


**STATE BOARD OF EQUALIZATION**

450 N STREET, SACRAMENTO, CALIFORNIA  
 (P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)  
 (916) 445-6450

MEMBER  
 First District

BRAD SHERMAN  
 Second District, Los Angeles

ERNEST J. DRONENBURG, JR.  
 Third District, San Diego

MATTHEW K. FONG  
 Fourth District, Los Angeles

GRAY DAVIS  
 Controller, Sacramento

May 27, 1993

BURTON W. OLIVER  
 Executive Director

Ms. K--- V---  
 A--- S--- Corporation  
 XXXX --- ---  
 --- ---, CA XXXXX

SR -- XX-XXXXXX

Dear Ms. V---:

This is in reply to your April 5, 1993 letter regarding the application of sales tax to charges by an advertising agency. You posed the following questions and asked that we assume, in each case, the client holds a valid seller's permit.

“1) An ad agency develops artwork for a client that will be used to package software for resale. The client gives the artwork to the printer to produce the packaging. Is the artwork taxable? Is the packaging taxable?”

The client may purchase for resale only the tangible personal property which the client sells prior to use. Since the sale of the artwork is for the client's use in reproducing the image on the packaging, the sale of the artwork is subject to sales tax. (Sales and Use Tax Reg. 1540, Advertising Agencies, Commercial Artists and Designers, subd. (b)(4)(B).)

There is a specific exemption from sales tax for the sale of nonreturnable containers when sold without the contents to persons who place the contents in the container and sell the contents with the container. (Rev. & Tax. Code § 6364, subd. (a).) That would be the case with the printer's sale of the software packaging. Enclosed is a copy of Sales and Use Tax Regulation 1589, Containers and Labels, for your further information. See subdivision (b)(1)(A) of the regulation.

“2) An ad agency provides artwork to the printer who produces the packaging, returns it to the agency who bills the client the total price for the packaging. What is taxable, what is not?”

We assume that the advertising agency only prepares the artwork for its own use and contracts with the customer only to sell the packaging. In other words, we assume the advertising agency does not sell the artwork to the client. In that case, the agency's sale of the packaging is exempt as discussed above.

“3) A graphic artist provides artwork for a mailer a client will use to advertise their product. Is the artwork taxable?”

Yes, the sale of the artwork is taxable. (Sales and Use Tax Reg. 1540, subds. (c) and (b)(4)(B).)

“4) An ad agency provides artwork for a mailer a client will use to advertise their product. Is the artwork taxable?”

Yes, the sale of the artwork is taxable. (Sales and Use Tax. Reg. 1540, subd. (b)(4)(B).)

“5) A graphic artist does the layout of a book manuscript and provides the artwork to the client who sends it to a book binder. The book will be resold. Is the artwork taxable? Is the cost of printing the book taxable?”

The sale of the artwork is taxable. (Sales and Use Tax Reg. 1540, subds. (c) and (b)(4)(B); Sales and Use Tax. Reg. 1543, Publishers, subd. (b)(3)(A).) The sale of the printing of the book is a nontaxable sale for resale. The client should issue a resale certificate to the bookbinder. (Sales and Use Tax Reg. 1668, Resale Certificates).

“6) A client and ad agency differ on their interpretation of the taxability of a charge. If the client provides a valid resale number, should the agency charge sales tax anyway? If the client withholds the tax payment charged by the ad agency, who is then responsible for the potential sales tax liability if the ad agency is audited?”

As noted as subdivision (d) of Regulation 1668, if the client insists that it is buying for resale tangible personal property of a kind not normally resold in the client's business, the advertising agency should require the client to provide a resale certificate containing a statement that the specific property is being purchased for resale in the regular course of business. In that case, if the advertising agency takes the certificate in good faith, the certificate relieves the advertising agency from the liability for the sales tax.

In the absence of a resale certificate taken in good faith from the client, the retailer remains liable for the sales tax. The sales tax is imposed upon the retailer for the privilege of selling tangible personal property at retail. (Rev. & Tax. Code § 6051.) Whether or not the retailer collects reimbursement for the tax from the purchaser is a matter of contract between the retailer and the purchaser. (Civil Code § 1656.1.)

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

Very truly yours,

Ronald L. Dick  
Senior Tax Counsel

RLD:sr