

STATE OF CALIFORNIA  
BOARD OF EQUALIZATION

385.0167

LEGAL DIVISION, APPEALS REVIEW SECTION

In the Matter of the Petition )  
for Redetermination Under the ) DECISION AND RECOMMENDATION  
Sales and Use Tax Law of: )  
)  
H--- R---, Inc. ) No. SR --- XX XXXXXX-010  
)  
)  
Petitioner \_\_\_\_\_ )

The Appeals conference in the above-referenced matter was held by Senior Staff Counsel James E. Mahler on April 8, 1994, in Sacramento, California.

Appearing for Petitioner: S--- Z. S---  
President

Appearing for the Sales and Use Tax Department: Kevin Hanks  
Senior tax Auditor

Protested Items

The protested tax liability for the period July 1, 1989, through March 31, 1992, is measured by:

<u>Item</u>	<u>State, Local, County &amp; Transit</u>	<u>EQRF</u>
A. Sales of books and other publications claimed as exempt in error	\$ 87,084	\$31,596
B. Reconciliation of audited sales to recorded	<u>31,953</u>	<u>8,111</u>
	<u>\$119,037</u>	<u>\$39,707</u>

Petitioner's Contentions

1. The Plant Site Database provided with the S--- Service is a part of the S--- Newsletter and is not taxable.

2. A Board employee advised petitioner that the S--- Service was not taxable.
3. Audit Item B cannot possibly be correct.

### Summary

The petitioner corporation is a market research and consulting firm specializing in the semiconductor industry. It sells various publications and reports to its customers. It has held a sellers permit since October 1984, but this is its first sales and use tax audit.

Insofar as concerns us here, petitioner's major publication is the S--- I--- & B--- S--- Newsletter (the "S--- Newsletter"). A subscription for 18 issues per year sells for \$495 to domestic customers. Each issue runs 20 to 26 pages and includes articles tracking and analyzing the activities of semiconductor firms worldwide. Petitioner and the staff agree that, until July 15, 1991 (the effective date of the 1991 amendments to Revenue and Taxation Code Section 6362), the S--- Newsletter qualified as an exempt periodical.

When it first started publishing the S--- Newsletter, petitioner often received telephone inquiries from subscribers seeking further information about the companies mentioned therein. Petitioner decided to compile the information into a publication to see if it would sell. This publication, now issued four times a year under the name S--- I--- P--- S--- Database (the "SIPS Database") lists names, addresses, phone numbers and other identifying information for --- plant site locations around the world. A year's subscription costs domestic customers \$695, and single issues sell for \$395. We understand that petitioner sells about fifteen copies per year on a single-copy basis, plus a number of other copies by subscription. Petitioner appears to agree with the staff that single-issue sales of the SIPS Database do not qualify for the former periodical exemption.

Petitioner also offers its customers a package called the "S--- Service." For a yearly fee of \$795, domestic customers selecting this option receive (1) a year's subscription to the S--- Newsletter; (2) one copy of the SIPS Database; and (3) "S--- On-Line", which is the right to access an on-line version of the S--- Newsletter for a discount price.

The on-line service is provided by N---, a computer service unrelated to petitioner. N---'s customers access that company's computers through telephone lines and are able to view current and past issues of the S--- Newsletter. Anyone can access the newsletter, but persons who have purchased the S--- Service from petitioner pay N--- only \$100 per hour. Other persons, including other subscribers to the S--- Newsletter, must pay N---'s normal access fee (apparently around \$240/hour). In either case, N--- pays petitioner 35% of its receipts from customers who access the newsletter. The S--- On-Line discount program is not sold separately; it is available only to persons who purchase the SIPS Service from petitioner.

According to testimony at the Appeals conference, persons who subscribe to the S--- Newsletter sometimes later decide that they also want the SIPS Database or S--- On-Line. Petitioner "upgrades" those customers to the S--- Service for an additional \$300 (*i.e.*, \$795 for the S--- Service minus the \$495 already paid for the S--- Newsletter). In return for the \$300, the customer gets both S--- On-Line and one copy of the SIPS Database.

The audit concluded that the SIPS Database is taxable, not only when sold separately, but also when provided as part of the S--- Service package. Petitioner disagrees and argues that the SIPS Database is included in the package as a component part or extra issue of the S--- Newsletter; since the newsletter concededly qualified as an exempt periodical prior to the 1991 statutory amendments, the extra issue should also qualify.

Petitioner also contends that it did not charge tax reimbursement to purchasers of the S--- Service in reliance on advice from a Board employee. Petitioner's president, Mr. S--- S---, states that he telephoned the Board's Santa Cruz office sometime in 1984, when the company began offering the S--- Service, to inquire about the taxability of the "newsletter product". The person to whom he spoke (whose name he does not recall) did not ask in detail about what was being sold, but did conclude that the S--- Service package was not a taxable item. Mr. S--- notes that petitioner would have charged and reported tax on the S--- Service if the Board had said to do so.

The audit measure of tax is based on the assumption that the \$795 price of the S--- Service should be allocated: \$420 to the S--- Newsletter; \$375 to the SIPS Database; and zero to S--- On-Line. We are uncertain exactly why the auditor allocated the price in this manner, but she apparently saw a few invoices charging \$375 for separate sales of the SIPS Database and felt that price was reasonable. Petitioner, on the other hand, argues that the \$795 price should be allocated \$495 to the newsletter, \$300 to the on-line service and zero the SIPS Database. In support, it alleges that the on-line service is at least an \$800 value to the customer, while the SIPS Database is added to the package only as a bonus or incentive for customers to sign up for the on-line service.

The protested sales of the S--- Service are included in Audit Item A. Of the total \$87,084 in that item, \$23,413 is from sales of periodicals after July 15, 1991, and \$7,828 is from other sales after that date, none of which are protested. The remaining \$55,843 apparently includes sales of various other publications in addition to the protested sales of the S--- Service, and we are uncertain of the exact amount in dispute.

Audit Item B is comprised of transactions where, according to the auditor, petitioner charged tax reimbursement to the customer but failed to pay tax to the State. (The invoice numbers for each such transaction are listed on schedule 12B.2, page 2, of the audit workpapers.) Petitioner argues that such mistakes are impossible because its record-keeping system is completely computerized; all charges for tax reimbursement are automatically recorded on the

sales journal and are reported. According to petitioner, however, the auditor "shuffled through" the business files and left them in complete disarray, so it would now be too expensive and time-consuming to match up each invoice with a journal entry to prove that the auditor was wrong.

Finally, Mr. S--- states that the audit was very costly and disruptive to the business. The auditor was a trainee who assumed that she could tie up petitioner's copy machine and telephone lines. Petitioner had to reserve a conference room where the auditor could work undisturbed. The petition process has already resulted in over \$6,000 in additional costs for attorney's fees and time lost from business, plus exorbitant interest on the determination. At each stage petitioner has met with bureaucratic delays. Also, since the 1991 repeal of the periodical exemption, some of petitioner's customers have refused to pay tax reimbursement, and it is too expensive to pursue collection, so petitioner has to pay the tax from its own funds.

#### Analysis and Conclusions

1. Subdivision (a)(2) of Sales and Use Tax Regulation 1590 defines the term "periodical", for purposes of the former sales and use tax exemption, to mean:

"... those publications which appear at stated intervals, each issue of which contains news or information of general interest to the public, or to some particular organization or group of persons. Each issue must bear a relationship to prior or subsequent issues in respect to continuity of literary character.... The term does not include catalogs, programs, score-cards, handbills, price lists, order forms or maps....

Petitioner appears to agree with the staff that the SIPS Database does not in itself qualify as an exempt periodical. We also agree. It has consistently been held that mere lists of addresses, telephone numbers and other identifying information do not meet the definition of "periodical", even if they are updated at periodic intervals, because they lack literary character and content. (See, *e.g.*, Sales & Use Tax Annots. 385.0840 [4/23/57], 385.0930 [2/18/77], 385.1330 [3/26/76] and 385.1600 [12/15/65].)

Petitioner contends, however, that the SIPS Database is exempt as a component part of the S--- Newsletter when the two are offered together as part of the S--- Service. Petitioner points out that the SIPS Database gives customers the opportunity to effectively utilize both the first issue of the newsletter and subsequent issues. Petitioner relies on subdivision (a)(3) of Sales and Use Tax Regulation 1590, which provides in the second paragraph:

"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."

We cannot agree. The SIPS Database is not attached to or inserted in the S--- Newsletter. Also, the first paragraph of subdivision (a)(3) defines "component part" of a periodical to include "only those items that become physically incorporated into the publication...." The SIPS Database is not physically incorporated into the S--- Newsletter and is therefore not a component part of the newsletter.

Petitioner also argues that the copy of the SIPS Database provided with the S--- Service is like an "extra issue" of the S--- Newsletter and thus exempt. It relies on Sales and Use Tax Annotation 385.0880 (5/26/65), which reads: "Directories [sic] issued as 13th edition of exempt periodical which is distributed to subscribers of periodical at no extra cost is considered to be an exempt periodical." However, Sales and Use Tax Annotation 385.0900 (6/26/52) clarifies that a "Directory Issue" is "not considered as 13th issue of monthly magazine where the format size, and name is [sic] different from the monthly magazine."

Here, petitioner does not provide the SIPS Database to S--- Newsletter subscribers for no extra cost; subscribers who decide they want the SIPS Database must instead pay at least \$300 over the subscription price to "upgrade" to the S--- Service. Furthermore, the SIPS Database's name and format differ from the S--- Newsletter. The SIPS Database is therefore not an "extra issue" of the newsletter.

Finally, petitioner argues that the \$795 price of the S--- Service is allocable entirely to the S--- Newsletter and S--- On-Line, with the SIPS Database provided as a "bonus" for no charge. The audit staff takes the opposite stance - that the \$795 price is allocable entirely to the S--- Newsletter and the SIPS Database, with S--- On-Line provided as a free bonus. We find both these positions untenable. Businesses normally obtain compensation from their customers for all products and services provided, and we see no reason to assume that petitioner is an exception to this rule. Both the SIPS Database and S--- On-Line are valuable to the customer, and we are unwilling to assume that either is provided free. In our view, therefore, the \$795 price must be allocated among all three components of the S--- Service.

The question is how to make the allocation. Usually "package deals" are allocated by the ratio of the prices which would be charged for each component sold separately, but that cannot be done here, since S--- On-Line is not sold separately. Another common technique, allocation by cost ratio, would also be inappropriate here, since the on-line service is provided by another company and petitioner's negligible costs do not truly reflect the value of the discounts to the customer. It might be possible to establish a value for S--- On-Line by determining petitioner's receipts from N---, and then use that value to allocate the price. Such an approach would require substantial additional audit time, however, and we have no guarantee it would produce a reasonable result. Under these circumstances, we believe it best to make the allocation on an estimated basis.

It seems to us that the S--- Newsletter is the main component of the S--- Service, while the SIPS Database and S--- On-Line are promotional incentives of relatively equal value. We therefore find that the \$795 package price should be allocated: \$495 to the newsletter (the normal price), \$150 to the SIPS Database and \$150 to S--- On-Line. We recommend a reaudit to adjust the measure of tax accordingly.

This allocation is admittedly a guess, and we have chosen it simply for lack of a better alternative. If petitioner believes that a more accurate allocation can be made by examining its gross receipts from the various components, or by any other method, it should provide the necessary records to the staff for use during the reaudit.

2. Revenue and Taxation Code Section 6596 authorizes the Board to grant relief from tax if certain requirements are satisfied. Among other things, the taxpayer must have relied on written advice which the taxpayer received from the Board in response to the taxpayer's written request for advice. The taxpayer must present a copy of its written request for advice, a copy of the Board's written response, and a statement under penalty of perjury setting forth the facts on which the claim for relief is based.

Petitioner contends that it is unreasonable to expect a business to wait for a written opinion from the Board every time it has a question about California taxes. The staff believes that it is reasonable to require written documentation, because that is the only way to avoid misunderstandings. For example, petitioner states that it inquired about the taxability of its "newsletter product", which indicates that the question may have been phrased in a way to suggest that the SIPS Database was part of the newsletter itself, not a separate publication. Without a written record, however, we have no way to determine exactly what questions were asked or exactly what advice was given.

In any event, the statute clearly and unequivocally requires a written request and response as prerequisites to relief, and we cannot ignore the law simply because petitioner believes it is unreasonable. Petitioner did not make a written request for advice and did not receive any written advice from the Board. Further, petitioner has not presented the required statement under penalty of perjury. Petitioner is therefore not entitled to relief.

3. A determination by the Board is presumed correct, and the taxpayer bears the burden of proving error. (Paine v. State Bd. of Equalization [1982] 137 Cal.App.3d 438.) Petitioner states that Audit Item B must be incorrect, but it would be too expensive and time-consuming to compile supporting evidence. Without evidence, however, there is no basis for any adjustment.

H--- R---, Inc.  
SR --- XX XXXXXXX-010

-7-

August 8, 1994  
385.0167

Recommendation

Reaudit to calculate the measure of tax on the SIPS Database furnished with the S--- Service at the estimated price of \$150 per copy, unless petitioner presents evidence supporting a more accurate estimate. In all other respects, redetermine without adjustment to the tax.

\_\_\_\_\_  
James E. Mahler, Senior Staff Counsel

\_\_\_\_\_  
Date