



STATE BOARD OF EQUALIZATION

January 16, 1976

In the Matter of the Petition	)	DECISION AND RECOMMENDATION
for Redetermination of State	)	OF HEARING OFFICER
and Local Use Tax:	)	

Account No. XXX XXX XXXX

The above-entitled matter came on regularly for hearing on Friday, May 21, 1976 in San Diego, California. Robert H. Anderson, Hearing Officer.

Appearing for Petitioner: --- --- ---

Appearing for the Board:	Mr. J. Johnson, Audit Supervisor
	Mr. E. Lucero, Auditor
	San Diego District

Protest

Pursuant to an audit covering the period from 7/1/72 through 6/28/75, and a determination issued on December 19, 1975, petitioner protests the assessment of use tax on out-of-state purchases of advertising circulars distributed in California. The audited measure of the tax is \$516,732, but petitioner does not protest the entire amount.

## Contentions

Petitioner contends that the advertisement publications under protest were distributed as a component of an exempt publication and were therefore exempt from tax pursuant to the provisions of Section 6362 of the California Revenue and Taxation Code.

## Summary

--- --- Hereinafter --- is a corporation that operates a multi-state chain of discount stores that sell hardware and miscellaneous houseware items. The business is very competitive so an aggressive advertising program is carried on constantly.

--- publishes a small newspaper style advertisement tabloid consisting of around 16 pages. In some instances the publication is distributed by newspaper publishers who insert it in the daily edition of the paper. The publications distributed in this manner are not the subject of this petition because they were recognized in the audit as qualifying for the newspaper periodical exemption under Section 6362 of the Code.

--- purchases its printing from a firm in Portland, Oregon, and has the publications shipped into California for distribution. The shipment is segregated into two categories; (1) the California Supplement category, and (2) the California Permit Portion category. The supplement category relates to those publications destined for insertion into newspapers in various cities where --- has store locations. In San Diego they are distributed as inserts in the --- and ---.

The permit category relates to publications not intended for distribution with newspapers, instead they are destined for shipment to handbill distribution contractors for delivery by hand or mail to California residences.

In this controversy the advertisement publications were delivered to --- --- --- in Westminster; Orange County, California. The auditor contacted American Postal and was advised that they place the publication in a plastic bag and it is delivered on a house-to-house basis in various areas in Orange County. Where possible the plastic bag is hung on the door knob of the residence.

--- --- indicated to the auditor that it was their practice to fill up the plastic bag with handbills, circulars, product samples, etc., that people contract to have distributed. One item that is included in many distributions is a publication entitled --- --- --- which was deemed to be an exempt publication issued weekly. There are similar publications but they are not included in the same bag. The exempt publications, like shopping news tabloids, are published for distribution in specific consumer areas. For example, the News-Times is distributed to an area covering North Orange, Villa Park, Nohl Ranch and Anaheim Hills. The Orange County Chronicle has a Costa Mesa edition and a Tustin edition. The Homeowner's Review has editions for Newport Beach, Fountain Valley and Irvine communities.

--- ---- --- advised the Board of Equalization in San Diego by letter that:

--- --- Corporation is in the business of delivering periodicals and advertising material to homes throughout Orange County. In this capacity we deliver the --- tab in conjunction with a periodical known as the --- --- Our method of delivery is to place the --- tab and the --- --- into a plastic bag which is then delivered to -- residences.”

--- --- not publish the --- --- it merely distributes it pursuant to an agreement with the firm that does publish it.

The --- publication is distributed by --- --- pursuant to an agreement with --- --- and as noted, there may be other circulars, samples, etc., placed in the same plastic bag containing the --- publication and the --- --- which are distributed for other unrelated firms.

Advertising published by competitors of --- are not distributed in the same bag with --- advertisements by reason of agreement with --- --- in some instances the bag does not contain the --- because of limited circulation range. Thus, there were --- distributions that did not contain an exempt periodical and, as to these, petitioner’s representative concedes tax applies to the coat of the publication. Tax has been paid on advertising publications that were not distributed with an exempt periodical. It was noted that out of approximately 440,000 --- advertisements printed and distributed approximately 312,000 are placed in plastic bags containing the exempt --- ---.

Petitioner’s representative contends that where the --- advertisement is placed in the bag with a copy of the --- --- becomes attached to the Review and therefore is an ingredient or component part of the --- ---. Accordingly, it is contended that the Handyman advertisement tab is an exempt publication under Section 6362 of the Code.

### Conclusions

Section 6362 provides, in part, as follows:

(a) There are exempted from the taxes imposed by this part, the gross receipts from the sale of, and the storage, use, or other consumption in this state, of tangible personal property which becomes an ingredient or component part of any newspaper or periodical regularly issued at average intervals not exceeding three months and any such newspaper or periodical.

Regulation 1590 (18 Cal. Admin. Code 1590) contains a paragraph relating to "Ingredient or Component Part of a Newspaper or Periodical". It provides, in part:

Handbills, circulars, flyers, order forms, reply envelopes, maps or the like are considered as component parts of a newspaper or periodical when attached to or inserted in and distributed with the newspaper or periodical.

Affixing an advertisement circular to a newspaper with a rubber band would meet the test for “attaching” it to the newspaper. Likewise, placing it in the same plastic bag would be attaching to the newspaper. The rubber band and the plastic bag are both containers.

However, Section 6362 is an exemption statute and there is a well established rule that statutes granting exemption from taxation must be reasonably, but nevertheless strictly, construed against the taxpayer. *Santa Fe Transportation v. State Board of Equalization* (1959) 51 Cal. 2d 531; *Good Humor Co. v. State Board of Equalization* (1957) 152 Cal. App. 2d 879; *Luer Packing Co. v. State Board of Equalization* (1950) 101 Cal. App. 2d 99.

The exemption in Section 6362 is for newspapers and periodicals and for tangible personal property which becomes an ingredient or component part of any newspaper or periodical. It follows that it is an exemption to be enjoyed by publishers, vendors and donors of the periodical and newspaper, and not by anyone who happens to be able to have his nonexempt publication become "attached" to an exempt publication independent of any action by the publisher, vendor or donor of the exempt publication.

Under petitioner's theory of attachment, an ingredient or component of a newspaper or periodical could result without the knowledge or consent of the publisher of the newspaper or periodical, without any economical tie in between the exempt publication and the component, and without any business purpose as far as the publisher of the exempt publication is concerned. This would be like the tail wagging the dog and would have the effect of turning the exemption statute inside out.

In this matter we have an exempt publication placed in a plastic bag by a third party --- --- --- who is not the publisher or donor of the publication. The publisher contracted with the third party to distribute the publication.

At the same time a publisher-donor of another publisher --- --- with a publication that is not itself exempt under Section 6362, contracts with the same third party to distribute its publication too; the two are placed into the 'same plastic bag and are hand delivered to residences and left hanging on the doorknobs where possible.

Inasmuch as the publisher-donor of the exempt publication had nothing to do with the attaching and distribution of the nonexempt publication, the latter can hardly be said to be a component or ingredient of the exempt publication within the framework of the exemption statute because of what some third party independently does with it.

For example, a newspaper carrier could independently agree with a local supermarket to deliver advertising handbills to his subscribers and, on his own, inserts them in the newspapers he delivers. This, in our opinion, would not make the handbill an exempt component of the newspaper within the scope of the exemption statute so that the supermarket could purchase it ex tax and claim a use tax exemption under Section 6362. Petitioner's situation is essentially the same.

Implicit in the component-ingredient provision of the exemption statute is some direct tie-in with the exempt publication itself through the publisher, vendor or donor of it, and not some unrelated act of a third party who happens to bring the two publications together and "attaches" them for delivery in the most economical and expeditious manner possible. --- has no tie-in with the publisher-donor of Homeowner's Review for distribution like it had with the San Diego Union and Evening Tribune for distribution of the advertisement publication.

In order to be an exempt ingredient or component, it must become a component pursuant to some business arrangement with the publisher of the exempt publication as that is what the nonexempt publication is going to be tied to. The --- publication, although delivered in conjunction with other publications and samples, is delivered independent of them including the exempt publications, and to this extent there is no tie-in between the --- publication and --- other than the fact that they are placed in the same container for purposes of expeditious and economical delivery by a third party.

In summary, it is concluded that the advertising material under consideration did not become an ingredient or component of an exempt publication.

Recommendation

Redetermine without adjustment.

\_\_\_\_\_  
Robert H. Anderson, Hearing Officer

\_\_\_\_\_  
Date

Reviewed for Audit: