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May 29, 1997

Ms. J--- M. C---  
 H---& C---  
 Ten --- Boulevard, --- Floor  
 --- ---, California XXXXX-XXXX

***Re: Unidentified Taxpayer***

Dear Ms. C---:

Your letter to Mr. Gary J. Jugum, Assistant Chief Counsel, has been referred to me for response. You request a legal opinion regarding the application of tax to charges made by your client to develop marketing and advertising programs for its customers. You have provided a summary of the various services and items of tangible personal property provided by your client. You state that each of the services and items of tangible personal property described below is distinct and may be provided independently of any other service or item of tangible personal property.

### DISCUSSION

#### SALES AND USE TAX LAW - GENERALLY

Retail sales of tangible personal property in California are subject to sales tax, measured by the gross receipts, unless the sale is specifically exempt from taxation by statute. (Rev. & Tax. Code § 6051.) Revenue and Taxation Code section 6006(a) defines the term sale as a transfer of title or possession of tangible personal property for consideration. Tangible personal property is personal property which can be seen, weighed, measured, felt or touched, or which is in any manner perceptible to the senses. (Rev. & Tax. Code § 6016.) When sales tax does not apply, use tax, measured by the sales price, applies to the use of tangible personal property purchased from a retailer for the storage, use, or other consumption in California, unless the use is exempt from taxation by statute. (Rev. & Tax. Code §§ 6201, 6401.) Neither the sales tax nor the use tax applies to charges for services not constituting sales of tangible personal property. (Reg. 1501.)

For purposes of clarity, we will analyze the application of tax to the various items of tangible personal property and services provided by your client separately.

1. Strategic and Marketing Consulting.

You state that your client develops a name, identity, and/or slogan tailored to a particular idea, product, or service offered by your client's customer. Your client conducts research, advises, develops, and recommends an overall strategy and marketing plan. In addition, your client may develop a marketing program, which may involve selecting specific trade shows, magazines, brochures, or other vehicles that are appropriate to market its customer's services or products. At the conclusion of the project, your client delivers its ideas in written form, which may be transmitted by mail, facsimile or electronic mail.

If your client delivers its ideas by facsimile or electronic mail and does not transfer any tangible personal property to its customer, any charges for the services described above as Strategic and Marketing Consulting are not subject to tax. The transfer of information including artwork, by remote telecommunications, is not a taxable sale because there has been no transfer of tangible personal property. (BTLG Annots. 100.0031 (5/31/94), 100.0037 (3/11/94).)

However, if your client transfers its ideas in written form through the mail, such transfer is not subject to tax only if the written form is in the format of a written report consisting of text only and does not contain any artwork, including photographs, drawings, diagrams, charts, graphs and other illustrative materials. If the transfer of the written form contains artwork, tax applies to the transfer of such artwork, including charges for services rendered that represent services that are a part of the sale of the artwork, or the labor or service cost for the production of the artwork. (See Reg. 1540(b).)

2. Writing.

You state that your client composes, edits and proofreads written content to be used in press kits, technical documentation, brochures, CD ROMs, and magazines. In addition, your client writes content to be used for marketing materials, including brochures, computer-based presentations and Internet Web sites. These written materials are usually delivered by facsimile or electronic mail.

Your client's charges for writing, editing and proofreading the written content of marketing materials constitute nontaxable charges for services. Thus, the transfer of these materials in written form is not subject to tax, regardless of the method of transfer.

3. Graphic Design & Production.

You state that your client creates art, graphics and other designs in the form of electronic files. The illustrations, graphic animation and pictures are used in marketing materials, including brochures, computer-based presentations and Internet Web sites. The graphic designs are also

used on CD-ROMs, the Internet or hard drives. Your client delivers these products as film and proofs (ready for printing), or as electronic files (delivered on some type of portable computer media, such as Syquest disks).

The transfer of artwork in the form of tangible personal property for consideration is subject to tax. (See BTLG Annot. 100.0135 (2/24/92).) Accordingly, if your client transfers art, graphics and other designs as film and proofs or as electronic files on a disk or other storage media, the entire charge for such artwork would be subject to tax.

4. Computer Multimedia Programming.

You state that your client engages in custom computer programming and integration, as well as testing and quality assurance for computer-based marketing materials, including computer-based presentations and Web sites that are written specifically for its customer's projects. The programming is done using basic programming languages, including C++, Java, Basic and Lingo. The final deliverable product consists of electronic digital files. The files are transferred by sending them over public telephone lines (the Internet), or by copying the files onto a hard drive or to the portable computer media that is provided by its customers.

Sales and Use Tax Regulation 1502(f)(2)(A) provides that tax does not apply to the sale of a custom computer program, other than a basic operational program, regardless of the form in which the program is transferred. Assuming that your client is engaged in custom computer programming, charges for the transfer of the custom computer program are not subject to tax, whether the custom computer program is transferred through the Internet, or by copying the files onto a hard drive or to the portable computer media that is provided by its customer. Additionally, charges for testing the custom computer program to insure that the program operates as required are nontaxable.

5. Video Production.

You state that your client creates custom corporate video presentations. The production of the video involves taping in studio and on location as well as editing the material. Your client transfers a final master analog videotape, or digital (electronic, computer-based) video files by copying the files onto a hard drive or other portable computer media provided by its customer.

Our understanding is that the custom corporate video presentations produced by your client are motion pictures produced for display at corporate training and sales presentations, and thus, fall within the definition of qualified motion picture as defined in subdivision (b)(1) of Sales and Use Tax Regulation 1529 (copy enclosed). Under such circumstances, tax does not apply to your client's transfer of the qualified motion picture if either: (1) the transfer is prior to the date that the qualified motion picture is exhibited or broadcast to its general audience; or (2) the transfer is to any person holding either directly or indirectly, or by affiliation, any exploitation rights obtained prior to the date that the qualified motion picture is exhibited or broadcast to its general audience. (See Reg. 1529(b)(1)(C).) Additionally, tax does not apply to

any of your client's charges for qualified production services which include any fabrication performed by any person in any capacity on film, tape, or other audiovisual embodiment in connection with the production of all or any part of any qualified motion picture. (See Reg. 1529(b)(2).) Your client would be the consumer of any tangible personal property purchased for use in producing a qualified motion picture or performing qualified production services and tax would apply to the sale of such property to your client. (Reg. 1529(a)(1).)

6. Audio Development.

You state that your client creates custom digital music, sound effects and voice-overs. On occasion, your client will hire a sub-contractor to assist with audio development. The final deliverable product is in the form of electronic digital files. The files are transferred by sending them over public telephone lines (the Internet), or by copying the files onto a hard drive or other portable computer media that is provided by your client's customer.

It appears that these recordings are original recordings as referred to in Sales and Use Tax Regulation 1527(a)(1). As such, if your client transfers them on tangible personal property, the measure of tax for the sale would be limited to the sales price of the unprocessed recording media provided by your client. However, since your client is not providing any recording media in any of the scenarios you have described, none its charges would be taxable.

7. Project Management.

You state that your client schedules and plans activities and events, organizes and runs meetings, and hires and manages vendors that provide services or products for its customer. Charges for managing a project are not subject to tax, assuming that such services are not services provided as part of the sale of tangible personal property. (See Rev. & Tax. Code § 6012.)

8. Licensing.

You state that your client negotiates licenses on behalf of its customers to use existing images as well as music, film and video clips. Our understanding is that in conducting such negotiations, your client does not lease tangible personal property from the licensors, then sublease such tangible personal property to its customers. Rather, your client merely negotiates a lease between its customer and a lessor with whom the customer contracts directly. Under these circumstances, charges for conducting negotiations are not subject to tax, assuming that such services are not provided as services that are part of the sale of tangible personal property. (See Rev. & Tax. Code § 6012.)

9. Video Tape Duplication.

You state that your client is engaged in video tape duplication by using a master tape to make multiple copies onto video tapes for distribution. Revenue and Taxation Code section 6006, subdivision (b) defines the term sale to include the production and fabrication of tangible personal property for consideration for consumers who furnish, either directly or indirectly, the materials used in the production or fabrication of the tangible personal property. The term sale also includes a transfer for consideration of title or possession of tangible personal property which has been produced or fabricated to the special order of the customer. (See Rev. & Tax. Code §§ 6006(f); 6010.6(c)(2).) Thus, charges for making video tapes duplications of the master tape for distribution are subject to tax.

10. CD-ROM Replication.

You state that your client will produce CD-ROMs which contain a computer program and/or files for distribution. Our understanding is that your client is not selling a custom computer program, but is merely charging its customers for duplicating prewritten computer programs provided by its customers onto one or more CD-ROMs for distribution. Under these circumstances, charges are for taxable sales of tangible personal property. If our understanding of your client's work is in error, please provide a detailed description of the work your client performs and the product or products transferred to its customer.

11. Film, Proofs, Plates & Printing.

You state that your client creates multiple copies of printing materials, including film, proofs and plates for distribution. Again, tax applies to your client's charges for the retail sale of those multiple copies of printing materials.

If you have any questions, please write again.

Sincerely,

Sophia H. Chung  
Tax Counsel

SHC:cl

Enclosure (Sales and Use Tax Regulation 1529)

cc: San Jose District Administrator (GH)