

DISCUSSION TOPICS

FRANCHISE TAX BOARD INTERESTED PARTIES' MEETING REGULATION SECTION 25137-12: PRINT MEDIA JANUARY 8, 2008

1. Overview and History of Print Media Regulation.

This regulation, adopted in 1995, addresses both the nature and sourcing of advertising in magazines and periodicals ("print media"). The precursor to this regulation was Legal Ruling 367, issued in 1973. In that ruling, the department ruled that sales of advertising in print media generated business income under Revenue and Taxation Code (RTC) section 25120, that the advertising was so intrinsically a part of the printed media itself, and that the sale of advertising was to be treated as a sale of tangible personal property under RTC section 25134 (the ruling noted that the advertiser's primary purpose was to reach the market established by the print media publisher). Further, sales of advertising were to be sourced on a geographical basis according to circulation statistics: they were sourced to California in the ratio that sales of the printed media bore to the total sales of printed media everywhere.

The regulation also addressed the issue of "nowhere income" by including a throw-back rule that requires advertising receipts to be thrown back to the state from which the printed media containing the advertising was shipped, stored, etc. To the extent that a publisher is not taxable in the state of the purchaser/subscriber of its printed media, the gross receipts from the sales and subscriptions of the printed material are thrown back to the state from which the printed media was shipped.

There have been numerous changes in the print media industry since the adoption of regulation section 25137-12. Print media once was limited to forms we could see, touch, physically store, and ship. Today there are alternatives to print, e.g., Internet, e-mail, and CDs. Together, they create an amalgam of tangible property and intangible services. E-commerce results in greater geographic diversity than does the traditional "print-and-distribute" process; the new global model is to distribute and, at the recipient's choice, to print, download, or transfer electronically to another receiver.

In addition, traditional "print media" activities now include online advertising services that are not covered under any of the RTC section 25137 special industry regulations. Some corporations provide online advertising services that are geographically targeted. The department has identified the following scenarios that are not currently covered by regulation section 25137-12: (1) sales of online advertising, (2) sales of "embedded advertising," and (3) sales of advertising distributed via cable or satellite transmission.

Some of the print media industry operates online and offshore, and may not be physically located in any particular state. It is also an increasingly international print media business, with customers in and outside the United States. Additionally, mergers and acquisitions mean that corporations today are rarely involved solely in the print

media business, but have diversified into television broadcasting, radio and other advertising-driven media.

2. LET'S TALK ABOUT IT!

The department anticipates having an open discussion to address these and other concerns that may be present in the industry, together with possible approaches to resolve potential problems.

Staff believes there are certain core principles that provide an objective basis to guide the discussion and to evaluate proposed solutions. Among these principles are:

- 1) Equity: Are all taxpayers being treated similarly?
- 2) Administrability: Is the rule clear and simple? Can taxpayers and the department apply the new rule?
- 3) Elimination of potential disputes: Does the new rule raise concerns that could lead to new disputes?
- 4) Recordkeeping: Does the new rule use existing records as much as possible to minimize taxpayer recordkeeping burdens?

With these principles as the backdrop, the department would like your thoughts on the following topics:

- 1) Defining the methods of technology currently being used by the print media industry to distribute advertising.
- 2) Inclusion of advertising revenue generated by technology identified in #1 within the scope of this regulation.
- 3) Accounting for advertising revenue: characterization as sale of tangible personal property, or as sale of intangible property, or as sale of a service.
- 4) The considerations that inform your determinations on issues raised in #3.
- 5) Use of a market-based formula to apportion advertising revenue.
- 6) Addressing the fact that the industry is changing and boundaries between media are becoming blurred.
- 7) Considering methods of identifying and sourcing new ad forms
- 8) The need, if any, to revise or add terms and/or definitions to the regulation in light of the foregoing considerations. This includes suggested language for revisions and/or additions.
- 9) The types of records that are currently required to be maintained either for governmental reporting purposes or marketing purposes which might be a basis for assignment of revenues. This could include either those which represent an industry standard or are entity specific.
- 10) Addressing other industry concerns that may exist.

3. LET'S THINK ABOUT IT!

The regulation could be updated to incorporate relevant aspects of the Multistate Tax Commission's Model Regulation for Publishing, and could include provisions for the payroll and property factors, as well as for the sales factor that is currently addressed by

regulation section 25137-12. A market-based determination rule for sourcing advertising revenue has the potential for providing one industry-wide formula that provides clarity and consistency for both taxpayers and the department.

To acknowledge the changes in forms of technology used to distribute advertising, regulation section 25137-12 could be revised and/or language could be added to include additional sources of advertising revenue, to determine the characterization of advertising revenue, and to provide uniformity for treatment of advertising revenue currently covered by regulation section 25137-8. It may be that a single regulation covering advertising revenue will better serve both the department's and industry's needs.

Additionally, the regulation could be amended to address identified industry concerns.

Note: The department is currently reviewing another regulation, regulation section 25137-8, related to motion picture and television film producers and to television networks. An interested parties' meeting on Regulation section 25137-8 is scheduled for January 8, 2008 at 1:00 p.m. Topics related to advertising revenue generated by those media will be discussed. A notice of that meeting and a list of discussion topics can be found at www.ftb.ca.gov. Highlight "Public Meetings" under the "News and Events" heading on the home page and click on "Interested Parties Meetings." You may also contact Carole Rouin, the department's legal staff member responsible for Regulation section 25137-8, at Carole.Rouin@ftb.ca.gov.