New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-86(35)S
Sales Tax
September 9, 1986

STATE OF NEW YORK
STATE TAX COMMISSION

ADVISORY OPINION PETITION NO. S851212A

On December 12, 1985, a Petition for Advisory Opinion was received from Greenstone & Rabasca Advertising Inc., One Huntington Quadrangle, Melville, New York 11747.

The issues raised are whether various advertising services provided by Petitioner are subject to sales tax, and how any such tax liability would be affected by the formation of a principal-agent relationship between Petitioner and its client.

Section 1105(c)(1) of the Tax Law imposes a tax on the services of furnishing information by printed or mimeographed matter, including the services of collecting, compiling or analyzing information of any kind or nature and furnishing reports thereof to other persons. However, that section excludes ". . . . the services of advertising or other agents, or other persons acting in a representative capacity . . .".

Section 1105(a) imposes a tax on receipts from every retail sale of tangible personal property, except as otherwise provided.

The Sales and Use Tax Regulations state that "Advertising services consist of consultation and development of advertising campaigns, and placement of advertisements with the media without the transfer of tangible personal property . . . . Sales of tangible personal property such as layouts, printing plates, catalogs, mailing devices or promotional handouts, tapes or films by an advertising agency for its own account are taxable sales of tangible personal property . . . .

> Example 5: An advertising agency is hired to design an advertising program and to furnish art work and layouts to the media. The fee charged by the agency to its client for this service is not subject to the tax. However, if the layout and art work is sold by the advertising agency prior to use by it to the customer for his use, the advertising agency is making a sale of tangible personal property which is subject to the sales tax." (20 NYCRR 527.3[b][5]).

All purchases of materials [or services taxed under Tax Law 1105] by an advertising agency for use in performing its services are purchases at retail subject to the sales tax. (20 NYCRR 527.3[c][2]).

An advertising firm does not necessarily act as an agent for its client when it purchases property for use in creating advertisements. A principal-agent relationship for such purpose will be recognized for sales tax application only if the following conditions are met:

1. the advertising agency must clearly disclose to the supplier the name of the client for whom the agency is acting as agent, and

2. the advertising agency must obtain and retain written evidence of agency status with the client prior to the acquisition of any tangible personal property or service, and

3. the price billed to the client, exclusive of any agency fee, must be the same as the amount paid to the supplier. The advertising agency may not use the property for its own account, such as by charging the item to the account of more than one client. See William Estey Company, State Tax Commission Advisory Opinion, Sept. 17, 1984, TSB-A-84(22)S.

Appended to the Petition are examples of six agreements Petitioner consummated with clients, none of which constitute principal-agent contracts according to the above quoted requirements, because they allow the agent to add a profit margin when re-billing purchases of material and outside services to the client. Thus, the agreements fail to satisfy condition 3. above. Whether or not conditions 1. and 2. are fulfilled has not been addressed herein, since noncompliance with any one of the three criteria will negate the existence of a principal-agent relationship.

The essence of the services performed will determine the tax consequences of transactions between an advertising agency and its customers.

Petitioner's services fall within the following categories:

A. Consulting and public relations services; planning and preparing advertising budgets, news releases, and publicity campaigns.

Petitioner is not required to collect tax on its charges to the client, provided no tangible personal property is transferred to the customer or its designees in connection with this service. All purchases by Petitioner, either for its own account or as agent for a principal, of material or taxable services to be used in performing these services are subject to sales tax. This ruling also applies to any advertising project canceled or abandoned before the production of tangible personal property.

B. The production or revision of advertisements and their placement in publications which are not for sale.

If no principal-agent relationship exists, Petitioner must pay tax on its purchases of property and taxable services necessary to fulfill its agreement with the client, even if the customer is an exempt organization. (See: Tromson Monroe Advertising, State Tax Commission Advisory Opinion, March 3, 1983, TSB-A-83(12)S). Petitioner's total charge to the client is not taxable whether or not the cost of its purchases is itemized on the bill rendered.

If the same services are performed under a principal-agent agreement, not only must Petitioner pay sales tax on material and services bought on the clients behalf, but it must also charge the client sales tax on the value added to the property by the labor of agency employees. (Tax Law 1105[c][2]). See William Estey Company, TSB-A-84(22)S, supra. Commissions and fees relating to Petitioner's services for the acquisition of property and the placement of advertising are exempt.

Where Petitioner carries out the services described under "B" for a principal who is an organization exempt from tax under section 1116 of the Tax Law, it is not required to collect tax on the total charge to the client, nor to pay tax on purchases on the client's behalf, provided that conditions 1, 2, and 3, quoted above, are met and Petitioner and its supplier are furnished with the proper exemption certificate (e.g., Form ST-119.1, Exempt Organization Certificate) executed by the client.

C. The production or revision of advertisements to be placed in publications which are for sale.

Here the agency usually prepares the layout and produces from it the printing plate which it forwards to the publisher who will print the advertisement. In accordance with Technical Service Bureau Memorandum TSB-M-79(7.1)S, May 15, 1980, if no principal-agent contract is in force, Petitioner may claim the manufacturing exemption (Tax Law 1115[a][12]) on its purchases of equipment such as typography, artwork, film, offset plates, etc., and also on parts, tools and supplies used and consumed directly and predominantly in the production of the advertisement, by obtaining from its client a properly completed Exempt Use Certificate (Form ST-121) and furnishing to its vendor a properly completed Exempt Use Certificate prepared by the agency.

Regulation 528.13(b)(1), in part, defines the terms "directly and predominantly":

> (1) "Directly means the machinery or equipment must, during the production phase of a process:
>
> (i) act upon or effect a change in material to form the product to be sold, or
>
> (ii) have an active causal relationship in the production of the product to be sold, or
>
> (iii) be used in the handling, storage, or conveyance of materials or the product to be sold,
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> * * *
>
> (2) Usage in activities collateral to the actual production process is not deemed to be used directly in production.

(4) Machinery or equipment is used predominantly in production, if over 50 percent of its use is directly in the production phase of a process."

If a freelance artist is employed to create illustrations or typography upon material supplied and used by Petitioner, this service is subject to sales tax under Section 1105(c)(2) of the Tax Law which imposes the tax on the receipts from every sale, except for resale, of the services of "[p]roducing, fabricating, processing, printing or imprinting tangible personal property, performed for a person who directly or indirectly furnishes the tangible personal property, not purchased by him for resale, upon which such services are performed."

Petitioner's total charge to its client will be exempt from tax as the "services of advertising".

When in conjunction with the services discussed under B. and C. above, material purchased by Petitioner for the purpose of creating advertisements is turned over to the client subsequent to such use, this transfer of tangible personal property is considered merely incidental to the "services of advertising" and will not negate the exclusion from tax provided for such services under Tax Law 1105(c)(1). See Matter of Laux Advertising v. State Tax Commission, 67 AD2d 1066.

However, in the event that artwork retained by Petitioner after completion of a contract is later transferred to the customer for an additional charge, such receipt is subject to tax and Petitioner may not claim a credit for tax paid on its purchase of the property.

If a principal-agent agreement exists, Petitioner's purchases for the client of equipment, parts, tools and supplies to be used in the production process of the advertisement qualify for the manufacturing exemption, provided vendors are supplied with an Exempt Use Certificate (Form ST-121) executed by the client. The tax liability for services described in Tax Law 1105(c)(2), supra, whether purchased by the agent or performed by its employees, passes to the client. Material and services obtained by the agent must be re-billed to the principal at cost. Separately stated agency fees, including charges for pre-production discussions and for placing advertisements with the media, are not taxable.

D. The production for sale of tangible personal property; for example: brochures, catalogs, logos, posters, mechanicals, printing plates, annual reports, photographic prints, etc.

If no principal-agent agreement is in force, Petitioner may purchase tax exempt any property or physical components thereof, which will be sold as such (without prior use by the agency) to the client, by issuing to its vendor a Resale Certificate (Form ST-120).

Material such as artwork and typography, which Petitioner will use to produce property for sale, may not be purchased for resale by the agency whether or not the property is actually transferred to the customer upon completion of the contract and regardless of whether the contract between the

advertising firm and the client requires such transfer. However, these purchases may qualify for the production exemption described under "C" above.

Sales tax is to be collected from the client by the advertising firm on the total selling price of the finished product without any deduction (except for separately stated transportation or delivery charges) for fees or commissions or other expenses of the agency when such finished product is transferred to the client or his designee in New York State. (Tax Law 1101[b][3]; 20 NYCRR 526.5[g]).

Under a principal-agent agreement, other than with an exempt organization, Petitioner's purchases of material for the account of its client will not qualify for exemption if, as in the production of promotional material, the finished product is not intended for sale. Furthermore, Petitioner must collect statewide and local sales tax on the receipts from services performed by its employees upon the client's property. (Tax Law 1105[c][2], quoted above; see also Technical Services Bureau Memorandum, June 10, 1983, TSB-M-83[16]S).

E. The direction and production of radio and television commercials.

1. Creation of commercials

The creation of a radio or television commercial is considered the production of tangible personal property. Therefore, sales of television or radio commercials embodied in tangible form in an original negative film, video tape or sound track are subject to sales tax if the property is delivered to the customer or its designee within New York State.

Petitioner may purchase tax exempt the raw film stock and other physical component parts of property actually transferred to the client, and also the services of processing, editing and sound mixing performed upon such property, by furnishing its suppliers with a Resale Certificate (Form ST-120). The resale exemption does not apply to raw material and services used in preparing an intermediate edited version of the original negative film as a preliminary step in the production for sale of the master positive.

Cameras, projectors, sound recorders, set lights, booms, etc., constitute production machinery and equipment as defined in Regulation 528.13(a)(1); backdrops, settings, props, wardrobes and similar articles qualify as manufacturing supplies. (20 NYCRR 528.13[3][i]). If used or consumed directly and predominantly in the production of a commercial, such machinery, equipment and supplies may be purchased exempt from statewide and local (except New York City) sales tax provided Petitioner issues a valid Exempt Use Certificate (Form ST-121) to its vendor.

Under a principal-agent agreement, Petitioner's client as the producer and end-user of the commercial can claim neither resale nor production exemption. Therefore, Petitioner must pay the appropriate sales tax when purchasing property to be delivered to the client or the advertising agency within New York State.

Additionally, tax is due on the agent's purchases for its clients account of taxable services employed within the State, unless such services are performed upon property which is to be sent, without prior use in the State, to an out-of-State destination. The same tax consequences will arise if the agency's employees furnish such services; in that instance the Petitioner as the vendor of the services must collect any applicable sales taxes from its client.

2. Post production processing

If, after producing an original negative film, Petitioner is engaged to convert the commercial from film to video tape, its purchases of raw tape and third party services will qualify for the resale exemption. The exemption does not extend to material not actually delivered to the client or to services performed upon property used in the conversion process which is not incorporated in the product to be sold. Petitioner's entire charge for the conversion will be subject to tax as the sale of tangible personal property.

Further post production processing (e.g. film editing, videotape editing and dubbing, audio recording and mixing) of a client's videotape constitutes services taxed under Section 1105(c)(2) of the Tax Law, Supra. (20 NYCRR 527.4[d], example 3.)

If a valid exemption certificate or direct payment permit is not supplied, Petitioner must collect tax on the price of post production services at the rate in effect where the processed videotape is delivered to the customer.

F. Providing mailing lists to clients and performing mailing services.

Mailing lists usually are available in the form of magnetic tape or cheshire labels. Transactions between list owner and list user therefore constitute either sales of tangible personal property as defined in Tax Law 1101 (b)(5) or, in the alternative, services taxed under section 1105(c)(1) of the Tax Law, quoted above. Accordingly, the list owner or the list broker must collect State and local sales tax from the user if the property is delivered to an in-State destination. Alan Drey Company, Decision of the State Tax Commission, Jan. 27, 1978, TSB-H-78(3)S, affd 67 AD2d 1055.

Receipts from addressing envelopes, manually or mechanically, are taxable at the locality where the property is delivered to the customer or at the point from which the mailing service occurs. Charges for collating, folding, inserting, sealing and posting are not taxable if segregated from the taxable amount on the customer's bill. See Capital District Mailing Co., State Tax Commission Advisory Opinion, Oct. 28, 1985, TSB-A-85(58)S.

It is assumed that question 2. in the Petition refers to receipts from the sale of promotional material Petitioner delivers to an in-State customer who afterwards sends some of the matter to out-of-State recipients. In that instance Petitioner is required to collect, on its entire taxable charge, the statewide and local sales tax in effect at the point where possession of the property is transferred to the customer. Tax Law 1119(a) provides that a refund or credit shall be allowed the customer for tax paid "(2) on the sale or use of tangible personal property purchased in bulk, or any portion thereof, which is stored and not used by the purchaser or user within this state if that property is subsequently re-shipped by such purchaser or user to a point outside this state for use outside this state".

Only the furnishing, by Petitioner's client, of a valid Exempt Organization Certificate (Form ST-119.1) or a Direct Payment Permit (Form AU-297) will exempt charges for promotional mailings from tax. Such documentation also will relieve Petitioner from collecting sales tax when it dispatches advertising material from within New York State directly to addressees designated by its client. Should Petitioner perform the latter services for non-exempt customers, review of Department of Taxation and Finance Form ST-152 (5/17 and 5/77), Collection and Reporting Instructions for Printers and Mailers, and George Silver, State Tax Commission Advisory Opinion, April 24, 1986, TSB-A-86(15)S, is recommended.

Petitioner states it engages in "writing letters to various parties advising them of our clients products". If these letters contain promotional information which is duplicated or interchangeable with other recipients on a mailing list, Petitioner is producing tangible personal property for sale, as discussed in section D above.

G. Reproduction of documents by Xerox or other methods.

The sale of duplicated written or printed matter constitutes the sale of tangible personal property taxable under Section 1105(a) of the Tax Law, if the duplicated material is delivered to an in-State destination.

H. Retouching Photographs.

When performed upon property furnished by the customer, this service is taxable pursuant to Section 1105(c)(2) of the Tax Law unless Petitioner has received a Resale Certificate (Form ST-120). A charge for retouching photographs intended for sale by the Petitioner is an expense which, even if stated separately on the invoice, must be included in the "taxable receipt", as such term is defined in Tax Law 1101(b)(3).

Generally, it should be noted that whenever an advertising firm renders to its client an invoice which includes both charges for services excluded from tax and for the sale or servicing of personal property, the taxable amount must be stated separately thereon, or the entire receipt will be subject to tax. (20 NYCRR 533.2[a][1]; [b][2]).

Furthermore, section 1132(c) of the Tax Law (as amended by Chapter 765 of the Laws of 1985) provides that a vendor who makes a sale which is tax exempt, either as a sale for resale or under the provisions of section 1115 and 1116 of the Tax Law, must have a supporting document in his possession no later than 90 days after the delivery of the property sold or service rendered, or the sale will be deemed a taxable sale at retail.

Finally, Petitioner is referred to Department of Taxation and Finance Publication 842 (4/84) "Sales Tax Information for Printers" which contains instructions and explanations pertinent to advertising firms.

DATED: September 9, 1986

s/FRANK J. PUCCIA
Director
Technical Services Bureau

NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.