

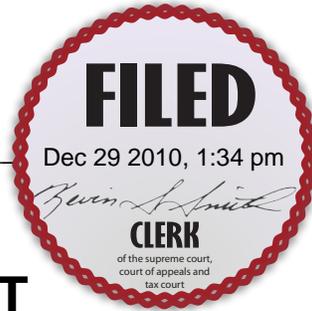
ATTORNEYS FOR PETITIONER:

JEFFREY S. DIBLE
ROBERT L. HARTLEY
FROST BROWN TODD LLC
Indianapolis, IN

MARTIN I. EISENSTEIN
STACY O. STITHAM
BRANN & ISAACSON
Lewiston, ME

ATTORNEYS FOR RESPONDENT:

GREGORY F. ZOELLER
ATTORNEY GENERAL OF INDIANA
TIMOTHY A. SCHULTZ
DEPUTY ATTORNEY GENERAL
Indianapolis, IN



IN THE
INDIANA TAX COURT

AOL, LLC,)
)
Petitioner,)
)
v.)
)
INDIANA DEPARTMENT OF STATE)
REVENUE,)
)
Respondent.)

Cause No. 49T10-0903-TA-7

ORDER ON PARTIES' CROSS-MOTIONS FOR SUMMARY JUDGMENT

NOT FOR PUBLICATION
December 29, 2010

FISHER, J.

AOL, LLC (AOL) appeals the Indiana Department of State Revenue's (Department) final determinations denying its two claims for refund of use tax paid from January 1, 2003 through November 30, 2006 and May 1, 2006 through June 30, 2007 (the tax periods at issue). The matter, currently before the Court on the parties' cross-motions for summary judgment, presents one issue: whether the Department's denials

of AOL's claims were improper.¹

FACTS AND PROCEDURAL HISTORY

The following facts are undisputed. AOL, a foreign limited liability company, is an online service provider.² (See Pet'r Des'g Evid. at Jt. Stip. ¶¶ 1, 11 (footnote added).) More specifically, AOL provides its members (i.e., its customers) with access to the Internet, e-mail, instant messaging, and other proprietary online content (e.g., news, weather, and stock quotes). (Pet'r Des'g Evid. at Jt. Stip. ¶ 11.) During the tax periods at issue, AOL distributed two types of promotional materials (free-of-charge) to prospective and current members in several states, including Indiana. (See Pet'r Des'g Evid. at Jt. Stip. ¶¶ 15, 39, 47.) (See *also* Pet'r Br. Supp. Mot. Summ. J. (hereinafter, "Pet'r Br.") at 3-4, 6.) These promotional materials, the "ROM Packages" and the "Customer Marketing Materials" (hereinafter, "the CM Materials"), are the subjects of this appeal. (Pet'r Des'g Evid. at Jt. Stip. ¶ 14.)

The ROM Packages, which were produced in two separate phases, were comprised of five components: 1) a CD containing AOL's proprietary software; 2) a printed instruction sheet; 3) a printed terms of use agreement; 4) a printed promotional flyer; and 5) a "paper carrier" or plastic case for these items. (Pet'r Des'g Evid. at Jt. Stip. ¶ 15; Donegan Aff. ¶ 6.) Each ROM Package also contained an ink-jetted certificate number and password which ultimately allowed prospective members to

¹ The parties have designated certain evidence as confidential pursuant to Indiana Administrative Rule 9. See *generally* Ind. Administrative Rule 9. Therefore, the Court's order will provide only that information necessary for the reader to understand its disposition of the issue.

² Prior to 2006, AOL was known as America Online, Inc. (Pet'r Des'g Evid. at Jt. Stip. ¶ 2.)

“sign-up” for AOL’s online services. (Pet’r Des’g Evid. at Jt. Stip. ¶¶ 15, 33.)

During the first phase of production, AOL’s out-of-state “vendors” copied AOL’s proprietary software onto blank CDs and added graphics to the CDs. (Pet’r Des’g Evid. at Jt. Stip. ¶¶ 18, 6-27, 46.) The vendors also added graphics to CDs already containing AOL’s proprietary software. (Pet’r Des’g Evid. at Jt. Stip. ¶ 26.) The paper carriers and plastic cases were also produced by out-of-state vendors during this phase of the production process.³ (See Pet’r Des’g Evid. at Jt. Stip. ¶¶ 29, 46 (footnote added).) AOL provided only 35 percent of the CDs and all necessary paper and plastic materials for these production processes. (See Pet’r Des’g Evid. at Jt. Stip. ¶¶ 28-29.)

When the out-of-state vendors’ production processes were completed, they shipped the components to AOL’s designated out-of-state assembly houses where the second phase of production commenced. (Pet’r Des’g Evid. at Jt. Stip. ¶ 36.) More specifically, the assembly houses assembled the components into a final package and printed the certificate numbers and passwords onto each of the packages. (See Pet’r Des’g Evid. at Jt. Stip. ¶¶ 33, 35.) The assembly houses then distributed those completed ROM Packages to several destinations, including Indiana. (Pet’r Des’g Evid. at Jt. Stip. ¶¶ 23, 47.)

The CM Materials consisted of a variety of printed letters, brochures, and other promotional materials. (Pet’r Des’g Evid. at Jt. Stip. ¶ 39.) To produce the CM Materials, AOL contracted with several out-of-state “letter shops.” (See Pet’r Des’g Evid. at Jt. Stip. ¶¶ 39, 45-46.) Pursuant to their contracts, AOL provided the letter shops with all of the paper used in the printing process. (Pet’r Des’g Evid. at Jt. Stip. ¶

³ In addition, Asian vendors produced other unspecified ROM Package components. (See Pet’r Des’g Evid. at Jt. Stip. ¶¶ 30-31.)

41.) In addition, AOL occasionally supplied the letter shops with the ink and the glue that was to be used in the printing process. (Pet'r Des'g Evid. at Jt. Stip. ¶ 41.) At the conclusion of the printing process, the CM Materials were mailed to AOL's current members, including those residing in Indiana. (See Pet'r Des'g Evid. at Jt. Stip. ¶ 47; Pet'r Br. at 6-7.)

During the tax periods at issue, AOL filed monthly Indiana Sales and Use Tax Returns with the Department, remitting all use taxes in conjunction with each return. AOL subsequently filed two claims with the Department, requesting a combined refund of \$371,464.00.⁴ On December 17, 2008, the Department issued two orders denying each of AOL's claims.

On March 16, 2009, AOL initiated an original tax appeal. On August 13, 2010, both AOL and the Department moved for summary judgment. The Court held a hearing on the parties' motions on November 15, 2010. Additional facts will be supplied as necessary.

STANDARD OF REVIEW

Summary judgment is proper only when the designated evidence demonstrates that no genuine issues of material fact exist and the moving party is entitled to judgment as a matter of law. Ind. Trial Rule 56(C). A genuine issue of material fact exists when facts concerning an issue which would dispose of the case are in dispute or when the

⁴ On December 12, 2006, AOL filed a claim with the Department requesting a refund of \$349,551.00 for use tax it paid on the ROM Packages and CM Materials for the January 1, 2003 through November 30, 2006 tax period. (Resp't Des'g Evid. Vol. III at 447-52.) On July 31, 2007, AOL filed another claim with the Department seeking a refund of \$21,913.00 for the use tax remitted on the ROM Packages and CM Materials for the May 1, 2006 through June 30, 2007 tax period. (See Resp't Des'g Evid. Vol. I at 22-28.)

undisputed material facts support conflicting inferences as to an issue. See *Gaboury v. Ireland Road Grace Brethren, Inc.*, 446 N.E.2d 1310, 1313 (Ind. 1983); *Scott Oil Co. v. Ind. Dep't of State Revenue*, 584 N.E.2d 1127, 1129 (Ind. Tax Ct. 1992).

The Court will construe all properly asserted facts and reasonable inferences drawn therefrom in favor of the nonmoving party. See *Scott Oil*, 584 N.E.2d at 1128-29 (citation omitted). Cross-motions for summary judgment do not alter this standard. *Horseshoe Hammond, LLC v. Ind. Dep't of State Revenue*, 865 N.E.2d 725, 727 (Ind. Tax Ct. 2007), *review denied*.

ANALYSIS AND ORDER

Indiana imposes an excise tax, known as the use tax, 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 (West 2003) (amended 2006). “The person who uses, stores, or consumes the tangible personal property acquired in a retail transaction is personally liable for the use tax.” IND. CODE ANN. § 6-2.5-3-6(b) (West 2003).

A “retail transaction” is “a transaction of a retail merchant that constitutes selling at retail as described in IC 6-2.5-4-1[.]” IND. CODE ANN. § 6-2.5-1-2(a) (West 2003). In turn, Indiana Code § 6-2.5-4-1 provides that 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.” IND. CODE ANN. § 6-2.5-4-1(b) (West 2003). This statute also provides that certain other transactions (i.e., retail unitary

transactions⁵) are taxable only to the extent that income from those transactions represents (1) the price of the property transferred and (2) any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer. See *id.* at (e) (footnote added).

In its motion, AOL claims it is entitled to judgment as a matter of law pursuant to Indiana Code § 6-2.5-3-2 and the three cases interpreting that statute. (See Pet'r Br. at 12-16 (*citing Ameritech Publ'g, Inc. v. Ind. Dep't of State Revenue (API II)*), 916 N.E.2d 752 (Ind. Tax Ct. 2009), *review denied*; *Ameritech Publ'g, Inc. v. Ind. Dep't of State Revenue (API I)*, No. 49T10-0305-TA-26, slip op. (Ind. Tax Ct. Oct. 19, 2006), *available at* <http://www.in.gov/judiciary/tax>, *review denied*; *Morton Bldgs., Inc. v. Ind. Dep't of State Revenue*, 819 N.E.2d 913 (Ind. Tax Ct. 2004), *review denied*.) More specifically, AOL asserts that those three cases clearly illustrate that its in-state use of the ROM Packages and CM Materials were not subject to Indiana use tax because they were not acquired in retail transactions. (See Pet'r Br. at 12-17.) (See also Hr'g Tr. at 3-12.)

In contrast, the Department claims that because AOL acquired the ROM Packages and CM Materials in taxable retail unitary transactions, its denials of AOL's claims were proper. (See Resp't Br. Supp. Cross-Mot. Summ. J. (hereinafter, "Resp't Br.") at 28-32.) (See also Hr'g Tr. at 21-22.) Indeed, the Department argues that:

- i.) AOL's Vendors, Assembly Houses, and Letter Shops were commercial printers[;]
- ii.) these Commercial Printers were

⁵ A retail unitary transaction is a "unitary transaction that is also a retail transaction." IND. CODE ANN. § 6-2.5-1-2(b) (West 2003). In turn, a "unitary transaction" "includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated." IND. CODE ANN. § 6-2.5-1-1(a) (West 2003).

manufacturers who purchased a majority of the manufacturing inputs used to produce a manufactured product sold at retail to AOL[;] iii.) the ROM Packages were a distinct and separate manufactured product from the manufacturing inputs[;] iv.) AOL did not manufacture the ROM Packages, rather the Commercial Printers manufactured the ROM Packages[;] v.) the invoices supplied by AOL show AOL paid consideration to the Commercial Printers[;] and vi.) the final manufactured product was used in Indiana by AOL.

(Resp't Reply Br. at 6 (footnotes omitted). (See *also* Resp't Des'g Evid. Vol. III at 240-427 (photocopies of the "commercial printers" invoices).) The Department has missed the mark.

The Department has characterized AOL's transactions with the letter shops, vendors, and assembly houses as one retail unitary transaction; the undisputed material facts indicate, however, that those transactions were separate from each other. Indeed, the facts, as stipulated to by the parties, establish that AOL entered into three separate transactions for production of the ROM Packages and the CM Materials. First, AOL purchased the majority of the *raw materials* used to produce the ROM Packages (i.e., blank CDs, paper carriers, and plastic cases) from several out-of-state vendors, who then copied AOL's proprietary software and graphics onto AOL's newly acquired and previously owned tangible personal property (i.e., the CDs, carriers, and cases), and then shipped the resulting products to the assembly houses. (See Pet'r Des'g Evid at Jt. Stip. ¶ 25-32, 36.) Second, the assembly houses performed two main functions in preparing the ROM Packages for shipment: 1) they printed certificate numbers and passwords onto the designated ROM Package components; and 2) they assembled the individual components into complete ROM Packages. (See Pet'r Des'g Evid. at Jt. Stip. ¶¶ 33-35, 47.) Third, the letter shops performed one primary function with respect to the

CM Materials: they printed certain information onto paper supplied by AOL, thereby producing the CM Materials, and then distributed them to AOL's current members. (See Pet'r Des'g Evid. at Jt. Stip. ¶¶ 39-43, 45.)

While AOL's transactions with the vendors bear the indicia of either retail transactions or retail unitary transactions, they do not serve as the basis for imposition of Indiana's use tax.⁶ Indeed, the raw materials that AOL acquired from the vendors were consumed in their entirety during the production process; thus, they were never used in Indiana. See *Morton Bldgs.*, 913 N.E.2d at 916-18. The ROM Packages therefore were products distinct and separate from the raw materials used to produce them. (See Pet'r Des'g Evid. at Jt. Stip. ¶ 22.) Given that the letter shops consumed AOL's paper during the printing process, it too was never used in Indiana. See *Morton Bldgs.*, 913 N.E.2d at 916-18. Therefore, the CM Materials, like the ROM Packages, were distinct and separate products from all of the materials used to produce them. (See Pet'r Des'g Evid. at Jt. Stip. ¶ 42.) Accordingly, the question of whether AOL must remit use tax on the ROM Packages and CM Materials depends solely on whether AOL's transactions with the assembly houses and the letter shops were either retail transactions or retail unitary transactions.

⁶ Services rendered in retail unitary transactions are taxable *only if* the transfer of the property and the rendition of services are inextricable and indivisible. See *Cowden & Sons Trucking, Inc. v. Ind. Dep't of State Revenue*, 575 N.E.2d 718, 722 (Ind. Tax Ct. 1991) (citing *Ind. Dep't of State Revenue v. Martin Marietta Corp.*, 398 N.E.2d 1309, 1313 (Ind. Ct. App. 1979)). In general, the divisibility of a transaction is "indicated by the temporal relationship between the provision of the services and the transfer of the property[.]" *Id.* For example, if services are performed before the property is transferred, the transaction is inextricable and completely subject to tax. See *id.* (citation omitted). Conversely, if the services are provided after the transfer of the property, the transaction is divisible, meaning that the sale of the property is taxed but not the services. *Id.*

As this Court has previously explained, two conditions must be met in order for AOL to incur a use tax liability: 1) AOL must have acquired tangible personal property (i.e., the ROM Packages and CM Packages) in retail transactions; and 2) AOL must have then used, stored, or consumed that tangible personal property in Indiana. See *Morton Bldgs.*, 819 N.E.2d at 918. While AOL indisputably used the ROM Packages and CM Materials in Indiana, it did not acquire them in retail transactions or retail unitary transactions. Rather, in engaging the assembly houses to assemble, print, and ultimately mail the ROM Packages to its prospective members, AOL purchased a service, and not tangible personal property. See *API I*, No. 49T10-0305-TA-26, slip op. at 7-13. Likewise, in engaging the letter shops to print and then mail the CM Materials to its current customers, AOL again purchased a service, not tangible personal property. See *id.* AOL owned all of the raw materials used to produce the ROM Packages and the CM Materials; consequently, the assembly houses and letter shops had nothing to sell to AOL other than their services.⁷ *Id.* (footnote added). See also *API II*, 916 N.E.2d

⁷ Alternatively, the Department claims that its denials of AOL's claims are proper pursuant to the 2006 amendment to Indiana Code § 6-2.5-3-2. (See Resp't Br. Supp. Cross-Mot. Summ. J. at 28.) Indiana Code § 6-2.5-3-2, as amended, provides that "[t]he use tax is imposed on a person who: (1) manufactures, fabricates, or assembles tangible personal property from materials either within or outside Indiana; and (2) uses, stores, distributes, or consumes tangible personal property in Indiana." IND. CODE ANN. § 6-2.5-3-2(d) (West 2006). Although AOL used both the ROM Materials and CM Materials in Indiana, it did not manufacture them. Rather, the assembly houses and letter shops manufactured the ROM Materials and CM Materials, respectively. (See Pet'r Des'g Evid. at Jt. Stip. ¶¶ 33, 45.) The 2006 amendment to Indiana Code § 6-2.5-3-2 therefore has no bearing on the outcome of this matter.

at 754-57.⁸ Accordingly, the Department's denials of AOL's two claims were improper.

CONCLUSION

AOL owes no Indiana use tax on its in-state use of the ROM Packages and the CM Materials: in purchasing assembly, printing, and mailing services, AOL did not acquire tangible personal property; accordingly, while AOL used its ROM Packages and CM Materials in Indiana, it did not acquire them in either retail transactions or retail unitary transactions. Therefore, the Department's final determinations, denying AOL's two claims for refund are REVERSED. The Department is ordered to refund to AOL the use taxes it paid during the tax periods at issue. The parties shall bear their own costs.

SO ORDERED this 29th day of December, 2010.

Thomas G. Fisher, Judge
Indiana Tax Court

DISTRIBUTION:

Jeffrey S. Dible, , Robert L. Hartley; FROST BROWN TODD LLC; 201 N. Illinois Street, Suite 1900; P.O. Box 44961; Indianapolis, IN 46244-0961

Martin I. Eisenstein, Stacey O. Stitham; BRANN & ISAACSON; 184 Main Street; P.O. Box 3070; Lewiston, ME 04243-3070

Gregory F. Zoeller, Attorney General of Indiana; By: Timothy A. Schultz Deputy Attorney General; Indiana Government Center South, Fifth Floor; 302 West Washington Street; Indianapolis, IN 46204-2770.

⁸ Lastly, the Department cites Indiana Code § 6-3-2-2 as support for its denials of AOL's claims. (Resp't Notice of Supp'l Authority (*quoting* IND. CODE ANN. § 6-3-2-2(e) (West 2009) ("Gross receipts derived from commercial printing . . . shall be treated as sales of tangible personal property for purposes of this chapter").) While the statute indicates that commercial printers are engaged in the business of selling tangible personal property, nonetheless, the phrase "for purposes of this chapter" suggests that the statute applies to the imposition of Indiana's adjusted gross income tax only.