

**STATE BOARD OF EQUALIZATION**

(916) 445-6450

June 20, 1986

Mr. L--- R---
D--- E--- & Co.
XXX --- ---
--- ---, NY XXXXX

Dear Mr. R---:

Your April 4, 1986 letter to Mr. T. M. Watwood has been referred to the legal staff for reply. You asked for an opinion as to the application of sales tax to the following situation:

“Our client, an advertising agency with branches located in Los Angeles and Palo Alto, renders an advertising service for its clients consisting of the placement of advertising in the printed media. The advertising agency makes purchases of supplies and taxable services that arise in connection with the rendering of the advertising services. There is no principal-agency agreement between the advertising agency and its clients. The purchases are made at retail and the advertising agency pays the tax on these purchases.

“The purchases enumerated above, consisting of but not limited to photographs, artwork, art supplies, copywriting, typesetting supplies, etc., are used to produce mechanical paste-ups (mechanicals). The mechanicals are usually retained by the advertising agency, so that photostats or other types of copying material can be made from the mechanicals to be sent to the printed media. When there is no further use for those mechanicals, the advertising agency may deliver those mechanicals to its clients, or destroy them.

“A typical invoice from the advertising agency to its clients will segregate charges for the cost of placing the advertisement with the media, which will include the advertising agency’s commission and either an ‘ad prep’ charge or a production charge, both of which represent the cost of preparing the ad material for forwarding to the media. The ‘ad prep’ charge includes purchases of supplies and services from outside vendors as well as the advertising agency’s employees’ labor charges to fabricate the property to produce mechanicals. The production charge is also a charge for preparing the ad material for forwarding to the media, but involves purchases from vendors where additional technical services to the mechanical are required.”

You believe that the preparation of the mechanical is part of the nontaxable service of placing advertisements with the media so that the "ad prep" or production charge separately stated on the invoice does not represent a sale of tangible personal property, i.e., the mechanical.

If your client merely prepares and delivers a mechanical to the media on your client's own behalf in fulfilling a contract to provide media advertising to its customer, and your client does not sell the mechanical to its customer, tax does not apply to the charge for the cost of mechanical, regardless of whether your client makes a separate charge that represents the cost of the mechanical. Your client is the consumer of the mechanical and tax applies to the sale to your client of tangible personal property your client consumes in making the mechanical. Such is the case when your client never delivers the mechanical to its customer. You noted that sometimes your client later delivers the mechanical to its customer. When your client delivers a mechanical to the customer, or contracts to pass title to the mechanical to the customer, such evidence shows that your client sells the mechanical to the customer. Tax applies to the charge for the mechanical in such case whether the charge is separately stated or not.

Of course, if, instead of providing a nontaxable media service to your client's customers your client makes a taxable sale of printed materials to the customer, tax applies to the total amount of the gross receipts of the sale of the printed matter including any charge for the mechanical.

We note that, during a telephone conversation with Mr. Robert Gordon of the Board's Out-of-State District office, you asked, in the event that the charge for "ad-prep" is taxable, whether the advertising agency can issue a resale certificate to a supplier when purchasing pens, ink, paper, etc., used in fabricating the mechanical. When your client sells a mechanical to a customer, your client may purchase for resale items such as typography, photostats, photoprints, paper, and ink, etc., which your client physically incorporates into the mechanical by pasting down on the mechanical. Your client is the consumer of property such as office supplies, pens, erasers, and manufacturing aids which do not become physically incorporated into the mechanical your client sells but which your client purchases for use in preparing the mechanical. For instance, a photograph does not become an ingredient or component part of a mechanical merely because the image of the photograph is reproduced as part of the mechanical. Tax applies to the sale of the photograph to your client as the sale of a manufacturing aid.

We hope this answers your question; however, if you need further information, feel free to write again.

Very truly yours,

R. L. Dick
Tax Counsel

RLD:sr