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SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

TX 2010-000404 04/17/2013

HONORABLE DEAN M. FINK

CLERK OF THE COURT
S. Brown
Deputy

C C I EUROPE INC PATRICK DERDENGER

v.

ARIZONA STATE DEPARTMENT OF REVENUE JERRY A FRIES

UNDER ADVISEMENT RULING

The Court took the following motions under advisement following oral argument on April 8, 2013: Plaintiff's Motion for Partial Summary Judgment #1 on the Issue of Whether a Newspaper Publisher is a Manufacturer; Plaintiff's Motion for Partial Summary Judgment #2 on the Issue of Whether the CCI Newspaper Production Software Qualifies for the Machinery and Equipment Deduction; and Plaintiff's Motion for Summary Judgment #3 on the Issue of Whether Gross Receipts From Software Maintenance Agreements are Subject to Arizona Sales Tax. Upon further consideration, the Court finds as follows.

Before addressing the legal analysis, the Court considers various arguments by CCI. There is no estoppel or infringement of the Taxpayer Bill of Rights, because CCI does not stand in the shoes of Phoenix Newspapers. CCI is not a newspaper publisher, it merely markets a product that is used by newspaper publishers. Even if Phoenix Newspapers has a right to rely on established tax treatment of newspaper publishers, CCI does not. The *New Times* decision by the Board of Tax Appeals is, as CCI acknowledges, in no way binding on the Tax Court, and the Court does not consider it persuasive. Attorney General Opinion I86-114, which of course is also not binding, seems if anything to support the Department's position. If conveying information and advertising to an audience is manufacturing for a newspaper publisher, as CCI argues, it must also be manufacturing for a broadcaster. If the opinion is correct, then, conveying information and advertising must not be manufacturing for anybody.

A.R.S. § 42-5061(B)(1) requires that the term "manufacturing," as applied to newspaper publishing, be construed as "commonly understood within [its] ordinary meaning." It strikes the Court that the reason "manufacturing" is not the *mot juste* for the production of a newspaper is that newspaper publishing contains elements that fall within the commonly understood meaning of the term and elements that do not. The Court does not believe that the statute requires an all-or-nothing interpretation, that either the presence of manufacturing elements means that the entire process is manufacturing or conversely that the presence of non-manufacturing elements disqualifies the entire process. (The requirement that the Court apply an integrated approach, as found at *State ex rel. Ariz. Dept. of Revenue v. Capitol Castings, Inc.*, 207 Ariz. 445, 449 ¶ 20 (2004), does not apply at this stage. The statute instructs how the term "manufacturing" is to be construed; the integrated approach is then used to determine what constitutes "manufacturing" as so construed.)[1] The process of creating the physical item out of paper and ink seems to fall well within the ordinary meaning of "manufacturing." Indeed, in R15-5-1303(A), albeit in another context, the Department itself uses the term to describe the activity preceding distribution of the finished product. At least the final steps of newspaper publishing, then, come under Section 5061(B)(1). But in its function of assembling information for communication to readers, it diverges from what the Court takes to be the commonly understood ordinary meaning of "manufacturing." A radio or television newscast conveys the same news and advertising to an audience, yet surely no one would regard the six o'clock news as a manufactured good; *see Meredith Corp. v. State Tax Comm.*, 23 Ariz.App. 152, 153-54 (1975). Nor would anyone so regard the websites maintained by the *Arizona Republic* and most other newspapers. This divergence did not originate with twentieth-century technology. The printing and binding of a copy of *Macbeth* was at least as clearly manufacturing four hundred years ago as it is today, but Shakespeare, when he sat down to write the Scottish play, was not himself part of the manufacturing process. Granted, everyday journalism is more ephemeral than the masterpieces of the Bard; the Court is reminded of the old television series *Lou Grant*, whose opening montage of the life cycle of a daily newspaper ended with the front page being slid into the bottom of a birdcage. Timelessness or quality, however, is a purely subjective judgment that cannot be the criterion to distinguish manufacturing from non-manufacturing. The critical dividing line can only be the affixing of ink to paper.

[1] A technical point. *Duval Sierrita Corp. v. Arizona Dept. of Revenue*, 116 Ariz. 200 (App. 1977), is not itself binding precedent. That opinion, in relevant part, was effectively overruled by the Court of Appeals in *State ex rel. Ariz. Dept. of Revenue v. Capitol Castings, Inc.*, 193 Ariz. 89 (App. 1998). In response to that opinion, the legislature amended the statute. That the amendment had the effect of restoring the *Duval Sierrita* test was recognized by the Supreme Court in the second *Capitol Castings* case. But the legislature, under the doctrine of separation of powers, cannot directly change judicial opinions; it could not undo the disapproval of *Duval Sierrita* in *Capitol Castings I*. The persuasive authority of *Duval Sierrita* derives from the Supreme Court's use of it in *Capitol Castings II*, which is binding precedent.

The Court must next apply an integrated approach to determine whether CCI's software is "used directly" in the manufacturing of the newspaper. "First, [the] court must apply flexible and commonly used definitions of machinery and equipment within the relevant industry." *Capitol Castings* at 450 ¶ 24. Given the breadth of the legislatively mandated flexibility, the Court concludes that the software constitutes machinery or equipment. "Next, bearing in mind these flexible definitions, a court should examine the nature of the item and its role in the operations. Items essential or necessary to the completion of the finished product are more likely to be exempt. The prominence of an item's role in maintaining a harmonious 'integrated synchronized system' with the indisputably exempt items will also directly correlate with the likelihood that the exemption applies. The closer the nexus between the item at issue and the process of converting raw materials into finished products, the more likely the item will be exempt. As part of its analysis, the court should consider whether the item physically touches the raw materials or work in process, whether the item manipulates or affects the raw materials or work in process, or whether the item adds value to the raw materials or work in process as opposed to simply reducing costs or relating to post-production activities." *Id*. at 450 ¶ 2 (internal citations omitted). The functions performed by the CCI software straddle the line between the manufacturing and non-manufacturing portions of the newspaper production process. Many, perhaps most, of them perform journalistic or presentational functions; their nexus with manufacturing is remote. But the software does work with the printing press, telling it where and how to apply ink, which is manufacturing even under the narrowest definition. This role in maintaining a harmonious integrated synchronized system meets the second *Capitol Castings* test.

The Court finds for Plaintiff: the software, and by extension the maintenance agreements, are exempt under A.R.S. § 42-5061(B)(1).

IT IS ORDERED granting Plaintiff's Motions for Partial Summary Judgment #1 and #2 and Plaintiff's Motion for Summary Judgment #3.

IT IS FURTHER ORDERED denying Defendant's Cross-Motions for Partial Summary Judgment #1 and #2 and Defendant's Cross-Motion for Summary Judgment #3.

IT IS FURTHER ORDERED directing Plaintiff to lodge a form of judgment and file any Application and Affidavit for Attorney's Fees and Statement of Taxable Costs by May 17, 2013.