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SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

TX 2007-000307 04/24/2009

HON. THOMAS DUNEVANT, III

CLERK OF THE COURT
S. Brown
Deputy

VAL-PAK EAST VALLEY INC — PAUL J MOONEY

v.

ARIZONA STATE DEPARTMENT OF REVENUE — SCOT G TEASDALE

UNDER ADVISEMENT RULING

(Defendant's Motion For Summary Judgment and Plaintiff's Cross-Motion For Summary Judgment)

The relevant facts can be briefly summarized. Val-Pak East Valley (EV), a franchisee of Val-Pak Direct Marketing (DM), sells advertising flyers to local businesses; these flyers are bundled with others and mailed in a common envelope. Pursuant to the Franchise Agreement, EV contracts with DM for the actual printing and mailing. The State seeks to impose use tax on EV for its out-of-state purchase of the flyers from DM.

The State acknowledges that, while its Motion for Summary Judgment encompasses the entirety of Plaintiff's Complaint, including the claim of discriminatory taxation, it does not substantially argue that issue. The State's motion is therefore denied with respect to the discrimination claim.

As the parties are aware, this Court has addressed the situation of EV and DM in *Mesa City v. Val-Pak East Valley, Inc.*, TX2006-050161 (April 25, 2008). While that case specifically turned on the Model City Tax Code rather than the state statutes addressed by the Court of Appeals in *Qwest Dex, Inc. v. Arizona Dept. of Revenue,* 210 Ariz. 223 (App. 2005), and *Service Merchandise Co. v. Arizona Dept. of Revenue*, 188 Ariz. 414 (App. 1996), the Court did apply those cases to the Val-Pak fact pattern. Subject to further instruction by the Court of Appeals (as the Court understands that its Mesa ruling is awaiting a decision), the Court repeats its analysis:

To the extent the case law is illustrative, the facts fall under the S*ervice Merchandise* pattern rather than the *Qwest Dex* pattern. In *Qwest Dex,* the physical elements of the printing – the paper, glue, and ink – were either directly supplied by Qwest or billed separately by the printer. The charges at issue were exclusively for the service of applying the ink to the paper and gluing the pages together. *Supra* at 228 ¶ 22. The *Qwest Dex* court distinguished its case from *Service Merchandise, supra*, and *Statewide Multiple Listing Service, Inc. v. Norberg*, 392 A.2d 371 (R.I. 1978), in which the printer started with nothing from the customer and provided a finished product: unlike the mere application of printing *services* to raw materials already owned by the taxpayer, the printers in the latter cases supplied a taxable *good* out of nothing previously owned by the taxpayer. *Qwest Dex* can further be distinguished by its discussion of the common understanding test. "[C]ase law has articulated that printers who print specific material on paper for a customer are not engaged in the business of selling tangible personal property, but are instead engaged in a service. The reasoning is that the paper is of no use to anyone except the customer for whom the printing is done." *Supra* at 229 ¶ 24 (citations omitted). Here, of course, the printed material *is* of use to someone else, namely EV's clients, and is of no use to EV except for the profit it makes from selling them to its clients. *Qwest Dex* therefore if anything supports the [State's] position.

A question raised here that was not squarely addressed in the Mesa case is the relationship of Val-Pak East Valley and Val-Pak Direct Marketing. Plaintiff describes EV as a "broker"; as it appears that EV sends business exclusively to DM (and is effectively bound to by the Franchise Agreement), a more accurate term might be DM's order-taker. Be that as it may, the contractual relationship with the advertising businesses governs. The businesses normally have no contact with DM. They sign a contract with EV by which EV undertakes to supply them with flyers to be distributed locally, and EV collects payment from them; EV then receives an invoice directly from DM. As this Court reasoned in the Mesa case, EV's contractual obligation to the businesses requires EV to have at least constructive possession of the finished flyers: a merchant cannot sell what he does not possess. This places EV in the position of Service Merchandise, not of Qwest Dex, because the printed product is of use to someone other than EV, namely, the businesses, and is of no use to EV other than to permit it to satisfy the terms of its contracts. There is thus a taxable good, not merely the provision of a service. As no transaction privilege tax is collected from DM, EV is properly subject to use tax.

Therefore, IT IS ORDERED:

1. Defendant's Motion For Summary Judgment (MPSJ) re: use tax is granted.

2. Plaintiff's Cross-Motion For Summary Judgment is denied.

3. Defendant's Motion For Summary Judgment re: Plaintiff's discrimination claim is denied.