OLR RESEARCH REPORT

July 27, 2011 2011-R-0266

SALES TAX ON ADVERTISING

By: Judith Lohman, Assistant Director

You asked for a comparison of Connecticut's sales tax on advertising services with those of New York, Massachusetts, and Rhode Island. You also asked how much revenue Connecticut has collected from its sales tax on advertising services for the most recent four years for which data is available.

This report updates our December 17, 2002 report on the same topic (OLR Report 2002-R-1003).

SUMMARY

Of the four states, Connecticut's sales tax applies most broadly to advertising and advertising services. Connecticut's law exempts only media advertising, such as advertising on television, radio, and newspapers, and cooperative direct mail advertising, which involves mailing a bundle of ads or coupons from various businesses to potential customers. All other types of advertising and public relations services are taxable in Connecticut.

Massachusetts, New York, and Rhode Island do not tax advertising services. New York and Rhode Island apply sales tax to certain tangible personal property that an advertising agency or graphic design firm provides to clients. Massachusetts generally considers such property to be an "inconsequential" part of the service such firms provide and thus, not subject to its sales tax.

In the last four calendar years for which data is available (2007-2010), Connecticut's sales tax revenue from advertising services fell by more than 25% overall with a drop of more than 27% from 2007 to 2009. According to the Office of Fiscal Analysis, revenue from advertising in 2007 was over $5.5 million. It dropped to just over $4 million in 2009 and rebounded slightly in 2010 to $4.1 million.

STATE SALES TAXES ON ADVERTISING SERVICES

Connecticut

Connecticut taxes all sales of advertising or public relations services other than those related to media or cooperative direct mail advertising. Taxable services include layout, art direction, graphic design, mechanical preparation, and production supervision (CGS § 12-407(a)(37)(U)).

The Department of Revenue Services (DRS) defines nontaxable "media advertising" as the sale of time or space in or on a preexisting medium for dissemination to the public or part of the public. The exemption covers Internet, radio, t.v. (broadcast, cable, and satellite), and newspaper ads, as well as ads:

1. on newspaper inserts, billboards and sports field signs, buses, and cabs;

2. in trade or campus directories, church bulletins, and phone and real estate books;

3. on maps and publicly available computers in hotels, airports, and other public places; and

4. on restaurant placemats and the backs of cash register tapes.

Connecticut's sales tax exemption for cooperative direct mail advertising applies to Val-Pak and similar mailings that involve sending coupons or advertisements from many different businesses to potential customers in a single envelope (DRS Special Notices (SN) 2003 (6) and 2003 (10)).

In 2003, Connecticut briefly eliminated its exemption for media and cooperative direct mail advertising, imposing a 3% sales tax on such services rendered on or after April 1, 2003. But the General Assembly quickly restored the exemption and eliminated the tax for sales on or after July 1, 2003 (PA 03-2, §§ 25 & 26; PA 03-1, June Special Session, §§ 95-97).

Massachusetts

Massachusetts' sales tax generally applies to the sale of tangible personal property, not to services. Thus, a transaction that involves only a service with no tangible personal property changing hands is not taxable in that state. In addition, any service transaction in which the exchange of tangible personal property is "inconsequential" (defined as making up less than 10% of the value of the total transaction) is likewise not taxable.

Under Massachusetts tax regulations, tangible personal property transferred by advertising agencies and graphic design firms in the course of performing their services is generally considered to be inconsequential, as long as the agency or firm keeps proper records. The regulations exempt the following from the tax:

- Consultation and other services where no tangible personal property is provided.

- Advertising campaigns in which graphic designs are created and intended to market a client's goods or services by incorporating the designs into "collateral property," such as pins, flyers, business cards, or cups. In such cases, the transfer of the collateral property is not taxed because it is considered an inconsequential part of the overall transaction.

- Media placement advertising where advertising for media such as television, radio, newspapers, and billboards, is created, developed, and produced and where, if tangible property is transferred, it is considered inconsequential (830 Commonwealth of Massachusetts Reg. 64H.1.2).

New York

New York does not tax advertising services, which it defines as consultation, developing advertising campaigns, or developing and placing ads with media outlets. But, tangible personal property sold to an ad agency or the agency's clients in connection with such services can be taxable in New York, depending on the circumstances.

For example, under New York sales tax regulations, an ad agency is not required to add sales tax to its total charge to a client for advertising services with respect to media placement even if it itemizes costs for such things as artwork or type on its bill for the services. On the other hand, an agency must pay sales tax when it purchases materials or services, such as layout, printing, plates, catalogs, or promotional handouts, needed to render an advertising service. But, if the agency is engaged to develop and place an ad in a publication that is intended for sale, it may be entitled to a manufacturing exemption from the tax on all the materials it buys to produce the ad (20 NYCRR 527.3 (b)(5); NY State Dept. of Taxation and Finance TSB-M-83 (16) S, June 10, 1983).

Rhode Island

Rhode Island's sales tax applies to transfers of tangible personal property and not to services. But charges for services that are part of a sale of the property or the labor or service cost to produce the property, such as supervision, consultation, and research services, are taxable.

State tax regulations provide that advertising agencies are considered retailers of all items of tangible personal property their employees produce. Consequently, any ad agency charges billed to clients that represent the sale of tangible property to the client, as well as the service costs related to producing that property, are taxable.

For example, under Rhode Island tax regulations, an ad agency's charges for the following are not taxable:

1. advising a client on advertising issues, such as how and in what markets to advertise;

2. retainers and fees for account management, including obtaining advertising space and time on media outlets, and any hourly billing rates for services;

3. advertising copy furnished to media in manuscript form;

4. media commissions for ad placement; and

5. media furnished electronically by the agency.

The following are taxable:

1. 30% of charges for preliminary art the agency prepares solely to demonstrate an idea or message to a client for approval and if the client does not take title to the art;

2. charges for finished art;

3. amounts charged by a producer or studio for producing a commercial in the form of a disc or tape;

4. photo retouching to prepare a photo for reproduction; and

5. items the agency, a commercial artist, or a designer buys to produce ads, such as ink, paint, drawing tools, and pens.

(RI Division of Taxation, Regulation SU 08-01).

CONNECTICUT REVENUE FROM SALES TAX ON ADVERTISING

Table 1 shows Connecticut's annual sales tax revenue from sales of advertising services for the calendar years 2007 through 2010, which are the most recent years for which information is available. As the table demonstrates, revenue fell dramatically from 2007 to 2009. Although revenue increased slightly in 2010, it was still less than 75% of the 2007 level.

Table 1: Connecticut Sales Tax Revenue from Advertising

Calendar Year	Revenue
2007	$5,539,531
2008	5,017,681
2009	4,019,700
2010	4,110,897

Source: Office of Fiscal Analysis

JL:ts