt. Bad debts may take the form of:

- Checks returned unpaid by the purchaser's bank that you have determined to be uncollectible, or
- Accounts from charge or credit sales found worthless.

Before you take the deduction, you must charge off the bad debt for income tax purposes. You should claim the deduction on the sales and use tax return you file for the period in which you found the amount worthless and charged it off for income tax purposes. If you are not required to file income tax returns, you must charge off the debt following generally accepted accounting principles. If the tax rate has changed since you made the original sale, you must adjust the amount of the bad debt deduction to conform to the tax rate in effect at the time of the sale. You cannot deduct amounts you paid to collect the funds due.

If you later collect the money due for a bad debt (including worthless checks), you must include in your taxable gross receipts any amount you previously claimed as a bad debt deduction.

Please note: There are many rules governing deductions for bad debt losses. For assistance, you may request a copy of [Regulation 1642](#), *Bad Debts*, or contact our Customer Service Center.

Credit sales and installment payments

Tax is due for the period in which a sale takes place, regardless of when you receive payment. The sale takes place when you transfer ownership or possession of your product to your client. You should not report deposits you receive from clients for future delivery of products until the sale is complete.

Example: You design logos for small businesses. Customarily, you take deposits for your services, requiring 50 percent of your payment in advance and 50 percent when you deliver the product to your client. You charge your client \$2,000 for designing and producing a logo, taking a deposit of \$1,000 from your client in late March. You deliver the finished art with the logo at the end of May. Your client pays the remaining \$1,000 in June. You must report the entire \$2,000 charge on your sales and use tax return filed for the tax-reporting period that includes the month of May.

Records

Be sure to keep complete records of your sales and purchases. You should keep required records for at least four years unless we give you specific, written authorization to destroy them sooner. For nontaxable transactions, your records should clearly indicate the reason the transaction was not taxable.

Exception: Records that cover reporting periods before January 1, 2003, may be covered by an extended statute of limitations if you did not participate in the 2005 tax amnesty program, or if fraud or intent to evade tax is discovered during an audit. You must keep these records for at least ten years.

If you are being audited, you should retain all records that cover the audit period until the audit is complete, even if that means you keep them longer than four years. In addition, if you have a dispute with us about how much tax you owe, you should retain the related records until that dispute is resolved.

For more information on recordkeeping, please see [publication 116](#), *Sales and Use Tax Records*, or [Regulation 1698](#), *Records*.



For More Information

For additional information or assistance, please take advantage of the resources listed below.

CUSTOMER SERVICE CENTER 1-800-400-7115 (CRS:711)

Customer service representatives are available Monday through Friday from 7:30 a.m. to 5:00 p.m. (Pacific time), except state holidays. In addition to English, assistance is available in other languages.

OFFICES

Please visit our website at www.cdtfa.ca.gov/office-locations.htm for a complete listing of our office locations. If you cannot access this page, please contact our Customer Service Center at 1-800-400-7115 (CRS:711).

INTERNET

www.cdtfa.ca.gov

You can visit our website for additional information—such as laws, regulations, forms, publications, industry guides, and policy manuals—that will help you understand how the law applies to your business.

You can also verify seller's permit numbers on our website (see [Verify a Permit, License, or Account](#)).

Multilingual versions of publications are available on our website at www.cdtfa.ca.gov/formspubs/pubs.htm.

Another good resource—especially for starting businesses—is the California Tax Service Center at www.taxes.ca.gov.

TAX INFORMATION BULLETIN

The quarterly *Tax Information Bulletin* (TIB) includes articles on the application of law to specific types of transactions, announcements about new and revised publications, and other articles of interest. You can find current TIBs on our website at www.cdtfa.ca.gov/taxes-and-fees/tax-bulletins.htm. Sign up for our [CDTFA updates](#) email list and receive notification when the latest issue of the TIB has been posted to our website.

FREE CLASSES AND SEMINARS

We offer free [online](#) basic sales and use tax classes including a tutorial on how to file your tax returns. Some classes are offered in multiple languages. If you would like further information on specific classes, please call your local office.

WRITTEN TAX ADVICE

For your protection, it is best to get tax advice in writing. You may be relieved of tax, penalty, or interest charges that are due on a transaction if we determine that we gave you incorrect written advice regarding the transaction and that you reasonably relied on that advice in failing to pay the proper amount of tax. For this relief to apply, a request for advice must be in writing, identify the taxpayer to whom the advice applies, and fully describe the facts and circumstances of the transaction.

For written advice on general tax and fee information, please visit our website at www.cdtfa.ca.gov/email to email your request.

You may also send your request in a letter. For general sales and use tax information, including the California Lumber Products Assessment, or Prepaid Mobile Telephony Services (MTS) Surcharge, send your request to: Audit and Information Section, MIC:44, California Department of Tax and Fee Administration, P.O. Box 942879, Sacramento, CA 94279-0044.

For written advice on all other special tax and fee programs, send your request to: Program Administration Branch, MIC:31, California Department of Tax and Fee Administration, P.O. Box 942879, Sacramento, CA 94279-0031.

TAXPAYERS' RIGHTS ADVOCATE

If you would like to know more about your rights as a taxpayer or if you have not been able to resolve a problem through normal channels (for example, by speaking to a supervisor), please see [publication 70, *Understanding Your Rights as a California Taxpayer*](#), or contact the [Taxpayers' Rights Advocate Office](#) for help at 1-888-324-2798. Their fax number is 1-916-323-3319.

If you prefer, you can write to: Taxpayers' Rights Advocate, MIC:70, California Department of Tax and Fee Administration, P.O. Box 942879, Sacramento, CA 94279-0070.

Regulations, forms, and publications

Lists vary by publication

Selected [regulations](#), [forms](#), [publications](#), and [industry guides](#) that may interest you are listed below. Spanish versions of certain publications are also available online.

Regulations

- 1507 *Technology Transfer Agreements*
- 1528 *Photographers, Photocopiers, Photo Finishers and X-Ray Laboratories*
- 1529 *Motion Pictures*
- 1540 *Advertising Agencies and Commercial Artists*
- 1541 *Printing and Related Arts*
- 1541.5 *Printed Sales Messages*
- 1543 *Publishers*
- 1614 *Sales to the United States and Its Instrumentalities*
- 1620 *Interstate and Foreign Commerce*
- 1628 *Transportation Charges*
- 1641 *Credit Sales and Repossessions*
- 1642 *Bad Debts*
- 1668 *Sales for Resale*
- 1698 *Records*
- 1700 *Reimbursement for Sales Tax*
- 1821 *Foreword*

Publications

- 17 *Appeals Procedure: Sales and Use Taxes and Special Taxes and Fees*
- 44 *District Taxes (Sales and Use Taxes)*
- 46 *Leasing Tangible Personal Property*
- 51 *Resource Guide to Tax Products and Services for Small Businesses*
- 58A *How to Inspect and Correct Your Records*
- 61 *Sales and Use Taxes: Exemptions and Exclusions*
- 70 *Understanding Your Rights as a California Taxpayer*
- 73 *Your California Seller's Permit*
- 74 *Closing Out Your Account*
- 75 *Interest, Penalties, and Collection Cost Recovery Fee*
- 76 *Audits*
- 100 *Shipping and Delivery Charges*
- 101 *Sales Delivered Outside California*
- 102 *Sales to the United States Government*
- 103 *Sales for Resale*
- 105 *District Taxes and Sales Delivered in California*
- 108 *Labor Charges*
- 109 *Internet Sales*
- 116 *Sales and Use Tax Records*

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