

**M e m o r a n d u m****100.0168**

To: Hollywood – Auditing (JKG)

Date: May 16, 1977

From: Gary J. Jugum

Subject: E---, J--- &amp; L--- Inc.

This is in response to your memorandum of February 14, 1977. During the course of your current audit of the subject taxpayer, a question has arisen concerning the taxability of finished art prepared in taxpayer's own art department.

Taxpayer is an advertising agency and has an agency agreement with each of its clients. Taxpayer buys from outside vendors items such as photographs, artwork, and typography. Taxpayer then assembles the components into a paste-up or mechanical for reproduction. Taxpayer bills its clients on an itemized invoice. All buy-outs except typography are purchased taxpaid. Typography and the house charge for "agency finished artwork" is taxed on the invoice. Taxpayer provides the engraver with finished art for reproduction in the form of a completed assembly or as a photostat.

Regulation 1540 "Advertising Agencies, Commercial Artists and Designers" provides in paragraph (a)(2)(B) that advertising agencies are sellers of all items of tangible personal property produced or fabricated by their own employees. The regulation specifically provides that "Advertising agencies are not agents of their clients with respect to the acquisition of materials incorporated into items of tangible personal property prepared by their employees." [Emphasis added.] One of the principles of Regulation 1540 is that advertising agencies are retailers of finished art prepared by their employees. "Finished art" as that term is defined in paragraph (b)(4)(B) means the final art used for actual reproduction and includes mechanicals and other camera-ready copy.

Taxpayer is the retailer of actual finished art, and a taxpaid purchased resold credit may be allowed with respect to items physically becoming a component part of the finished art physically used for reproduction. Taxpayer should be regarded as an agent with respect to items not physically incorporated into finished art even though the items may be used in the production of finished art. As provided by paragraph (b)(2) of the regulation, charges made to the client for such items, including agency fees added thereto, are not taxable. Charges for "manufacturing items" purchased as agent are not a part of the "total charge" made by the agency for finished art produced by it.