

M e m o r a n d u m**100.0130**

To: San Francisco – Audit (LL)

Date: February 8, 1983

From: Headquarters – Legal (RLD)

Subject: H---

This is in reply to your December 18, 1982 memorandum regarding the application of tax to H---'s charges for "Design time" under the following situation:

The owner of H---, Miss ---, consults with clients to advise and educate the clients; suggests what they need in the way of stationery, letterhead, business cards and brochures; and advises the clients of the costs. During this stage, she may show the clients some layouts or roughs. The consultation may take one or several meetings. H--- then produces the mechanical art and charges tax reimbursement for all the work involved with the production.

You provided the following charge showing how H--- itemizes charges on the invoice:

<u>Service Type</u>	<u>Billing Description</u>	<u>Invoice Computation</u>	<u>Tax Treatment</u>
Stage 1	Design Time	Hours X Hourly rate	Nontaxable
Stage 2	Mechanicals	\$ Amount	Taxable
	Camera Ready Art and others	\$ Amount	Taxable

You noted that approximately 90 percent of H---'s contracts are verbal and evidence of the stage 1 work may consist of scratch notes or hand drawn layouts.

You asked whether tax applies to the stage 1 charges, whether H--- can relabel the charges as preliminary art, and if not, what aspects of stage 1 charges H--- may exclude to qualify the charge as being preliminary art.

Sales and Use Tax Regulation 1540(b)(4)(C) provides that, effective January 1, 1975, tax applies to charges for consultation or research that relates solely to tangible personal property sold by the agency. It is our opinion that H--- charges for design time to consult with clients relates to the sale of the mechanicals, camera-ready art, and other taxable charges. Tax applies to the charges for design time.

We also believe that H--- cannot escape paying tax on such charges by merely relabeling the charges as being for preliminary art. There is no evidence of purchase orders of the client or work orders of H--- to prove that H---'s clients ordered, or H--- produced, preliminary art prior to a contract or approval for the finished art. In addition, a charge on an invoice for "design time" does not clearly identify the charge as for preliminary art as required by Regulation 1540(b)(4)(A).

In summary, it is our opinion that the entire charge is subject to sales tax.

RLD;jw