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March 17, 1992

BURTON W. OLIVER  
*Executive Director*

Mr. D--- H. W---  
D--- H. W--- E---, Inc.  
XXXX --- ---  
---, CA XXXXX

Dear Mr. W---:

Your January 29, 1992 letter to Principal Tax Auditor Glenn Bystrom has been referred to me for reply.

You asked if there is a way that computerized preliminary roughs can be managed such that they can be treated as nontaxable preliminary art under Sales and Use Tax Regulation 1540.

We concluded in a July 9, 1991 letter to you that, under the facts you then provided, tax applied to the charge for computer-generated roughs and visualizations. In that case, the Art Director manipulated data on a storage medium which formed the roughs or visualizations so that the roughs or visualizations became the finished art. The roughs were physically incorporated into the finished art.

That is not to say that there cannot be nontaxable computer-generated preliminary art. For example, assume that an artist created five different concepts on a disk and presented the designs to a client for approval. The client chooses one design, and the artist recreates the design on another disk. If the artist follows the procedures provided at subdivision (b)(4)(A) of Regulation 1540, the artist could consider the charge for preliminary art as nontaxable.

You asked, in such case, what proof would be acceptable. The artist must retain the medium containing the design for audit purposes. The artist must also retain purchase orders, work orders, or other records to prove the client ordered, or the artist produced, the preliminary art prior to the date of the contract or approval for the finished art.

Finally, you asked whether artwork composed on a computer can be construed as a custom program when the storage media is not transferred to the purchaser. The only transfer is the printout of the results generated by the program and not the program itself.

No, we would not consider the transfer of the artwork to be the transfer of a custom program. Under the facts you provide any programming would be created by the data processor for his or her own use. The transfer of the output is a sale of tangible personal property. The transaction is subject to sales tax. (See Sales and Use Tax Regulation 1502, Computers, Programs, and Data Processing, subd. (c)(4)). Tax applies to the entire charge for the artwork, including any portion of the charge attributable to programming by the retailer.

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

cc: Mr. Glenn A. Bystrom