

**M e m o r a n d u m****100.0160**

**To :** Mr. Ed Pedeupe  
Audit Evaluation and Planning Section

**Date:** December 14, 1992

**From :** Ronald L. Dick  
Senior Tax Counsel

**Subject :** Request for Advice  
Ms. A--- T---

This is in reply to your October 7, 1992 memorandum regarding the application of sales tax to charges for preliminary art under the following facts you provided regarding a letter from Ms. A--- T---

“In the letter she explains that she enters one or more concepts into the computer. She gives the client a laser print proof of the layout(s). Whichever layout they choose is then refined and proofed (with laser print-outs) until it is ‘perfect’. At that point she obtains signed final approval to have it printed on a high resolution printer. A modem or a disk is used to transport the information to a service bureau who prints out the paper or film that is given to the client. Occasionally, when the client wants to save money, the final art that the client is given is simply the final laser proof.”

Ms. T--- asks for an opinion as to what point her work changes from nontaxable preliminary art to taxable finished art.

As you know, the provision concerning preliminary art in Sales and Use Tax Regulation 1540, Advertising Agencies, Commercial Artists and Designers, was written with traditional concepts in mind; that is, the taxpayer creates a rough design in physical form to present for the client’s approval. The client approves the design, and the charge for concepts is excludable from the gross receipts of the sale of the final art provided the retailer follows the procedure in the regulation at subdivision (b)(4)(A).

Ms. T--- notes that she has figured that 60 percent of her charge is nontaxable preliminary art, because that amount was the average of her nontaxable charges for the four years prior to her performing the work on her computer. We disagree that her procedure is appropriate. When a designer uses a computer to prepare art, the designer must abide by the provisions of the regulation in order to consider any part of the charge as nontaxable preliminary art. The designer must show that it did, in fact, prepare roughs, visualizations, layouts, or comprehensives to demonstrate an idea or message for approval by the client before a contract is entered into or before approval is given for preparation of finished art to be furnished to the

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client.

Based on your description of Ms. T---'s procedures, we believe that she produces a rough design in physical form which she could identify as preliminary art when she produces the "laser print proof" of the layout you mention in the second sentence of your facts. She should have the client initial and date approval of that design or have other similar evidence to show the customer ordered, or she produced, the proofs prior to the date of the contract or approval for finished art.

Your memorandum referred to a March 17, 1992 letter we sent to Mr. D--- W--- on this subject. Under the facts we understood at that time, the designer made no printouts before continuing on to develop finished art.

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

RLD:sr