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**STATE BOARD OF EQUALIZATION**

(916) 445-2641

October 17, 1975

This is in response to your letter of October 7, 1975. You advise us that your records are currently being audited on sales tax reported for the period July 1, 1972 to June 30, 1975. Our auditor has disallowed certain claimed freight charges in connection with proofs, and you inquire as to our views on this issue.

We understand that a large portion of your business is the printing of preliminary and final prospectuses for large corporations. Before the printing of either the preliminary or final prospectus commences, you are required to deliver proofs to the customers' lawyers, accountants, and other interested parties. Since time is of the essence, the proofs are sent out via airmail and/or air freight. The recipients of the proofs may make changes or corrections on the proofs and return them to you, or they can accept the proofs without correction.

We are in agreement with our auditor's conclusion that separately stated charges for transporting the proofs are not excludable from your measure of tax liability. We are of the opinion that these charges are nondeductible expenses incurred in the production of the items sold to your customers, namely the preliminary prospectus or the final prospectus is taxable, the measure of tax includes expenses incurred in the shipping proofs to the customer.

While we recognize that proofs are a vital and intrinsic component in producing the final product and that you recoup your cost of producing the proofs in the charge made for the final product, we are of the opinion that the rule stated in our Regulation 1541 "Printing and Related Arts", that typographers are the consumers of proofing materials, is applicable in this situation. The proofs are not the object of the sale but are the means of insuring that the object of sale meets the specifications of the customer.

Tax applies when you ship the proofs because the charge made by you is regarded as a recoupment of an expense incurred in the production of a taxable item. If your customer were to ship the proofs to interested parties, the tax would not apply because your customer would not be making a taxable sale.

We are further in agreement with our auditor that separately stated freight charges for the distribution of the preliminary prospectuses are not subject to the tax. This question arose sometime ago, and we initially took the position that the printer was the consumer of the preliminary prospectus. It was pointed out to us, however, that the preliminary prospectus is an item sought by the customer and used by the customer in fulfillment of its regulatory and

contractual obligations. In other words, the preliminary prospectus is an item which is sold to the customer under the contract.

Very Truly yours,

Gary J. Jugum  
Tax Counsel

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