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Memorandum

October 8, 1991

To: Mr. Robert Nunes
Deputy Director
Sales and Use Tax Department

From: Gary J. Jugum
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Subject: Taxation of Newspapers and Periodicals - Regulation 1590

The sales tax exemption for newspapers and periodicals regularly issued at average intervals not exceeding three months was repealed effective July 15, 1991. (AB 2181, SB 179.) The grandfather clause provision with respect to subscriptions entered into prior to July 15, 1991 was clarified by SB 180. Free newspapers were exempted from the tax effective October 2, 1991. (AB 23X.) Certain distributions of publications for a fee were exempted from tax effective November 1, 1991. (SB 89.)

The Board adopted amendments to its Regulation 1590 on an emergency basis on August 1, 1991. The emergency regulation became effective on August 29, 1991, and was retroactive to July 15, 1991.

The public hearing with respect to the emergency amendments to Regulation 1590 is scheduled for October 15, 1991 in Sacramento at 2:00 p.m.

Upon the repeal of the newspaper and periodical exemption and the adoption of trailer legislation, a number of issues have been identified which have been of concern to the staff and to the newspaper and magazine publishing industries. Substantially all of these issues have now been resolved. Some may require resolution on a formal basis, by regulatory action of the Board.

Set forth below are the issues which we have identified with respect to both the initial repeal of the exemption and the follow-up legislation. The staff's recommendation with respect to these issues also is set forth below.

Magazines

The issues which have been of concern to the magazine publishing industry are set forth in a list prepared by the Magazine Publishers of America, dated August 28, 1991, captioned "Issues Regarding California Sales and Use Tax on Magazines."

Issue 1:

What is the treatment for California sales taxes on a magazine subscription, where the subscriber can pay in installments? Assume that the subscription is recorded by the fulfillment house before July 15, 1991, and that the first collection was made before that date.

This question concerns the interpretation of Revenue and Taxation Code section 6362.3, added to the Code by SB 180. Section 6362.3 provides as follows:

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 newspapers or periodicals, during the term of a prepaid subscription, if the subscription was entered into and paid for prior to July 15, 1991.

The staff has advised the industry that where a partial payment of a subscription fee to a retailer was made prior to July 15, 1991, the subscription is considered to be "paid for prior to July 15, 1991," within the meaning of that phrase as it is used in 6362.3. In other words, the entire subscription is sheltered from taxation by the grandfather clause provision.

Issue 2:

Many magazine publishers do not have the capability, and may not be able to develop the capability to accurately report publication sales of magazines as delivered in California. Will the SBE permit alternative methods of reporting the tax, e.g., based on total orders received or copies served using Audit Bureau of Circulation data to allocate subscription sales to California.

The staff has advised the industry that tax must be reported in accordance with the Sales and Use Tax Law (i.e. accrual basis). However, we will continue to work with the industry to develop acceptable reporting procedures which will be subject to audit. This procedure would be analogous to the reporting procedures used by grocers. Depending on the final solution, our discussions may result in a regulation similar to Regulation 1602.5. At this time, we do not believe any modifications to Regulation 1590 are necessary to handle this problem.

Issue 3:

What recordkeeping will be required by the SBE to permit them to audit sales tax returns during the period the statute of limitations is open?

Regulation 1698, "Records," provides that "All records pertaining to transactions involving sales or use tax liability must be preserved for a period of not less than four years

unless the State Board of Equalization authorizes in writing their destruction within a lesser period."

The Magazine Publishers indicated that subscriptions are generally handled by independent fulfillment houses. Because of the volume of transactions, original records are generally kept no more than 90 days. This agency has historically been able to accommodate taxpayers with special documentation problems on a case-by-case basis. Staff believes that we can handle this problem in the same manner as we have other taxpayers with similar problems. That is, after review of the taxpayer's system, a letter will be sent to the taxpayer outlining the retention of specific documents on a sample basis. Here again, we do not believe this issue requires any modification to Regulation 1590.

Issue 4:

With respect to transit district taxes and the Bradley-Burns Uniform Local Sales and Use Taxes, what, for example, is the correct tax rate to be collected by an out-of-state publisher with one or two advertising offices in the state? What is the correct tax rate to be collected by California-based publishers?

The staff has explained application of the Bradley-Burns and district tax provisions and is prepared to furnish the industry with written descriptive material specifying applicable rate imposition and allocations requirements. The initial instructions have been prepared and are included in the notice to publishers. We plan further distribution of these instructions in the quarterly newsletter.

Issue 5:

What is the proper measure for sales tax purposes of publications given away as promotion or for similar purposes, or free copies given to employees?

The proper measure of tax with respect to paid circulation publications given away as promotion or for similar purposes, or given to employees, is the cost of the production of the publications given away. This includes costs of paper, ink, and printing. The cost is determined on a pro rata basis in accordance with the ratio of copies given away to copies sold.

One specific issue identified here is the issue of so-called "soft offers." This is a merchandising technique where the offer to the subscriber is that a cancellation can occur without payment, if the subscriber is unhappy with the initial issues received. This arrangement is initiated by the subscriber. If the subscriber does not cancel after receiving the initial issues, the subscriber is billed in full, and the initial issues are treated as a part of the subscription term.

These transactions are treated as receivables by the seller, and then as a bad debt if there is a cancellation. However, the subscriber has no obligation to pay for the initial issues if the subscriber chooses to terminate the subscription. The question is, where there is a cancellation, are the one to three initial issues' self-consumed for sales and use tax purposes such that tax must be paid on cost, or may they properly be purchased for resale?

As recently as October 7, 1991, the industry representatives indicated that they would be providing the staff with more information on this subject.

Issue 6:

Who is the retailer when a publisher sells ' magazines through a third party?

This is the issue which the staff believes is the most significant to be resolved of those issues concerning the magazine industry.

Subscriptions are placed directly to the publisher as the result of direct mail, insert card, television commercial, or renewal activities of the publisher. In a substantial number of other cases, however, subscriptions are sold by, or through, what the magazine publishers describe as "third party retailers." The issue is, whether these third party retailers are retailers selling for their own account, or are agents selling for the publishers. Basically, the question is, who owes the tax? Third party retailers include direct mail agencies, school agencies, "paid during service" retailers, cash agencies, catalog agencies, and telephone agencies. Generally these groups solicit subscriptions for as many as 150 to 200 magazines. The orders are placed directly with the third party retailer. Payment is made by the subscriber to the third party retailer, and complaints concerning service are made to, and resolved by, the third party retailer. The staff has taken the position that these third party retailers are retailers of the publications in question.

The staff would propose the following language as an addition to the regulation:

(a)(7) Third Party Retailer. "Third party retailer" means and includes any person who sells at retail subscriptions to newspapers and periodicals who is not the publisher of the newspapers or periodicals. Typically third party retailers solicit subscriptions in a single offering for a large number of different publications, require that payment be made to the account of the third party retailer, and undertake to resolve subscription problems. The term includes persons commonly known as direct mail, school, paid during service, cash, catalog, and telephone agents. "Third party retailer" does not include persons who solicit renewals of subscriptions on behalf of individual publishers.

We would recommend that Regulation 1590 be amended to include this provision. Since third party retailers have not been officially notified of the proposed change in Regulation 1590, they should be given an opportunity to be heard on this issue.

Issue 7:

Should the maintenance of a news bureau, or the presence of reporters or photographers in California be one of the factors considered in determining whether an out-of-state publisher has sufficient contact with California to subject the publisher to the sales and use law?

The staff has advised that the maintenance of a news bureau in California is sufficient to establish nexus for use tax collection purposes under Revenue and Taxation Code section 6203. National Geographic Society v. St. Bd. of Equalization (1977) 430 u. S. 551. Staff is advised that the mere fact that reporters or photographers may sporadically come to California will not establish nexus.

Issue 8:

Would an out-of-state publisher that contracts with an independent advertising representative to solicit advertising in California be considered the retailer for purposes of sales and use tax assuming the publisher has no other contact with the State?

There is no nexus for use tax collection purposes where the advertising representative is an independent contractor.

Issue 9:

How is the value of a subscription determined when a subscription to a magazine or periodical is included in the dues paid to a membership organization?

Emergency Regulation 1590 presently provides that membership organizations are retailers of periodicals sent to members unless the fair retail value of the periodical is minimal, in which case the organization is the consumer for sales and use tax purposes. The staff initially intended to rewrite the membership organization rule to make it consistent with second-class mailing privilege provisions of the U. S. Postal Service Domestic Mail Manual. However, as a result of the passage of SB 89, the staff now believes it would be more appropriate to model the regulation on the provisions' of Revenue and Taxation Code section 6362.8(b)(2)(B). That section provides that sales of periodicals by certain nonprofit organizations are exempted under certain qualified limitations which include the following:

The amount paid or incurred by the nonprofit organization for the cost of printing the newspaper or periodical is less than 10 percent of the membership fee attributable to the period for which the newspaper or periodical is distributed.

For the period July 15, 1991, until October 31, 1991, the staff has proposed that Regulation 1590 be revised with the following text:

(b)(3) Membership Organizations. Operative July 15, 1991, until October 31, 1991, membership organizations which issue newsletters or periodicals to members are retailers of the newsletters or periodicals sent to members unless the fair retail value of the periodical is minimal. The fair retail selling price of the periodical will be regarded as minimal if the amount paid or cost incurred by the organization for the cost of printing the newsletter or periodical is less than 10 percent of the membership fee attributable to the period for which the newsletter or periodical is distributed. If the fair retail value of the periodical is not minimal, the measure of tax is the price charged to members for the newsletter or magazine. If the price is not separately stated, the measure of tax is that portion of the membership fee reasonably attributable to the publication.

As the result of the passage of 5B 89, many publications issued by nonprofit organizations will be fully free of tax on both cost and selling price effective November 1, 1991. The proposed revision is also based upon the provisions of AB 89:

(b)(3) Nonprofit Organizations Qualifying for Exemption. Operative November 1, 1991, newspapers or periodicals and their ingredients or component parts are exempted from tax under certain circumstances. Tax does not apply to the distribution or sale of any newspaper or periodical published or purchased by an organization that qualifies for tax exempt status under 501(c)(3) of the Internal Revenue Code provided distribution is to the members of the organization in consideration for payment of the organization's membership fee, or to the organization's contributors. Additionally, tax does not apply to the sale or distribution by a nonprofit organization, whether or not it qualifies for tax exempt status under section 501(c) (3) of the Internal Revenue Code, provided (a) distribution is to any member of the nonprofit organization in consideration, in whole or in part, of payment of the organization's membership fee, and (b) the amount paid or incurred by the nonprofit organization for the cost of printing the newspaper or periodical is less than 10 percent of the membership fee attributable to the period for which the newspaper or periodical is distributed.

(b)(3.2) Other Sales or Distributions by Membership Organizations. With respect to sales or distributions of newspapers or periodicals by membership organizations which do not qualify for the exemptions described above, such organizations will be regarded as the retailer of newsletters or periodicals unless the amount paid or cost incurred by the organization for the cost of printing the newsletter or periodical is less than 10 percent of the membership fee attributable to the period for which the newsletter or periodical is distributed, in which case the organization will be treated as the consumer of the newsletter or periodical. If the organization is regarded as the consumer, the sale of the publication or ingredients to the organization is exempt. If the organization is the retailer, sales tax applies to the price charged to members for the periodicals, if the price is separately stated. If the price is not separately stated, the measure of tax is that portion of the membership fee reasonably attributable to the publication.

Issue 10:

This an issue that was not raised by the Magazine Publishers Association, but arises as a result of the passage of SB 89. SB 89 creates an entirely new exemption for paid circulation magazines sold by section 501(c) (3) organizations, where the organization does not derive revenue from, or accept, any commercial advertising.

As a result of the passage of SB 89, Regulation 1590 should be amended to include language, in substance, as follows:

(b)(3.5) Publications Which Do Not Accept Commercial Advertising. Operative November 1, 1991, tax does not apply to the sale or distribution of any newspaper or periodical published or purchased by an organization that qualifies for tax exempt status under Section 501(c)(3) of the Internal Revenue Code, provided the publication does not derive revenue from, or accept, any commercial advertising.

Newspapers

The issues which have been of--concern to the newspaper industry have also been resolved in substantial part.

Free Newspaper Issue:

Free newspapers are exempted from tax effective October 2, 1991. The issue of whether free newspapers can qualify for the printed sales message exemption provided by Revenue and Taxation Code 6362.5 is moot after that date. There is little relevance to this question for the period July 15, 1991 through October 1, 1991, because it is unlikely that many free newspapers reorganized distribution systems during that period. At this date, the technical legal question remains as to whether publications previously classified as newspapers or periodicals may qualify as "printed sales messages." The emergency regulation is silent on this point. At this point, we do not believe that this is an issue. If it becomes one, the cases will be brought to the Board's attention for guidance.

Kiosk Vendors:

AB 2181 amended Revenue and Taxation Code section 6015 to provide that a newspaper carrier is not a retailer of newspapers. The retailer is the publisher or distributor. Regulation 1590 was amended to include "hawkers" as newspaper carriers. A "hawker" is an individual who sells single copies of newspapers to passersby on a street corner or other trafficked area. Regulation 1590 provides in paragraph (a) (6) that "newspaper carrier" does not include persons selling newspapers or periodicals from a fixed place of business. In San Francisco there are persons who sell both of the two leading daily newspapers from kiosk locations. Some may also sell two or three other local minor newspapers. Industry representatives would like the Board to classify these retailers as "newspaper carriers." The staff's view is that the statutory provision does not include this classification. However, such persons could be classified by the Board as 6015 retailers under Revenue and Taxation Code section 6015. That paragraph provides:

When the board determines that it is necessary for the efficient administration of this part to regard any salesmen, representatives, peddlers or canvassers as the agents of the dealers, distributors, supervisors, or employers under whom they operate or from whom they obtain the tangible personal property sold by them, irrespective of whether they are making sales on their own behalf or on behalf of such dealers, distributors, supervisors, or employers the board may so regard them and may regard the dealers, distributors, supervisors, or employers as retailers for purposes of this part.

We believe that publishers interested in pursuing registration under section 6015 for kiosk newspapers should apply on a case-by-case basis.

Vending Machine Issue:

Newspaper publishers have been concerned with two issues. First, must each vending machine bear the legend "Price includes sales tax"? The staff view is that this is the requirement of Regulation 1574, "Vending Machine Operators," paragraph (a) (1). The industry presently seems to be in substantial compliance with the regulation.

Second, what is the obligation with respect to reporting local tax? Must the tax be reported on a city-by-city basis? In fact, this issue is resolved by Regulation 1574, which presently provides, in paragraph (a) (3), that allocation must be made only on a county-by-county basis, not a city-by-city basis.

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cc: Mr. Glenn A. Bystrom
Mr. Charles Cordell