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IN THE
INDIANA TAX COURT

AMERITECH PUBLISHING, INC.,	)	
	)	
Petitioner,	)	
	)	
v.	)	Cause No. 49T10-0305-TA-26
	)	
INDIANA DEPARTMENT OF STATE REVENUE,	)	
	)	
Respondent.	)	

ON APPEAL FROM THE FINAL DETERMINATIONS OF
THE INDIANA DEPARTMENT OF STATE REVENUE

NOT FOR PUBLICATION
October 19, 2006

FISHER, J.

Ameritech Publishing, Inc. (API) appeals the two final determinations of the Indiana Department of State Revenue (Department) that denied its claims for refund of use tax paid from October 1, 1998 through September 30, 2003 (the years at issue). On appeal, API asks the Court to decide the following issue: whether, in publishing its

telephone directories, API's purchases of paper and printing services were subject to Indiana use tax.

FACTS

The parties have stipulated to the following facts. API is a Delaware corporation, headquartered in St. Louis, Missouri, with its principal place of business in Troy, Michigan. API is a wholly-owned subsidiary of Ameritech Corporation.[1] During the years at issue, API published Yellow Pages and White Pages (telephone directories) and then distributed them to business and residential customers in several states, including Indiana. API's publication process is essentially comprised of four components: 1) content development; 2) paper procurement; 3) printing; and 4) directory distribution.

1. Content Development

API's Yellow/White Pages contain single-line listings of businesses and individuals (i.e., name, address, and telephone number). API purchases this information from the local telephone companies. The local telephone companies send this information, in an electronic database format, directly to API's printer.

In addition to the single-line listings, API's Yellow Pages also contain business advertisements. API sells space in the Yellow Pages to interested advertisers. API's art staff works with the advertisers to design the layout of their advertisements. API then converts the advertisement layout into an electronic format and forwards it to its

[1] Ameritech Corporation, in turn, is a wholly-owned subsidiary of SBC Communications.

printer.[2]

2. Paper Procurement

During the years at issue, API contracted with paper mills in both Canada and Europe to supply the paper for its telephone directories. API established and negotiated all paper quality, quantity, and price specifications directly with the paper mills.

Pursuant to API's contracts with the paper mills, the paper was delivered directly to API's printer who received and stored the paper as API's agent.[3] The contracts nevertheless specified that title to the paper vested in API upon delivery to the printer. In addition, API's contracts with the paper mills also authorized the printer (again, as API's agent) to perform certain "procurement activities such as estimating following year and half-year requirements, placing individual orders, invoice processing,

[2] With respect to the information printed in the telephone directories, API's printer is not authorized to alter the content it receives from API.

[3] Thus, API's printer was authorized to, upon delivery, inspect and reject any paper that did not meet API's pre-established specifications.

claims processing, [and] testing[.]"[4,5] (Jt. Stip. Ex. 8-6 (footnotes added).) API bore all financial responsibility for the paper shipped by the paper mills to its printer.

3. Printing

API engaged R.R. Donnelley & Sons (RR Donnelley), a Chicago-based commercial printer, to "perform all lineup, platemaking . . . presswork and binding" of its telephone directories during the years at issue. (Jt. Stip. Ex. 11-2.) RR Donnelley completed its work for API at its plant in Dwight, Illinois.

As indicated earlier, API supplied the content for the directories. Upon receiving the content, RR Donnelley would "burn" printing plates with images of API's content. RR Donnelley would then print API's content on API's paper using an offset lithography process. After RR Donnelley printed API's content onto the paper, it assembled, bound (glued), and trimmed the printed pages into directories. RR Donnelley then shrink-wrapped stacks of finished directories into bundles and loaded the bundles onto pallets.

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[4] Similarly, API's contract with its printer provided that the printer was authorized, as API's agent, to perform the following services relating to API's acquisition of paper:

> Perform paper forecast assembly functions[;]
> Place purchase orders based upon [API's] forecasts, subject to [API's] contracts with the paper suppliers[;]
> Expedite shipments as required, with additional freight costs to be borne by [API; and]
> Negotiate settlement with the [paper vendors] for defective paper and with carriers for transportation claims[.]

(Jt. Stip. Ex. 11-5.)

[5] Any paper that API's printer purchased on behalf of API was invoiced to API at cost, in addition to a 4.04% paper management fee. (*See, e.g.,* Jt. Stip. Exs. 11-6, 13-8.)

RR Donnelley invoiced API for printing services, i.e., photocomposition, presswork, binding, and packing. (*See, e.g.,* Jt. Stip. Exs. 13-1 through 13-5.) The invoices also separately stated RR Donnelley's charges for the glue, shrinkwrap, and ink it used in printing the telephone directories. (*See, e.g.,* Jt. Stip. Exs. 13-5, 13-6.) Finally, the invoices also separately stated the cost, in addition to the 4.04% paper management fee, of any paper RR Donnelley purchased on behalf of API. (*See, e.g.,* Jt. Stip. Exs. 13-6 through 13-8.)

4. Distribution

During the years at issue, API hired an independent contractor (Carrier) to pick up the completed telephone directories from RR Donnelley and transport them to API's local distributors who were hired by API to distribute the telephone directories to API's customers. API retained title to the directories while they were in the possession of the Carrier and the local distributors.

PROCEDURAL HISTORY

During the years at issue, API filed quarterly and monthly Indiana Sales and Use Tax Returns with the Department, paying all use taxes in conjunction with each return. API subsequently filed two claims with the Department, however, requesting a combined refund of $2,659,364.53.[6] API's claims for refund asserted that it erroneously paid use tax on its purchases of paper and its purchases of printing services. In final

[6] On January 18, 2002, API filed a claim with the Department requesting a refund of $1,497,104.93 for use tax it paid on its purchases of paper and printing services from October 1, 1998 through December 31, 2000 (the First Claim). (*See* Jt. Stip. Exs. 1-3, 1-4, 1-5.) On November 14, 2003, API filed another claim with the Department requesting a refund of $1,162,259.60 for use tax it paid on its purchases of paper and printing costs from January 1, 2001 through September 30, 2003 (the Second Claim). (*See* Jt. Stip. Exs. 3-4, 3-5, 3-6.)

determinations issued on March 4, 2003 and June 4, 2004, the Department denied both claims for refund.

API subsequently filed an original tax appeal.[7] A trial was held on August 31, 2005, and the Court heard the parties' oral arguments on July 7, 2006. Additional facts will be provided as necessary.

STANDARD OF REVIEW

This Court reviews the Department's denials of claims for refund *de novo*. IND. CODE ANN. § 6-8.1-9-1(d) (West 2006). Accordingly, the Court is bound by neither the evidence nor the issues presented at the administrative level. *See Snyder v. Indiana Dep't of State Revenue*, 723 N.E.2d 487, 488 (Ind. Tax Ct. 2000), *review denied*.

DISCUSSION AND ANALYSIS

Indiana's use tax is "[a]n excise tax . . . imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IND. CODE ANN. § 6-2.5-3-2(a) (West 1998). As this Court has previously explained, Indiana's gross retail (sales tax) is imposed on retail transactions that occur within Indiana; in contrast, Indiana's use tax is designed to reach the out-of-state sales of tangible personal property to Indiana residents who subsequently use, store, or consume that tangible personal property in Indiana. *See Rhoade v. Indiana Dep't of State Revenue,* 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002). The purpose for

[7] API filed two original tax appeals: one on May 30, 2003 (after the Department issued its final determination on the First Claim) and the other on June 29, 2004 (after the Department issued its final determination on the Second Claim). By order dated September 22, 2004, the Court consolidated the two appeals.

imposing Indiana's use tax is to prevent the erosion of the state's tax base when its residents make purchases in other states. *See id.*

Pursuant to Indiana Code § 6-2.5-3-2, two conditions must be met in order for a taxpayer to incur a use tax liability: 1) the taxpayer must acquire tangible personal property in a retail transaction; and 2) the taxpayer must then use, store, or consume that tangible personal property in Indiana. *See* A.I.C. § 6-2.5-3-2(a). API argues that neither of these conditions has been met with respect to its purchases[8] of paper and printing services. More specifically, API argues that while it did acquire tangible personal property – paper – in a retail transaction, it never stored, used, or consumed the paper in Indiana. Instead, the paper was consumed entirely in Illinois in the production of its telephone directories. Moreover, API explains that the tangible personal property it did use in Indiana – the telephone directories – was not acquired in a retail transaction; rather, they were manufactured by API and have an identity separate from the "raw material" (i.e., content and paper) used to produce them. API also maintains that the costs related to printing the telephone directories are not subject to Indiana use tax because, in engaging RR Donnelley to print the telephone directories

[8] While Indiana's use tax is imposed on the act of "using, storing, or consuming" tangible personal property in Indiana, the amount of tax due is determined as a percentage of the price by which the tangible personal property was purchased. *See* IND. CODE ANN. § 6-2.5-3-2 (West 1998); *cf. with* IND. CODE ANN. § 6-2.5-3-3 (West 1998).

for it, API purchased a service, and not tangible personal property.[9] Therefore, API maintains it is entitled to a refund of use taxes it erroneously paid on its purchases of paper and printing services during the years at issue.

API is correct pursuant to this Court's holding in *Morton Buildings, Inc. v. Indiana Department of State Revenue,* 819 N.E.2d 913, 915 (Ind. Tax Ct. 2004), *review denied.* In that case, this Court held that neither the raw materials which a manufacturer purchased at retail and used outside Indiana to make building components, nor the building components themselves, which were eventually assembled into prefabricated buildings in Indiana, were subject to Indiana's use tax. *Morton Bldgs., Inc. v. Indiana Dep't of State Revenue,* 819 N.E.2d 913, 916-17 (Ind. Tax Ct. 2004), *review denied.* As the Court explained, the use tax did not apply to the retail purchase of the raw materials because they were consumed entirely in the out-of-state production of building components, a process that rendered a product with "an entirely different appearance, character, and utility than the raw materials used to fabricate it." *Id.* at 917. In turn, the Court explained that although the manufacturer used its products – the building components – in Indiana, they too were not subject to Indiana's use tax because they were not acquired in a retail transaction. *Id.*

The Department asserts, however, that *Morton* does not apply to this case for two reasons. First, it argues that *Morton* does not apply because the issue in this case is not whether API's purchases of paper and printing services are subject to use tax, but

[9] The sale of services generally falls outside the scope of taxation because no transfer of tangible personal property has occurred. IND. CODE ANN. § 6-2.5-4-1 (West 1998). *See also Howland v. Indiana Dep't of State Revenue*, 790 N.E.2d 627, 628 (Ind. Tax Ct. 2003). As API explains, it owned and supplied both the content for the telephone directories and the paper on which the content was printed; RR Donnelley merely transferred the content onto the paper for API.

rather whether API's purchases of telephone directories are subject to use tax. In other words, the Department maintains that API is not entitled to a refund because the two conditions of Indiana Code § 6-2.5-3-2(a) have unequivocally been satisfied: 1) API acquired the telephone directories from RR Donnelley in a retail transaction; and 2) API subsequently used the telephone directories in Indiana. (*See* Resp't Br. at 5.)

To support this argument, the Department offers its conclusion that "[RR] Donnelley sold the Directories at retail because it transferred tangible personal propert[y], the Directories, and the Directories' title, to API in exchange for API's payment of consideration." (Resp't Br. at 9 (footnote omitted).) The Department attempts to "back-up" this conclusion by employing the following rationale:

> 1) in Indiana, manufacturers are exempt from paying sales tax on purchases of tangible personal property ("raw material") if they incorporate that tangible personal property into other tangible personal property which they manufacture for sale in their business ("final product") because the purchaser of the final product will pay Indiana sales tax on the price of the final product (commonly known as the incorporation exemption);
>
> 2) for purposes of imposing Indiana sales tax, Indiana deems commercial printers to be manufacturers;
>
> 3) because RR Donnelley, a commercial printer, is a manufacturer, it sold the telephone directories to API in a retail transaction.

(See Resp't Br. at 7-10 (citations omitted) (footnotes omitted).) The Department's rationale, and therefore its ultimate conclusion, however, is flawed in several respects.

First, the Department operates on the theory that all transactions between a commercial printer and its customers are retail transactions. (*See* Resp't Br. at 10.) This, however, is not necessarily the case. Pursuant to Indiana Code § 6-2.5-4-1, "[a]

person is a retail merchant making a retail transaction *when* he engages in selling at retail." IND. CODE ANN. § 6-2.5-4-1(a) (West 1998) (amended 2003) (emphasis added). In turn, "a person is engaged in selling at retail *when*, in the ordinary course of his regularly conducted trade or business, he: (1) acquires tangible personal property for the purpose of resale; and (2) transfers that property to another person for consideration." *Id*. at (b) (emphasis added). The use of the word "when" in these statutes emphasizes the point that a retail transaction will not be found to exist merely because one party is a manufacturer or a commercial printer; rather, certain facts must be found to exist before that manufacturer or a commercial printer statutorily qualifies as a retail merchant making a retail transaction. *See Johnson County Farm Bureau Coop. Ass'n v. Indiana Dep't of State Revenue*, 568 N.E.2d 578, 580-81 (Ind. Tax Ct. 1991), *aff'd by* 585 N.E.2d 1336 (Ind. 1992) (stating that the cardinal rule in construing a statute is to ascertain the intent of the legislature, and that can be achieved by giving effect to the plain and ordinary meaning of the language used in the statute itself). *See also* WEBSTER'S THIRD NEW INT'L DICTIONARY 2602 (3d ed. 1981) (defining the word "when" as "at any and every time that; on condition that: if"). Accordingly, the sole fact that RR Donnelley is a commercial printer does not dictate whether a retail transaction took place between it and API. Instead, the proper inquiry is whether RR Donnelley, in the ordinary course of its business as a commercial printer, "acquired tangible personal property for resale" and "transferred that property" to API for consideration. *See* A.I.C. § 6-2.5-4-1(b).

Second, the Department's argument that API owes Indiana use tax is based entirely on how Indiana's sales tax is imposed. Although Indiana's sales and use taxes

are complementary, the scope of Indiana's use tax is not a mere function of Indiana's sales tax. Consequently, Indiana's use tax is not imposed merely because Indiana's sales tax was *not* imposed. The two are separate taxes and, as such, are imposed upon the occurrence of separate, distinct events.

Third, given the facts of this case, it is hard to conceive how RR Donnelley could have sold the telephone directories to API: it did not own anything to sell. At all times, API, not RR Donnelley, owned both the content for the telephone directories and the paper on which the content was printed. RR Donnelley merely assembled these components into a final format for API. Consequently, RR Donnelley sold API a service.[10] *See Faris Mailing, Inc. v. Indiana Dep't of State Revenue,* 512 N.E.2d 480,

[10] The Department asserts that the provision in RR Donnelley's contract with API stating that "[u]nless otherwise agreed, shipment of products under this Agreement will be F.O.B. [RR Donnelley] plant of manufacture" solidifies its claim that RR Donnelley sold the telephone directories to API. (Oral Argument Tr. at 28 and Resp't Br. at 3 n. 13 (both citing Jt. Stip. Ex. 11-4, ¶ 13).) In other words, the Department claims that given this provision, there can be no dispute that "title passes to API when it receives possession of those directories at RR Donnelley's plant." (Oral Argument Tr. at 28-29.) The Court disagrees, as a subsequent provision in the same contract more appropriately explains transfer of title:

> Title; Risk of Loss. [RR Donnelley] shall be responsible for any loss or damage to material belonging to [API] in [RR Donnelley's] possession under this Agreement.
>
> Unless otherwise agreed in writing, risk of loss and title to *Work* shall vest in [API] when the *Work* has been delivered at the f.o.b. point . . . Title to all Master Information and Media furnished by [API] to [RR Donnelley] shall remain in [API].

(Jt. Stip. Ex. 11-5, ¶16 (emphases added).) "Work" is, in turn, defined as RR Donnelley's "lineup, platemaking, and other preliminary operations[,] presswork and binding of [API's] existing telephone directories[.]" (Jt. Stip. Ex. 11-1, ¶1(h); 11-2, ¶ 2.) Under these provisions, it is clear that, at all times, both API and RR Donnelley understood that title to paper and content, and the finished telephone directories, was always with API.

483 (Ind. Tax Ct. 1987) (explaining that a manufacturer was not eligible for the incorporation exemption because it was engaged in providing a service when it assembled components *already belonging to its customers* into packages for mailing).

The Department offers a second reason for *Morton's* alleged inapplicability to this case:

> In *Morton* [], the manufacturer and alleged taxpayer were one in the same. . . . That is, there were not two distinct, separate entities transferring a finished product (building components) from one entity to another in exchange for consideration. There was only one entity, the manufacturer Morton, who used or consumed its own finished manufactured product in Indiana.
>
> The same is not true in API's case. There exist two distinct and separate entities, [RR Donnelley] and API. As discussed earlier, API acquired the Directories in a retail transaction. The Directories transferred from [RR Donnelley] to API in exchange for API's payment of consideration. API is not a manufacturer using or consuming its own finished product like the manufacturer in *Morton*[.] Hence, *Morton* [] does not apply[.]

(Resp't Br. at 15-16.)

Admittedly, the facts in *Morton* are different than the facts in this case. Nevertheless, the distinction between the facts in *Morton* and this case should not be confused with *the holding* in *Morton.* Indeed, that case clearly explains that pursuant to Indiana Code § 6-2.5-3-2, two conditions must be met in order for a taxpayer to incur a use tax liability: 1) the taxpayer must acquire tangible personal property in a retail transaction; and 2) the taxpayer must then use, store, or consume that tangible personal property in Indiana. *Morton,* 913 N.E.2d at 915, 918. In this case, API is not subject to use tax on its purchases of paper and printing services, nor on its telephone directories: the paper was acquired in a retail transaction but not used in Indiana; in

purchasing printing services, API did not acquire tangible personal property; and while API used its telephone directories in Indiana, it did not acquire them in a retail transaction.[11] *See id.* (footnote added).

Based on this Court's holding in *Morton,* Indiana's use tax does not apply to API's purchases of paper and printing services.[12] The Department's final determinations are therefore REVERSED.

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[11] The Court notes that in defining a retail transaction, the Department relied on Indiana Code § 6-2.5-4-2, which states:

> (a) A person is a retail merchant making a retail transaction when he is making wholesale sales.
>
> (b) For purposes of this section, a person is making wholesale sales when he . . . sells tangible personal property to a person who purchases the property for incorporation as a material or integral part of tangible personal property produced by the person in his business of manufacturing, assembling, constructing, refining or processing[.]

(Resp't Br. at 6 (quoting IND. CODE ANN. § 6-2.5-4-2(a), (b)(3) (West 1998).) Thus, although it never explicitly states so, the Department apparently believes RR Donnelley is a wholesaler making wholesale sales in this case. (*See* Resp't Br. at 6-11.) In any event, the Department's argument that *Morton* does not apply because the facts are different than the facts in this case contradicts its belief that RR Donnelley is a wholesaler: if RR Donnelley is indeed a wholesaler, then API *is* manufacturing its own telephone directories. *See* A.I.C. § 6-2.5-4-2(b)(3).

[12] In essence, the Department makes the same argument here that it did in the *Morton* case: the taxpayer has simply exposed, and taken advantage of, a loophole in the use tax imposition statute. (*See* Oral Argument Tr. at 27.) While the Department is correct, it is for the legislature, not this Court, to correct the loophole in the statute. *See Weger v. Lawrence*, 575 N.E.2d 659, 663 (Ind. Ct. App. 1991), *trans. denied*. *See also Indiana Dep't of State Revenue v. Endress & Hauser, Inc.*, 404 N.E.2d 1173, 1178 (Ind. Ct. App. 1980) ("[L]egislatures make the tax statutes and courts enforce them as written, not as departments of revenue may wish they had been written"). Effective in 2006, the Indiana legislature has closed the loophole. *See* IND. CODE ANN. § 6-2.5-3-2(d) (West 2006). The correction, however, is not retroactive, and therefore does not apply to the years at issue in this case.

CONCLUSION

The raw materials API purchased at retail were consumed in the out-of-state production process and, therefore, never used in Indiana. Furthermore, the materials that API used in Indiana – the telephone directories – were not acquired in a retail transaction. Accordingly, Indiana Code § 6-2.5-3-2 does not apply and API is not subject to the use tax. The Department's final determinations are REVERSED and the Department is ordered to refund to API the use taxes it paid during the years at issue.