State of Rhode Island – Division of Taxation

Sales and Use Tax

Regulation SU 08-1

Advertising Agencies

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RULE 1 PURPOSE

This regulation implements Chapter 44-18 and 44-19 of the Rhode Island General Laws. These Chapters provide for Sales and Use Taxes Liability and Computation and Sales and Use Taxes Enforcement and Collection in regards to Advertising Agencies.

RULE 2 AUTHORITY

This regulation is promulgated pursuant to RIGL Chapter 44-18 and 44-19 as amended. These rules have been prepared in accordance with the requirements of RIGL Chapter 44-1 and 44-19-33.

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RULE 3 APPLICATION

The terms and provisions of these rules and regulations shall be liberally construed to permit the Department of Revenue to effectuate the purposes of RIGL Chapter 44-18 and 44-19 and other applicable state laws and regulations.

RULE 4 SEVERABILITY

If any provision of this regulation, or the application thereof to any person or circumstances, is

held invalid by a court of competent jurisdiction, the validity of the remainder of this regulation shall not be affected thereby.

RULE 5 SPECIFIC APPLICATIONS

(a) Charges for an *initial consultation* for discussion of ideas that do not specifically include tangible personal property are not taxable. Generally, these charges are for advising a client on advertising issues such as the means of advertising and desired markets. These charges must be reasonable and billed as an *initial consultation charge* by an account management or consultation division of the ad agency.

(b) Account Management Service Fees and Retainers which oversee the management of client accounts only, are not considered a service in connection with a sale of tangible personal property, and therefore are not subject to tax. This is considered non creative time and includes staff time to manage client accounts throughout the agency, as well as obtaining space and time for ads to run through media outlets. In addition, fees based on an hourly billing rate or by project are not subject to tax unless they are directly related to the creation or producing of finished art or other tangible personal property.

(c) Preliminary Art. "Preliminary art" means roughs, visualizations, layouts and comprehensives, title to which does not pass to the client, but which are prepared by an advertising agency, commercial artist or designer solely for the purpose of demonstrating an idea or message for acceptance by the client before a contract is entered into or before approval is given for preparation of finished art to be furnished by the agency, commercial artist or designer to its client. To determine the tax status of "preliminary art", refer to Rule 6(c)(3) and Rule 7(a)(2).

(d) Finished Art. "Finished art," means the final art used for actual reproduction by photomechanical or other processes; or for display purposes including charts, graphs, and illustrative materials not reproduced. Tax applies to the total charges made by advertising agencies, commercial artist or designers to their clients for finished art produced by them.

(e) Advertising Copy. Tax does not apply where copy is furnished to media in manuscript form.

(f) Commercials in the Form of Discs or Tapes. Where a local advertising agency contracts with a producer or studio for the production of a commercial (in the form of disc or tape) to be used on a radio or T.V. station, the total amount which such producer or studio charges such advertising

agency for such disc or tape is subject to the tax.

(g) Commissions. Media Commissions derived by agencies for placement of advertising are not taxable whether paid by the medium, by another agency, or by the client. The placing of advertising is not a service that is a part of a sale of tangible personal property. Supplier commissions paid to agencies by suppliers are not taxable receipts of the agencies. Examples of such nontaxable commissions would be commissions paid to an agency by a premium manufacturer (or distributor) or a direct-by-mail supplier.

(h) Fees. The term "fee" as used herein means a general over-all fee or retainer encompassing all agency services performed for the client. Such fees may be fixed or based on agency costs and are generally in lieu of commissions, fees added to purchases, and separate time charges added to jobs or agency projects or any combination thereof.

- Fees added by an ad agency to a total billing which includes items as to which the ad agency is a retailer and other items acquired as agent, are taxable in accordance with the ratio between the charges for the items as to which the agency is a retailer and acting as an agent (see Example in Rule 8).
- Fees added to a total billing encompassing taxable and non-taxable items is not taxable if the agency has acted as an agent for its client with respect to the acquisition of tangible personal property acquired for the client from outside sources, provided the taxable items are billed at the same amount paid to the supplier.
- If an agency which has acted as agent for its client fails to bill the items as to which it is a retailer at their fair market selling price, the fee added to the billing is taxable in accordance with the ratio between the taxable and non-taxable charges.

(i) Retouching. Retouching ordinarily constitutes a step in the process of preparing photographs or other artwork for reproduction, and is done to improve the quality of the reproductions. Tax applies to charges for photo retouching unless it can be clearly demonstrated that the retouching is done only for the purpose of repairing or restoring a photograph to its original condition.

(j) Items Purchased by Agency or by Artist or Designer. An advertising agency, artist, or

~~designer is the consumer of tangible personal property used in the operation of its business. Such property may include stationery, ink, paint, tools, drawing tables, T-squares, pens, pencils and other office supplies. Tax applies to the sale of such property to the agency, artist or designer.~~

~~The agency, artist, or designer is the retailer of, and may purchase for resale, any tangible personal property that it resells before use, or that becomes physically an ingredient or component part of tangible personal property sold by it prior to use. Such property may include illustration board, paint, ink, rubber cement, flap paper, and wrapping paper.~~

~~An advertising agency, artist, or designer is the consumer of property such as photographs and art which it uses in the preparation of tangible personal property as to which it is acting as a retailer unless, prior to any use having been made of the property, the property is sold or becomes an ingredient or component part of other tangible personal property sold. The agency, artist, or designer may purchase for resale photographs and art, which, prior to any use, are sold or become physically an ingredient or component part of other tangible personal property that is sold by the agency, artist or designer.~~

~~The term "ingredient or component part of other tangible personal property" includes only those items that become physically incorporated into the property sold and not those, which are merely consumed or used in the production of the property sold. A photograph, for example, does not become an ingredient or component part of property sold merely because the image of the photograph is reproduced as part of the property sold. A photograph or art is regarded as having been used when a reproduction is made from the photograph or art.~~

~~(k) Electronic Media. Media furnished electronically by an agency to a client or to the agency by a supplier is not subject to a Sales or a Use Tax as it is not tangible personal property.~~

~~**RULE 6 ADVERTISING AGENCY AS AGENT OF CLIENT (PRINCIPAL)**:~~

~~(a) General. An agent is one who represents another, called the principal, in dealings with third persons. To the extent advertising agencies act as agents for their principal in acquiring tangible personal property they are neither purchasers of the property with respect to the supplier nor retailers of the property with respect to their principals.~~

~~(b) To establish that a particular acquisition was made as agent for its client:~~

~~(1) the agency must clearly disclose to the supplier the name of the principal for whom~~

~~the agency is acting as agent.~~

~~(2) the agency must obtain, prior to the acquisition, and retain written evidence of agent status with the principal and the agency must renew contracts with each principal every three (3) years or less.~~

~~(3) the price billed to the principal, exclusive of any fee an advertising agency might charge, must be the same as the amount paid to the supplier. Agency fees, which include fees for management, public relations, retainers, etc. must be separately stated.~~

~~(c) Application of Tax:~~

~~(1) When an advertising agency purchases tangible personal property as an agent of the client, the agency shall pay the tax billed with respect to such transactions unless an exemption applies. If the vendor does not charge the sales tax, the advertising agency shall pay the use tax on behalf of the client as measured by the cost of the property billed. The agency shall retain a satisfactory record of the tax paid to the vendor and /or the applicable use tax paid by the agency with respect thereto. Additionally, the agency shall state on its invoice to the client, the applicable Rhode Island tax on the representative third party transactions that has been paid.~~

~~(2) Sales/use tax is not due on the cost of tangible personal property purchased on behalf of the principal if the principal is exempt. Exempt principals include:~~

~~ State of Rhode Island and any city, town, or district of this State,~~

~~ Federal Government,~~

~~ Charitable, educational and religious organizations as defined under 44-18-30(5)(i) with approved exemption status from the Division of Taxation.~~

~~(3) In regards to an advertising agency acting as an agent, 30% of charges for separately stated preliminary art as defined in Rule 5(c), in conjunction with the sale of tangible personal property by a third party to the agent, are also subject to sales or use tax in lieu of records that do not substantiate the taxable portion of such charges. This represents the percentage of preliminary art charges that ordinarily become~~

~~physically incorporated into finished art, and would therefore be subject to tax.~~

~~(4) The agency may make no use of the property for its own account, such as charging the item to the account of more than one principal.~~

~~(5) The agency must maintain detailed job folders for each principal. If proper records of the agency are not maintained, tax will apply to the total charge to the principal.~~

~~(d) Examples:~~

~~A client comes to an agency with poor sales and asks what can be done to increase sales. The account executive researches the issue and develops a "game plan" (advertising idea/marketing strategy) and counsels the client. This idea/strategy may be a newspaper add or brochures, TV ad (video) or other type of tangible personal property. The account executive writes a creative brief, which is turned over to the "house" (creative dept), which then creates the ad.~~

~~Example #1 Agency acting as an Agent:~~

~~Steve's Advertising itemizes the following charges to Bill's Kitchen:~~

~~Initial meeting $ 300.00~~

~~Menu Proofs (considered finished art) from Dennis' Design Studio 214.00*~~

~~Printing of Menus from Bob' Print House 535.00*~~

~~Agency Fee 180.00~~

~~Total $ 1,229.00~~

~~• Note sales tax paid directly to the design studio and print house by agency. No additional sales/use tax due on this transaction.~~

~~If vendors do not charge RI Sales Tax, the agency would be required to remit use tax on these purchases.~~

~~Example #2~~

~~Steve's Advertising itemizes the following charges to Bill's Kitchen. The proofs and menus are provided by companies located in Mass.~~

~~Initial Meeting $300.00~~

~~Menu Proofs from Dennis Design Studio located in Mass 214.00 *~~

~~Printing of Menus from Bob's Print House located in Mass 500.00 **~~

~~Agency Fee 180.00~~

~~1,194.00~~

~~• Note: Dennis Design Studio is registered to collect tax in RI ** Note: Bob's Print House is not registered to collect RI tax, therefore use tax is due on the $500 printing charges by the ad agency~~

~~RULE 7 ADVERTISING AGENCY ACTING AS RETAILER~~

~~(a) General. Advertising agencies are considered to be retailers when they acquire (purchase) tangible personal property for delivery to their clients or to third parties for the benefit of their clients.~~

~~(1) Items Prepared by Agency. Advertising agencies are deemed to be retailers of all items of tangible personal property produced or fabricated by their own employees, and are required to obtain a sales tax permit and charge tax on all taxable sales. Accordingly, an advertising agency is not dealing with third persons and, therefore, they cannot act as agent with respect to that activity.~~

~~(2) In addition, 30% of charges for separately stated preliminary art as defined in Rule 5(c) in conjunction with the sale of tangible personal property, are also subject to tax in lieu of records that do not substantiate the taxable portion of such charges. This represents the percentage of preliminary art charges that ordinarily become physically incorporated into finished art, and would therefore be subject to tax.~~

~~(3) Application of Tax. Except for preliminary art discussed above and defined in Rule 5(c), sales tax applies to the total amount of the retail sale of the property.~~

~~• Tax applies whether the property was prepared by employees of the agency or acquired from an outside source. Whether the items of property are used for reproduction or display purposes is immaterial.~~

~~• Tax applies to charges for services rendered that represent services that are a part of a sale of the property, or a labor or service cost in the production of the property.~~

~~• Charges for such items as supervision, consultation, research, postage,~~

~~express, telephone and telegraph messages, and travel expense, if involved in the rendering of such services, are likewise taxable.~~

~~• No deduction may be taken on account of the payment of model fees or talent fees, or for the cost of typography, or for the cost of other services involved in the producing of such items, even though such costs are itemized in the billing rendered to the client.~~

~~(b) To the extent advertising agencies act on their own behalf, they are not retailers. In acquiring tangible personal property they are purchasers of the property with respect to the supplier and tax is due upon purchase.~~

~~(c) Examples:~~

~~A client comes to an agency with poor sales and asks what can be done to increase sales. The account executive researches the issue and develops a "game plan" (advertising idea/marketing strategy) and counsels the client. This idea/strategy may be a newspaper add or brochures, TV ad (video) or other type of tangible personal property. The account executive writes a creative brief, which is turned over to the "house" (creative dept), which then creates the ad.~~

~~Example #1 Agency acting as a Retailer:~~

~~Steve's Advertising Itemizes the following charges to Bill's Kitchen~~

~~Initial meeting $ 300.00~~

~~Menus proofs (designed internally & provided to Bill's Kitchen in tangible format, in preliminary form for approval) 400.00 *~~

~~Finish Art (accepted art for reproduction) 200.00~~

~~Printing of menus from Bob's Print House 700.00~~

~~Agency Fee 180.00~~

~~Sales Tax 84.00**~~

~~Total $ 1,864.00~~

~~$400.00 x 30% x .07 = $ 8.40 (not itemized - therefore 30% taxed)~~

~~** $200.00 + $700.00 +180 x .07 = $ 75.60~~

~~Sales Tax $84.00~~

~~Example #2 Agency acting as a Retailer:~~

~~Steve's Advertising Itemizes the following charges to Bill's Kitchen~~

~~Initial meeting $ 300.00~~

~~Menus Proofs (designed internally & provided to Bill's Kitchen in electronic format) 400.00*~~

~~Finish Art (accepted art for reproduction) 200.00~~

~~Printing of Menus from Bob's Print House 700.00~~

~~Sales Tax 63.00**~~

~~Total $ 1,663.00~~

~~*Menu Proofs – Electronic format, therefore not taxable~~

~~**Sales Tax $200 +$700.00 x .07 = $63.00~~

~~RULE 8 ADVERTISING AGENCY ACTING AS AGENT OF CLIENT AND AS RETAILER~~

~~**(a)** General. When an advertising agency acts as both an agent for the client in dealings with third persons and a retailer of tangible personal property purchased or fabricated for delivery to their clients, the requirements in Rules 5, 6 and 7 apply.~~

~~Example: Agency acting as both an agent and retailer for client~~

~~Steve's Advertising itemizes the following charges to Bill's Kitchen~~

~~Initial Meeting $300.00~~

~~Menu Proofs (designed internally, in preliminary form for approval – acting as retailer) 400.00 *~~

~~Finish Art (accepted art for reproduction–acting as retailer) 200.00 **~~

~~Printing of Menus from Bob's Print House (acting as agent) 749.00 ***~~

~~Agency Fee 180.00~~

~~Sales Tax 27.94 ****~~

~~Total $1,856.94~~

~~* $400.00 x 30% x .07 = $8.40 (not itemized – therefore taxed at 30%)~~

~~** $200.00 x .07 = $14.00~~

~~$400+ $200+ $749 = $1349 (total retail/agent charges)~~

~~$400+$200 (retail charge)/1349 = .44% x $180 = $79.20 x .07 = $5.54~~

~~****$8.40 + $14.00 + $5.54 = $27.94 sales tax (Refer to Rule 5 (h))~~

~~*** Note: Sales tax paid directly to print house by agency ($700 + 49 tax).~~

~~If vendor did not charge RI sales tax, the agency would be required to remit use tax on these purchases.~~

~~EFECTIVE DATE: January 1, 2009~~

~~David M. Sullivan~~

~~Tax Administrator~~

~~Date:~~