



BOARD OF EQUALIZATION

BUSINESS TAXES COMMITTEE MEETING MINUTES

HONORABLE DIANE L. HARKEY, COMMITTEE CHAIR

450 N STREET, SACRAMENTO

MEETING DATE: JANUARY 26, 2016, TIME: 10:00 A.M.

ACTION ITEMS & STATUS REPORT ITEMS**Agenda Item No: 1****Title: Proposed revisions to Regulation 1590, *Newspapers and Periodicals*****Issue/Topic:**

Whether the Board should amend Regulation 1590, *Newspapers and Periodicals*, to clarify the application of tax to subscriptions of newspapers that include or combine access to digital content.

Committee Discussion:

Staff introduced the issue.

Committee Action/Recommendation/Direction:

Upon motion by Mr. Runner and seconded by Ms. Stowers without objection, the Committee approved and authorized for publication the proposed amendments to Regulation 1590, *Newspapers and Periodicals*. A copy of the proposed amendments to Regulation 1590 is attached.

Agenda Item No.: 2**Title: Proposed Cigarette and Tobacco Products Tax Regulations 4076, Wholesale Cost of Tobacco Products, and 4001, Retail Stock****Issue:**

Whether the Board should approve proposed Regulation 4076, *Wholesale Cost of Tobacco Products*, and Regulation 4001, *Retail Stock* to provide definitions for "wholesale cost of tobacco products" and "retail stock."

Committee Discussion:

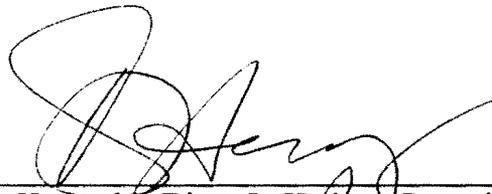
Staff introduced the proposed Regulation 4076 and Regulation 4001 which define and clarify the wholesale cost and retail stock, as they relate to cigarette and tobacco products tax. Mr. Randall Cheek of SEIU Local 1000 stated that they had concerns with Regulation 4001. Specifically, he expressed a concern regarding the possible commingling of taxed and untaxed tobacco products maintained in a walk-in humidor. Mr. Parrott of the Special Taxes and Fees Division responded that staff believes its proposed language made clear the differences between tobacco products held in retail and wholesale inventories.

Mr. Cheek explained that he did not believe his organization participated in the interested parties' process. The members discussed continuing the interested parties' process to allow further discussion on the Regulation 4001 issue.

Committee Action:

Upon motion by Mr. Runner, seconded by Ms. Stowers, without objection, the Committee approved and authorized for publication proposed Regulation 4076. A copy of proposed Regulation 4076 is attached.

Upon motion by Mr. Horton, seconded by Ms. Ma, without objection, the Committee decided to postpone proposed Regulation 4001 to the March 29, 2016 Business Taxes Committee meeting to allow staff to work with interested parties to address their concerns.



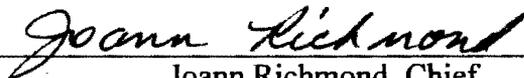
Honorable Diane L. Harkey, Committee Chair



David Gau, Chief Deputy Director

BOARD APPROVED

at the 1-26-16 Board Meeting



Joann Richmond, Chief
Board Proceedings Division

Regulation 1590. Newspapers and Periodicals.

Reference: Sections 6005, 6006, 6007, 6010, 6015, 6361.5, ~~6362.3~~, 6362.7, and 6362.8, Revenue and Taxation Code.

(a) Definitions.

(1) "Newspaper." The term "newspaper" as used herein conforms to the definition of a newspaper as set forth in a ruling of the United States Treasury Department published in the Federal Register, December 29, 1960. Under this definition, the term is limited to those publications which are commonly understood to be newspapers and which are printed and distributed periodically at daily, weekly, or other short intervals for the dissemination of news of a general character and of a general interest. The term does not include handbills, circulars, flyers, or the like, unless distributed as a part of a publication which constitutes a newspaper within the meaning of this subparagraph. Neither does the term include any publication which is issued to supply information on certain subjects of interest to particular groups, unless such publication otherwise qualifies as a newspaper within the meaning of this subparagraph. For purposes of this subparagraph, advertising is not considered to be news of a general character and of a general interest.

(2) "Periodical." The term "periodical" as used herein is limited to 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 or similarity of subject matter, and there must be some connection between the different issues of the series in the nature of the articles appearing in them.* Each issue must be sufficiently similar in style and format to make it evident that it is one of a series. An annual report of a corporation which is substantially different in style and format from the corporation's quarterly reports is not part of a series with the quarterly reports. The term "periodical" does not include books complete in themselves, even those that are issued at stated intervals, for example, books sold by the Book-of-the-Month Club or similar organizations; so-called "pocket books," a new one of which may be issued once a month or some other interval; or so-called "one-shot" magazines that have no literary or subject matter connection or continuity between prior or subsequent issues. The term does not include catalogs, programs, score-cards, handbills, price lists, order forms or maps. Neither does it include shopping guides or other publications of which the advertising portion, including product publicity, exceeds 90 percent of the printed area of the entire issue in more than one-half of the issues during any 12-month period.

(3) "Ingredient or Component Part of a Newspaper or Periodical." The term "ingredient or component part of a newspaper or periodical" includes only those items that become physically incorporated into the publication and not those which are merely consumed or used in the production of the publication. For example, newsprint and ink are ingredients of a newspaper; however, a photograph does not become an ingredient or component part of a

* This definition is based upon *Business Statistics Organization, Inc. v. Joseph*, 299 N.Y. 443, 87 N.E. 2d 505, and *Houghton v. Payne*, 194 U.S. 88, 48 L.Ed 888.

newspaper or periodical merely because the image of the photograph is reproduced in the publication.

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.

(4) "Publisher." "Publisher" means and includes any person who owns the rights to produce, market, and distribute printed literature and information.

(5) "Distributor." "Distributor" means any person who acquires newspapers or periodicals for subsequent distribution to retailers or newspaper carriers.

(6) "Newspaper Carrier." "Newspaper carrier" means any person who acquires newspapers from a publisher or distributor to deliver to consumers. The term includes a hawker. A "hawker" is an individual who sells single copies of newspapers to passersby on a street corner or other trafficked area. "Newspaper carrier" does not include persons selling newspapers or periodicals from a fixed place of business.

(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.

(8) "Mixed Newspaper Subscription." "Mixed newspaper subscription" means and includes a subscription for a tangible newspaper combined with a subscription for the right to access digital content.

(9) "Digital-Only Subscription Rate." "Digital-only subscription rate" means the price a customer would pay to access digital content from a newspaper publisher, exclusive of any promotions or discounts, without any print delivery.

(10) "Print-Only Subscription Rate." "Print-only subscription rate" means the price a customer would pay to have the print edition of a newspaper delivered to their home, exclusive of any promotions or discounts, without any access to digital content.

(b) Application of Tax.

(1) In General. ~~Effective July 15, 1991,~~ The sale of newspapers and periodicals, including sales by third party retailers, is subject to tax unless otherwise exempt.

Tax does not apply to sales of tangible personal property to persons who purchase the property for incorporation as a component part of a newspaper or periodical which will be sold notwithstanding that the purchaser is not the seller of the newspaper or periodical.

See Regulation 1574 (18 CCR 1574) for the application of tax to sales through vending machines and Regulation 1628 (18 CCR 1628) for the application of tax to transportation charges.

(2) ~~Distributions of Newspapers and Periodicals Without Charge. Effective October 2, 1991.~~ Tax does not apply to the sale or use of tangible personal property which becomes an ingredient or component part of a copy of a newspaper or periodical regularly issued at average intervals not exceeding three months when that copy of such newspaper or periodical is distributed without charge, nor does tax apply to such distribution.

Newspapers and periodicals distributed on a voluntary pay basis shall be considered as distributed without charge. Newspapers and periodicals are distributed on a voluntary pay basis when payment is requested from the consumer but is not required.

(3) ~~Subscriptions. The sale or use of newspapers and periodicals is exempt from tax during the term of a prepaid subscription if the purchaser ordered and paid for the subscription prior to July 15, 1991.~~

~~Effective November 1, 1992, t~~

(A) Exempt Subscriptions. Tax does not apply to the sale or use of a periodical, including a newspaper, which appears at least four, but not more than 60 times each year, which is sold by subscription, and which is delivered by mail or common carrier. For example, a daily newspaper is not a periodical for the purposes of this subdivision (b)(3). Tax does not apply to the sale or use of tangible personal property which becomes an ingredient or component part of such a periodical.

~~Sales tax reimbursement collected on the sale of a periodical subscription prior to the November 1, 1992 effective date of the exemption for the sale of issues delivered on or after November 1, 1992 constitutes excess tax reimbursement. The retailer must refund the tax reimbursement to the customer or pay it to the state in accordance with subdivision (b) of Regulation 1700 (18 CCR 1700).~~

(B) Mixed Newspaper Subscriptions. In the sale of a mixed newspaper subscription, tax is applied to the tangible personal property portion of the transaction (unless otherwise exempt or excluded) and the right to access the digital content is not subject to tax.

1. For sales of mixed newspaper subscriptions made on and after October 1, 2016, forty-seven (47) percent of the charge for the mixed newspaper subscription is presumed to be the taxable measure from the sale of tangible personal property and tax applies to that amount; the remaining fifty-three (53) percent is presumed to be the nontaxable sale of the right to access the digital content.

2. This presumption may be overcome by evidence demonstrating to the satisfaction of the board that the digital-only subscription rate divided by the sum of the print-only subscription rate and the digital-only subscription rate is greater than fifty-three (53) percent. Taxpayers shall maintain records to substantiate a nontaxable allocation

greater than fifty-three (53) percent. Rates shall not be computed more often than once per quarter.

(C) Reporting Subscription Sales. Each delivery of a newspaper or periodical pursuant to a subscription sale is a separate sale transaction. When the sale is subject to tax, the retailer must report and pay the tax based upon the reporting period within which the delivery is made. The subscription price shall be prorated over the term of the subscription period.

(4) Membership Organizations. Generally, tax applies to sales of newspapers and periodicals by membership organizations. If the price is separately stated, tax applies to that amount. If the price is not separately stated, the measure of tax is the fair retail selling price of the publication.

The application of tax to distributions of newspapers and periodicals by nonprofit organizations is provided at subdivision (b)(5). The application of tax to sales of periodicals by subscription is provided at subdivision (b)(3).

(5) Nonprofit Organizations.

~~(A) Internal Revenue Code Section 501(c)(3) Organizations. Effective November 1, 1991, until October 31, 1992, tax does not apply to the sale or use of any newspaper or periodical distributed by an organization that qualifies for tax exempt status under section 501(c)(3) of the Internal Revenue Code, nor tangible personal property which becomes an ingredient or component part of any such newspaper or periodical, regularly issued at average intervals not exceeding three months only as to issues and distributed under either of the following circumstances:~~

- ~~1. The issues are distributed to the organization's members in consideration of the organization's membership fee; or~~
- ~~2. The issues are of a newspaper or periodical which neither receives revenue from, nor accepts, any commercial advertising.~~

~~Effective November 1, 1992, the exemption is applicable only as to a newspaper or periodical regularly issued at average intervals not exceeding three months.~~

For purposes of this subdivision, any governmental entity established and administered for the purposes provided in Internal Revenue Code Section 501(c)(3) shall be considered to be an organization that qualifies for tax exempt status under that section.

~~(B) Other Nonprofit Organizations. Effective November 1, 1991, tax does not apply to the sale or use of any newspaper or periodical regularly issued at average intervals not exceeding three months and distributed by a nonprofit organization, nor tangible personal property that becomes an ingredient or component part of or any such newspaper or periodical, only as to issues distributed pursuant to both of the following requirements:~~

1. The issues are distributed to the organization's members in consideration, in whole, or in part, of the organization's membership fee;
2. The amount paid or incurred by the nonprofit organization for the cost of printing the newspaper or periodical is less than ten percent of the membership fee attributable to the period for which the newspaper or periodical is distributed, whether the publication is printed within or without this state. The cost of printing shall be determined as follows.

The cost of printing includes costs of tangible personal property purchased to become an ingredient or component part of the newspaper or periodical (e.g., ink and paper) and costs of labor to print the newspaper or periodical. The cost of printing does not include costs not attributable to actual printing, such as costs of special printing aids, typography, and preparation of layouts.

If the organization contracts with an outside printer to print the newspaper or periodical, the organization shall obtain and retain documentation segregating the costs of printing from the printer's other charges.

If the organization is the printer of the newspaper or periodical, the cost of printing includes the aggregate of the cost of tangible personal property purchased to become an ingredient or component part of the newspaper or periodical; labor of printing, including fringe benefits and payroll taxes; and other costs attributable to the actual printing of the newspaper or periodical.

If an organization has published the newspaper or periodical for a period exceeding twelve months and the method of printing has not changed, the organization may elect to consider the cost of printing for a reporting period to be equal to the amount paid or incurred for the same reporting period for the previous fiscal or calendar year.

(6) Newspaper Carriers. A newspaper carrier is not a retailer. The publisher or distributor for whom the carrier delivers is the retailer of the newspapers delivered. The publisher or distributor shall report and pay tax measured by the price charged to the customer by the carrier.

(7) Consumption of Property. Tax applies to the sale to or use by a newspaper or periodical publisher of tangible personal property consumed in the manufacturing process. Tax does not apply to the cost of tangible personal property lost or wasted in the manufacturing process when that property was purchased for the purpose of incorporation into a newspaper or periodical to be sold or to be distributed in accordance with subdivision (b)(2).

~~(8) Fixed Price Contracts. The sale or use of newspapers and periodicals is exempt from tax during the term of a prepaid subscription if the purchaser ordered and paid for the subscription prior to July 15, 1991.~~

(98) School Catalogs and Yearbooks. Public or private schools, county offices of education, school districts, or student organizations are the consumers of catalogs and yearbooks

prepared for or by them, and tax does not apply to their receipts from the distribution of the publications to students.

Tax applies to charges for the preparation of such publications made to public or private schools, county offices of education, school districts, or student organizations by printers, engravers, photographers and the like.

(c) Exemption Certificates. Any seller claiming a transaction as exempt from sales tax pursuant to Revenue and Taxation Code sections 6362.7 or 6362.8 should timely obtain an exemption certificate in writing from the purchaser. The exemption certificate will be considered timely if obtained by the seller at any time before the seller bills the purchaser for the property, or any time within the seller's normal billing and payment cycle, or any time at or prior to delivery of the property.

(1) Certificate A. Certificate to be used for purchases of tangible personal property for incorporation into newspapers or periodicals for sale in accordance with subdivisions (b)(1) or (b)(3), above.

(2) Certificate B. Certificate to be used for purchases of tangible personal property that becomes an ingredient or component part of newspapers or periodicals that are distributed without charge in accordance with subdivision (b)(2), above.

(3) Certificate C. Certificate to be used for purchases of tangible personal property that becomes an ingredient or component part of newspapers or periodicals that are distributed by organizations which qualify for tax-exempt status under Internal Revenue Code section 501(c)(3) in accordance with subdivision (b)(5)(A), above.

(4) Certificate D. Certificate to be used for purchases of tangible personal property that becomes an ingredient or component part of newspapers or periodicals that are distributed by nonprofit organizations in accordance with subdivision (b)(5)(B), above.

Certificate A

California Sales Tax Exemption Certificate

Sales of tangible personal property for
incorporation into a newspaper or periodical for sale

(Name of Purchaser)

(Address of Purchaser)

I HEREBY CERTIFY:

Initial one of the following:

____ That I hold valid seller's permit No. _____ issued
pursuant to the Sales and Use Tax Law.

____ That I do not hold a seller's permit issued pursuant to the Sales and Use Tax Law. I
do not sell any tangible personal property for which a permit is required.

I further certify that the tangible personal property described herein which I shall purchase
from

(Name of Vendor)

will become a component part of the newspaper or periodical *

and sold as a component part of the publication.

I understand that in the event any such property is sold or used other than as specified
above or used other than for retention, demonstration, or display while holding it for sale in
the regular course of business, I am required by the Sales and Use Tax Law to report and
pay any applicable sales or use tax. Description of the property to be purchased:

Date: _____, 19____

(Signature of Purchaser or Authorized Agent)

(Title)

* Insert name and type of newspaper or periodical

Certificate B

California Sales Tax Exemption Certificate

Sales of tangible personal property which becomes an ingredient or component part of newspapers or periodicals that are distributed without charge

(Name of Purchaser)

(Address of Purchaser)

I HEREBY CERTIFY:

Initial one of the following:

____ That I hold valid seller's permit No. _____ issued pursuant to the Sales and Use Tax Law.

____ That I do not hold a seller's permit issued pursuant to the Sales and Use Tax Law. I do not sell any tangible personal property for which a permit is required.

I further certify that I am engaged in the business of publishing *

which is regularly issued at average intervals not exceeding three months and distributed without charge by me. The tangible personal property described herein which I shall purchase from

(Name of Vendor)

will become a component part of the publication listed above. I understand that if I use any of the property purchased for any other purpose I am required by the Sales and Use Tax Law to report and pay tax, measured by the purchase price of the such property.

Description of property to be purchased:

Date: _____, 19 _____

(Signature of Purchaser or Authorized Agent)

(Title)

* Insert name and type of newspaper or periodical

Certificate C

California Sales Tax Exemption Certificate

Sales of tangible personal property that becomes an ingredient or component of newspapers or periodicals that are distributed by organizations which qualify for tax-exempt status under Internal Revenue Code section 501(c)(3)

(Name of Purchaser)

(Address of Purchaser)

I HEREBY CERTIFY:

Initial one of the following:

____ That I hold valid seller's permit No. _____ issued pursuant to the Sales and Use Tax Law.

____ That the purchaser does not hold a seller's permit issued pursuant to the Sales and Use Tax Law. The purchaser does not sell any tangible personal property for which a permit is required.

I further certify that the purchaser is an organization that qualifies for tax-exempt status under Section 501(c)(3) of the Internal Revenue Code and is engaged in the business of selling or publishing *

which is regularly issued at average intervals not exceeding three months.

The tangible personal property described herein which I shall purchase from

(Name of Vendor)

will be sold in the form of tangible personal property or will become a component part of a newspaper or periodical distributed by the organization and (check one or both):

____ The organization will distribute the newspaper or periodical to the members of the organization in consideration of payment of the organization's membership fee or to the organization's contributors,

____ The publication does not receive revenue from or accept any commercial advertising.

I understand that in the event any such property is sold or used other than as specified above or used other than for retention, demonstration, or display while holding it for sale in the regular course of business, I am required by the Sales and Use Tax Law to report and pay any applicable sales or use tax. Description of the property to be purchased:

Date: _____, 19 _____

(Signature of Purchaser or Authorized Agent)

(Title)

* Insert name and type of newspaper or periodical

Certificate D

California Sales Tax Exemption Certificate

Sales of tangible personal property which becomes an ingredient or component part of newspapers or periodicals that are distributed by nonprofit organizations

(Name of Purchaser)

(Address of Purchaser)

I HEREBY CERTIFY:

Initial one of the following:

____ That the purchaser holds valid seller's permit No. _____ issued pursuant to the Sales and Use Tax Law.

____ That the purchaser does not hold a seller's permit issued pursuant to the Sales and Use Tax Law. The purchaser does not sell any tangible personal property for which a permit is required.

I further certify that the purchaser is a nonprofit organization which is engaged in the business of selling or publishing *

which is regularly issued at average intervals not exceeding three months.

The tangible personal property described herein which I shall purchase from

(Name of Vendor)

will be resold by the organization in the form of tangible personal property or will become a component part of a newspaper or periodical distributed by the organization and both of the following apply:

(A) Distribution will be to any member of the nonprofit organization in consideration, in whole or in part, of payment of the organization's membership fee.

(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.

I understand that in the event any of such property is sold or used other than as specified above or used other than for retention, demonstration, or display while holding it for sale in the regular course of business, I am required by the Sales and Use Tax Law to report and pay any applicable sales or use tax. Description of property to be purchased:

Date: _____, 19 _____

(Signature of Purchaser or Authorized Agent)

(Title)

* Insert name and type of newspaper or periodical

Regulation 4076. WHOLESAL COST OF TOBACCO PRODUCTS.**(a) Definitions.**

(1) Arm's-length transaction. An "arm's-length" transaction means a sale entered into in good faith and for valuable consideration that reflects the fair market value in the open market between two informed and willing parties, neither under any compulsion to participate in the transaction.

(2) Discounts or trade allowances. "Discounts or trade allowances" are price reductions, or allowances of any kind, whether stated or unstated, and include, without limitation, any price reduction applied to a supplier's price list. The discounts may be for prompt payment, payment in cash, bulk purchases, related-party transactions, or "preferred-customer" status.

(3) Finished tobacco products; finished condition. "Finished tobacco products" and tobacco products in "finished condition" are tobacco products that will not be subject to any additional processing before first distribution in the state.

(b) Wholesale cost.

(1) If finished tobacco products are purchased by a distributor from a supplier in an arm's-length transaction, the "wholesale cost" of the tobacco product is the amount paid for the tobacco product, including any federal excise tax, but excluding any transportation charges for shipment originating within the United States. Discounts and trade allowances must be added back when determining "wholesale cost."

(2) If a manufacturer or an importer is also the distributor, the wholesale cost of tobacco includes all manufacturing costs, the cost of raw materials (including waste materials not incorporated into the finished tobacco product) prior to any discounts or trade allowances, the cost of labor, any direct (including freight-in) and indirect overhead costs, and any federal excise and/or U.S. Customs taxes paid. Wholesale cost includes all freight or transportation charges for shipment of materials and/or unfinished product from the supplier to the manufacturer concurrently licensed as a distributor, but excludes domestic freight or transportation charges for shipment of finished tobacco products as defined in subdivision (a)(3).

(3) If tobacco product costs include express, implicit, or unstated discounts or trade allowances, the correct wholesale costs to be reported by the distributor may be determined using any of the methods provided in subdivision (c).

(4) If tobacco products are not purchased in an arm's-length transaction, the correct wholesale costs to be reported by the distributor may be determined using any of the methods provided in subdivision (c).

(c) Alternative methods of estimating or calculating wholesale cost.

The following resources or methods may be used.

The proposed language contained in this document may not be adopted. Any revisions that are adopted may differ from this text.

(1) A publicly or commercially available price list that the distributor used to determine the prices of tobacco products sold to customers in arm's-length transactions during the time period at issue, less an estimate based on the best available information of the distributor's or a similarly situated distributor's profit.

(2) If a publicly or commercially available price list is not available, industry data from the time period to be estimated or calculated that provides reasonable evidence of typical tobacco product costs during such time period, including, but not limited to:

(A) Evidence reasonably indicative of the typical costs of the same or similar tobacco products for similarly situated distributors, with appropriate adjustments to such costs as indicated by all the facts and circumstances.

(B) All the direct and indirect costs that the supplier paid or incurred with respect to acquisition, production, marketing, and sale of the tobacco products sold by the supplier to the distributor, with appropriate adjustments to such costs as indicated by all the facts and circumstances, plus a reasonable estimate of the supplier's profit.

(C) The price of the same or similar tobacco products as reflected in a supplier's price list, with appropriate adjustments to such price as indicated by all the facts and circumstances.

(D) The retail price of the same or similar tobacco products as reflected in a retailer's price list, with appropriate adjustments to such price as indicated by all the facts and circumstances, less reasonable estimates of the retailer's and distributor's profits.

(E) Additional methods not mentioned above, with Board approval.

(d) Sales not made at arm's-length.

(1) **Presumption.** Sales, purchases, and transfers of tobacco products are rebuttably presumed to not be at arm's-length if they are between related parties such as: relatives (by blood or marriage, which relationships include, but are not limited to, spouses, parents, domestic partners, children and siblings); partners or a partnership and its partners; a limited liability company or association and its members; commonly controlled corporations; a corporation and its shareholders; or persons, as defined in Revenue and Taxation Code section 30010, and entities under their control or between commonly controlled entities.

(2) **Rebuttal of presumption.** If the Board determines that a sale, purchase, or transfer of tobacco products was between related parties, the distributor may rebut the presumption that the sale, purchase, or transfer was not at arm's-length by showing that the price, terms, and conditions of the transaction were substantially equivalent to those that would have been negotiated between unrelated parties.

(e) Examples of estimating or calculating the wholesale cost of tobacco:

(1) **Example 1:** Distributor B produces handmade cigars. B's tobacco product costs include: all manufacturing costs, the cost of raw materials (including waste materials not incorporated

into the final product), the cost of labor, any direct and indirect overhead costs, and any federal excise and/or U.S. Customs taxes paid. The cost does not include freight or transportation charges for shipment from the supplier to the distributor.

(2) Example 2: Distributor C purchases tobacco products from a subsidiary corporation in which it owns or controls more than 50 percent of the voting stock. Due to this corporate relationship between seller and buyer, the Board presumes that the sale and purchase were not at arm's-length, and the presumption is not rebutted by C. In the absence of an arm's-length transaction, the methods discussed in subdivision (c) may be used to determine the correct wholesale cost.

(3) Example 3: Distributor D acquires tobacco product free of charge and reports no wholesale cost for the product on its Tobacco Products Distributor Tax Return. However, D acquired such tobacco product at a 100 percent discount or trade allowance. In the absence of an arm's-length transaction, the methods discussed in subdivision (c) may be used to determine the correct wholesale cost.

(4) Example 4: Distributor E, with a tobacco products importers license, acquires tobacco products or finished tobacco products from a supplier outside the United States. E's tobacco product costs include, in addition to all other production or acquisition costs, the costs of all U.S. Customs fees and federal excise taxes paid or incurred by E with respect to such tobacco products.

(5) Example 5: Distributor F receives three tobacco products packaged as one unit, as a "three for the price of two" promotional package, labeled with a single UPC barcode. As the products are packaged together as one inseparable unit, tax is based on the total package price.

(6) Example 6: Distributor G receives 2 units, to sell as a "buy one, get one free" promotion. Each unit is separately packaged and each unit is labeled with a UPC barcode. Because one unit is being provided for free, tax would apply to the wholesale cost of each separate unit as calculated by a method discussed in subdivision (c).

(7) Example 7: Distributor H receives a three percent discount for paying their supplier within 10 days of receipt of their items. To calculate the wholesale cost, Distributor H must add the three percent discount to the price paid for the products.

(f) Rate Setting. The Board's annual determination of the rate of tax that applies to other tobacco products shall be made based on the wholesale cost of tobacco products as of March 1 of the current calendar year and shall be effective during the next fiscal year, beginning July 1.

Note: Authority: Section 30451, Revenue and Taxation Code. Reference: Sections 30008, 30010, 30011, 30017, 30105, 30121, 30123, 30131.2, 30201, and 30221, Revenue and Taxation Code.

The proposed language contained in this document may not be adopted. Any revisions that are adopted may differ from this text.