

STATE OF WISCONSIN
TAX APPEALS COMMISSION

AMERITECH PUBLISHING, INC. (P),

DOCKET NO. 01-I-227(P)

Petitioner,

vs.

RULING AND ORDER

WISCONSIN DEPARTMENT OF REVENUE,

Respondent.

DIANE E. NORMAN, COMMISSIONER:

The above-entitled matter comes before the Commission on a Motion for Partial Summary Judgment by Ameritech Publishing, Inc. (“petitioner” or “API”). A Stipulation of Facts and briefs have been submitted by the parties. Attorneys Margaret M. Derus and Kristina E. Somers represent petitioner. Attorney Mark S. Zimmer represents respondent, Wisconsin Department of Revenue (“respondent”).

Having considered the parties’ briefs, affidavits, and exhibits in support of and in opposition to the motion, the Commission finds, concludes, rules, and orders as follows:

FINDINGS OF FACT

For its Findings of Fact, the Commission adopts the parties’ stipulated facts, omitting extraneous, duplicative, and irrelevant material, and making format and nonsubstantive changes.

1. API is a Delaware corporation, with its principal place of business

for 1994-1997, inclusive ("years at issue")¹, in Troy, Michigan.

2. API was engaged in business both within and outside of the state of Wisconsin. It had offices in Michigan, Indiana, Ohio, and Wisconsin, and was subject to taxation in those states. During 1997, API also had an office in Illinois, and, pursuant to Wis. Stat. § 71.25(5), was subject to the income and franchise tax and allocation and apportionment provisions of Chapter 71 of the Wisconsin Statutes.

3. API timely filed a Form 4 Wisconsin Corporation Franchise/Income Tax Return for each of the taxable years ending December 31, 1994 through December 31, 1996, inclusive. Those original returns were filed using an apportionment method which sourced sales revenue based on the geographic distribution of Yellow Pages directories. This was the same apportionment method API had utilized in prior years.

4. On or about December 19, 1998, and within the time allowed under Wis. Stat. § 71.75, API filed a Form 4X Amended Wisconsin Corporation Franchise/Income Tax Return for each of the taxable years ending December 31, 1994 through December 31, 1996, inclusive.

5. API's basis for filing amended returns was to amend the computation of the sales factor of the apportionment formula. API filed the 1994-1996 amended returns using an apportionment method that sourced receipts from the sale of advertising services based on the cost of performing those services, under Wis. Stat. § 71.25(9)(d) ("cost of performance method").

6. API timely filed a Form 4 Wisconsin Corporation

¹ Unless specifically stated otherwise, all facts relate to the years at issue, 1994-1997.

Franchise/Income Tax Return for the taxable year ending December 31, 1997. API used the cost of performance method in this return for apportionment of its income from the sale of advertising services.

7. Respondent timely issued a Notice of Field Audit Action, dated December 13, 2000, notifying petitioner of a denial in full of its claims for refund of franchise taxes and assessing additional franchise taxes for the years at issue.

8. In the Notice of Field Audit Action, respondent denied petitioner's use of the cost of performance method in determining petitioner's Wisconsin income for the years at issue.

9. By letter dated February 5, 2001, petitioner timely filed a petition for redetermination of the Field Audit Action with respondent.

10. By Notice dated November 2, 2001, respondent denied the petition for redetermination, and petitioner timely filed a petition for review with the Commission on December 27, 2001.

11. By agreement of the parties, and with the approval of the Commission, this matter has been bifurcated. In this first phase, the issue is whether API's income from the sale of advertising for Yellow and White Pages directories is from the sale of tangible personal property or the sale of services. This threshold question must be answered before API can be allowed to use the cost of performance method in allocation and apportionment of its advertising revenue income.

12. Petitioner's sales representatives solicited advertising orders from current and prospective customers of petitioner. They solicited current advertisers to either renew an existing advertisement or to purchase additional or expanded

advertisements. These solicitations were performed in person, by telephone, and/or through written correspondence. Petitioner also had sales representatives in its call center operations in other states. These representatives were generally responsible for soliciting current advertisers to renew or expand their advertisements. These call center solicitations were made by telephone communications.

13. API solicited advertisements from subscribers and businesses for placement of advertising in directories. It offered a variety of advertising services to be included in Yellow Pages, White Pages, and Internet Yellow Pages (*i.e.*, www.SMARTpages.com) directories.

14. On its original and amended Federal and Wisconsin corporation income tax returns, API classified its business under the Standard Industrial Classification Manual of 1987 as industry number 7310, Business Services, Advertising.

15. As part of its advertising service, API entered into agreements with its customers to provide advertising and listings to be inserted in specified directories. API's customers did not purchase space and had no right to determine placement of their ads on any given page of a directory (except that customers could purchase space specifically designated for covers).

16. Yellow Pages directories are designed to provide access to information about the advertisers contained therein. Yellow Pages advertising consists of category-based advertising in many formats (such as display, leader ads, and coupons) and image and reach advertising (such as covers, spines, and tabs).

17. White Pages advertising primarily consists of enhancements to telephone listings with bold or feature type or by adding a customer's logo.

18. Online internet advertising consists of Internet Yellow Pages for business advertising in various formats.

19. API estimates that the percentages of its revenues from each general revenue source are as follows:

| | <u>1994</u> | <u>1995</u> | <u>1996</u> | <u>1997</u> |
|--------------------------------------|-------------|-------------|-------------|-------------|
| Yellow Pages Advertising | 89.86% | 88.66% | 88.71% | 91.90% |
| White Pages Advertising | 3.06% | 4.39% | 5.69% | 5.64% |
| Interest and Other Financial Revenue | 7.09% | 6.94% | 5.60% | 2.46% |
| Total | <u>100%</u> | <u>100%</u> | <u>100%</u> | <u>100%</u> |

20. The revenue received by API from its advertising customers was generated by API sales representatives (either employees or independent contractors) who were responsible for contacting customers for placement of directory advertising for upcoming directory issues.

21. The advertising revenues received by API from advertisers in the Yellow Pages directories were based in part on the circulation of the Yellow Pages directories to telephone subscribers in Wisconsin.

22. Wisconsin Bell, Inc. (trade name Ameritech Wisconsin, and referred to herein as "WBI"), provides telecommunications services to its customer subscribers in Wisconsin. Wisconsin Administrative Code § PSC 165.055 requires WBI to provide a White Pages directory to subscribers as part of its telecommunications services. WBI's tariffs also provide for a primary listing in the White Pages as part of the telephone service at no additional charge to the subscriber.

23. A White Pages directory is an alphabetical list of customers, users, and others for whom directory listings are provided. According to WBI's tariffs filed with the Public Service Commission of Wisconsin, White Pages directories are designed solely for the purpose of informing calling parties of the telephone numbers of customers and others listed therein.

24. A Yellow Pages directory is an alphabetically arranged listing of businesses that offer products and services to the general public, and advertising is placed within each product and service listing by advertisers who offer that product or service. The Yellow Pages directory includes various types of advertising formats including bold and/or contrasting color typeset, display ads, coupons, and so forth.

25. Yellow Pages and White Pages directories (collectively "directories") are updated annually, rendering the prior edition obsolete. Internet Yellow Pages are updated periodically.

26. Directories are distributed free of charge to WBI subscribers and other Wisconsin residents and businesses in the directory coverage area. Except for certain directories in the Milwaukee area, all of the Wisconsin directories distributed were "integrated" (i.e., bound together as a single volume).

27. A small number of directories are purchased by individuals or businesses that are generally located outside of the directory coverage area. During 1995-1997, API may have sold a small number of directories to other Wisconsin purchasers.

28. Substantially all of the directories for the Wisconsin directory coverage area were distributed in the state of Wisconsin.

29. API entered into agreements with WBI related to directory services (the “WBI agreements”). In the WBI agreements, API agreed to publish and deliver both White Pages and Yellow Pages directories on behalf of WBI.

30. As part of the WBI agreements, WBI granted API the right to solicit advertising in Yellow Pages directories. For this exclusive right, API paid an annual royalty fee to WBI.

31. API did not itself print or manufacture telephone directories during the years at issue.

32. API entered into an agreement with R.R. Donnelly & Sons Company on behalf of WBI, to print and bind telephone directories.

33. API entered into agreements with Product Development Corporation on behalf of WBI, to distribute and deliver telephone directories.

APPLICABLE WISCONSIN STATUTES

71.25 Situs of income; allocation and apportionment. For purposes of determining the situs of income under this section:

* * *

(9) SALES FACTOR. . . .

* * *

(d) Sales, other than sales of tangible personal property, are in this state if the income-producing activity is performed in this state. If the income-producing activity is performed both in and outside this state the sales shall be divided between those states having jurisdiction to tax such business in proportion to the direct costs of performance incurred in each such state in rendering this service. Services performed in states which do not have jurisdiction to tax the business shall be deemed to have been performed in the state to which compensation is allocated by s. 71.25(8), 2001 stats.

ISSUE INVOLVED

Whether petitioner’s sale of Yellow Pages advertising is the sale of tangible personal property or the sale of services under Wis. Stat. § 71.25(9)(d).

OPINION

Petitioner has moved for a partial summary judgment finding that its sale of directories advertising is the sale of services and not the sale of tangible personal property in determining the sales factor for franchise/income tax apportionment purposes.

Apportionment or allocation of income may be necessary since a state may only tax that part of a corporation's income that is fairly attributable to its income-producing activities in the state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). For corporations that engaged in business both inside and outside the state of Wisconsin during the years at issue, Wis. Stat. § 71.25 contains a three-factor apportionment formula related to the taxpayer's sales, payroll, and property. Each of these factors is a component of the formula (50% sales, 25% payroll, and 25% property) and is expressed as a fraction. The numerator of each fraction is the Wisconsin portion of the value, while the denominator represents the total value in all jurisdictions. The resulting percentage represents the taxing percentage on the taxpayer's business activity in Wisconsin. The present case is concerned with the 50% sales factor as applied to petitioner's Wisconsin directories advertising revenue.

The parties have agreed to bifurcate this case into separate phases. This first phase only applies to the issue of whether the sale of directories advertising is the sale of tangible personal property or the sale of a service. If it is the sale of tangible personal property, the cost of performance method of allocation cannot be applied to the advertising revenue. If API's sale of directories advertising is a service, the next phase of this case shall determine whether the sale is performed both inside and outside

the state of Wisconsin. If performed both inside and outside of the state of Wisconsin, the cost of performance method of allocation can be used with regard to petitioner's directories advertising revenue under Wis. Stat. § 71.25(9)(d).

Partial Summary Judgment

A partial summary judgment on the issue of whether the revenues from the sale of directories advertising is a sale of tangible personal property or the sale of a service under Wis. Stat. § 71.25(9)(d) is appropriate in this case. A summary judgment motion will be granted if there is no genuine issue as to any material fact and the moving party is entitled to a judgment as a matter of law. Wis. Stat. § 802.08(2). A partial summary judgment is appropriate in this matter because there is no genuine issue as to any material fact regarding the issue of whether petitioner's directories advertising sales are the sale of tangible personal property or the sale of a service, and petitioner is entitled to a partial summary judgment as a matter of law.

Statutory Interpretation

Petitioner argues that revenues from the sale of directories advertising should be apportioned by the cost of performance method under Wis. Stat. § 71.25(9)(d) because it is the sale of the service of advertising, not the sale of tangible personal property.

In contrast, respondent argues that revenues from the sale of directories advertising are from the sale of tangible personal property. Respondent apportioned the income from petitioner's directories advertising sales revenues based on the geographic distribution of the directories, since respondent considered the directories tangible personal property sold in Wisconsin. Respondent argues that since petitioner

entered into agreements with WBI to publish and distribute both White Pages and Yellow Pages directories, petitioner's principal purpose was publishing and not advertising. Further, respondent argues that the directories advertising revenue is inextricably linked to the directories (without the existence of the tangible personal property of the directories, petitioner would be unable to generate the advertising revenues associated with the directories) and so constitutes the "gross receipts" to which petitioner was entitled for producing the tangible personal property of the directories.

This case presents a question of statutory interpretation. The purpose of statutory interpretation is to determine what a statute means in order to give the statute its full, proper, and intended effect. *State v. Reed*, 280 Wis. 2d 68 (2005). To determine if directories advertising revenue is the sale of a service under Wis. Stat. § 71.25(9)(d), "[w]e begin with the statute's language because we assume that the legislature's intent is expressed in the words it used." *Id.* at 75. Generally, language is given its common, ordinary, and accepted meaning. *Kalal v. Circuit Court*, 271 Wis. 2d 633, ¶ 45 (2004).

Neither Wis. Stat. § 71.25(9)(d), nor any of the Wisconsin income/franchise tax statutes, directly address whether the sale of directories advertising should be treated as the sale of a service or the sale of personal property. To determine the meaning of Wis. Stat. § 71.25(9)(d) as it relates to directories advertising revenue, statutory language is interpreted in the context in which it is used, in relation to the language of surrounding or closely-related statutes, and interpreted to avoid absurd or unreasonable results. *Kalal*, ¶ 46. Because statutory language is interpreted "in relation to the language of surrounding or closely-related statutes . . . to avoid

absurd or unreasonable results,” *Id.*, the plain meaning analysis of the allocation and apportionment statute for franchise/income tax purposes can also focus on related sales/use tax statutes and regulations.²

Wisconsin sales and use tax regulations have explicitly defined the solicitation of advertising for telephone directories as a service enterprise. Wis. Admin. Code § Tax 11.67(3)(m).

Also, Wisconsin case law has adopted the following test for sales/use tax that has been codified in Wis. Admin. Code § Tax 11.67(1) to help determine when a transaction is a service or personal property:

Tax 11.67 Service enterprises.

(1) GENERAL. When a transaction involves the transfer of tangible personal property along with the performance of a service, the true objective of the purchaser shall determine whether the transaction is a sale of tangible personal property or the performance of a service with the transfer of the property being merely incidental to the performance of a service. . . . If the objective of the purchaser is to obtain the personal property, a taxable sale of that property is involved. However, if the objective of the purchaser is to obtain the service, a sale of a service is involved even though, as an incidence to the service, some tangible personal property may be transferred.

See, Dep’t of Revenue v. Dow Jones & Company, Inc., 148 Wis. 2d 872, 923 (1989); *Frisch Dudek and Slattery, Ltd. v. Dep’t of Revenue*, 133 Wis. 2d 444, 448-449 (1986); *Janesville Data Center, Inc. v. Dep’t of Revenue*, 84 Wis. 2d 341, 346-347 (1978).

In this case, the purchasers are the advertising customers. Most of petitioner’s income (92-97%) was derived during the years at issue from the sale of

² The Wisconsin Supreme Court looked to tax law for defining a term in the trade and marketing law area because both areas of the law related to the same subject matter that had to be defined. The Court found that defining the term differently in different areas would have led to an “absurd” result. *Orion Flight Services, Inc. v. Basler Flight Service, LLC*, 2006 WI 51, ¶¶ 33-34. In the present matter, the Commission is looking to a different section within the tax laws to determine if directories advertising revenue is the sale of a service or tangible personal property.

directories advertising to its customers, and the true objective of those customers is the purchase of the service of advertising. Petitioner performed the work to earn advertising revenue by soliciting advertisements from customers, plus a variety of other advertising services to be included in the directories. The advertising revenue was paid to petitioner as a direct result of the solicitation and other services related to advertisements in the directories, not directly from the sale of the directories themselves.

Petitioner furnished the directories to WBI's customers as part of the consideration for the privilege of soliciting sales of Yellow Pages advertising to such customers. Petitioner entered into agreements with WBI to produce the directories.³ Under those agreements, petitioner purchased the right to solicit advertising, and was obligated to pay for that privilege by payment of an annual royalty fee and by furnishing a stated number of directories to the companies and their subscribers.

While the sale of directories advertising is “inextricably linked” to the tangible directories, there is no sale of the directories or circulation income as the directories are distributed free of charge. The directories were the vehicles for delivering the advertisements from the advertisers to the advertisers’ customers. The purchasers or customers of petitioner are not WBI’s customers who receive the directories. Petitioner’s customers are the advertising customers who pay for the advertising services. These advertising revenues do not pay the purchase price of the directories and are not attributable to the purchase price of the directories. Indeed, the

³ Respondent argues that petitioner was required to publish the White Pages directories. However, it was not petitioner but WBI who was required to publish the White Pages directories. WBI fulfilled this requirement by entering into the agreements with petitioner to publish the directories.

directories are distributed to WBI's customers free of charge.

Moreover, the advertisement services provided by petitioner are not always connected to a physical directory. The advertising is also provided in Internet Yellow Pages directories. It is the information contained therein, not the tangible directory, which provides the value to petitioner's advertisers who are paying for the advertising services.

Respondent also argues that the Commission should not look to the sales/use tax statutes and regulations to determine if directories advertising revenue is the sale of a service or personal property. This would lead to an absurd contradiction: the sale of advertising for directories would be defined as a service enterprise under sales/use tax law while at the same time would be defined as the sale of tangible personal property under income/franchise tax law.

Since sales/use tax and income/franchise tax laws both may apply to revenues derived from the sale of advertising for telephone directories, the Commission should attempt to read the laws in harmony, if possible, to avoid absurd results. *State v. Wachsmuth*, 73 Wis. 2d 318, 326 (1976) (concluding that when two statutes are "*in pari materia*, the court must harmonize them if possible").

OTHER JURISDICTIONS

Respondent argues that the sale of directories advertisement should be found to be the sale of personal property by reference to case law in other jurisdictions that involve sales/use tax. However, these cases do not state whether those jurisdictions have regulations similar to Wisconsin when defining service enterprises within the sales/use tax law even though the majority of the cases cited by respondent

involve sales and use tax. Moreover, most of the cases cited by respondent involve sales/use tax law as applied to the sale or resale of the cost of directories themselves, not to advertising revenues.⁴ There is no issue in the present case as to the tax as applied to the sale or resale of the cost of the directories themselves. The issue in the present case involves only the revenue from the sale of advertising in those directories.

The case of *The New Yorker Magazine, Inc. v. Dept. of Revenue*, 187 Ill. App. 3d 931, 543 N.E. 2d 957 (1989), does involve an apportionment statute that is very similar to Wisconsin's. In this case, the Illinois Supreme Court found that the advertising sales of The New Yorker Magazine were sales of personal property and not sales of a service. The Court found that The New Yorker Magazine, Inc., was in the business of publishing a magazine and not in the business of advertising, and that the sale of advertising was incidental to and inseparable from the circulation sales. In so finding, the Court cited the case of *District of Columbia v. Evening Star Newspaper Co.*, 273 F. 2d 95, 106 U.S. App. D.C. 360 (1959), where it was found that circulation and advertising revenues were too closely intertwined to be separated for apportionment purposes (but did not find that the sale of advertising was the sale of personal property). In *The New Yorker*, the taxpayer's primary business was publishing a magazine and selling that magazine through circulation sales.

⁴*Verizon Yellow Pages v. Commis. of Revenue*, 2004 WL 2218373 (Mass. App. Tax Bd.) (Taxpayer was seeking abatement of use tax on purchases of printed directories from out-of-state printers as exempt advertising material); *GTE Directories Service Corporation v. Dept. of Treasury*, 1998 WL 2016608 (Mich. App.) (Taxpayer was challenging the use tax on the procurement of telephone directories); *Bi-Rite Directories, Inc. v. Director of Revenue*, 1987 WL 51117 (Mo. Admin. Hrg. Com.) (Taxpayer was appealing use tax on purchase of directories from out-of-state printers as exempt advertising material); *Telepages, Inc. v. Baldwin*, 9 N.J. Tax 30 (1987) (Taxpayer challenged use tax for purchases of directories as exempt resale transactions); *Fairlawn Shopper, Inc. v. Director, Division of Taxation*, 98 N.J. 64, 484 A. 2d 659 (1984) (Taxpayer was seeking exemption from use tax for printing cost of newspaper).

In the present case, there are no circulation sales or revenue. Unlike in *The New Yorker*, the sale of advertising space in the present matter is not closely connected with the sale of the publication. Since the directories are distributed free of charge, there is no circulation revenue that would be too closely intertwined to the advertising revenue to be separated for apportionment purposes. Moreover, this is a very different type of publication because the Yellow Pages directories contain virtually all advertising as opposed to other types of publications that contain news and other content. Finally, there is nothing in this case that states whether there are statutes or regulations defining service enterprises similar to the Wisconsin regulations. Therefore, the facts of *The New Yorker* are not similar enough to be helpful in the present matter.

The other cases cited by respondent are also not helpful in this matter.⁵ While these cases involve the sale of advertising, they involve very different factual situations that have nothing to do with tangible printed publications.

Accordingly, we find that the evidence shows that petitioner was in the business of selling advertising services and not tangible personal property for the purposes of Wis. Stat. § 71.25(9)(d).

IT IS ORDERED

1. Partial summary judgment is granted to petitioner, on the basis that it is engaged in the business of selling advertising services and not tangible personal property for the purposes of Wis. Stat. § 71.25(9)(d).

⁵ *State of Alaska, Dept. of Revenue v. Northern TV, Inc.*, 670 P. 2d 367 (1983) (Income to a local television station from a national television network for airing programming and advertisements for television was the sale of “air time” and constituted the sale of goods); *Mountain States Advertising, Inc. v. Bureau of Revenue*, 552 P. 2d 233 (N.M. Ct. App. 1976) (The sale of outdoor billboard advertising by a company that was in the business of erecting billboards was taxable for “displaying,” not for advertising).

2. A **telephone status conference** will be held on September 12, 2006, at 11:00 a.m., to determine a briefing schedule for the next phase in this matter.

Dated at Madison, Wisconsin, this 22nd day of August, 2006.

WISCONSIN TAX APPEALS COMMISSION

Jennifer E. Nashold, Chairperson

Diane E. Norman, Commissioner

David C. Swanson, Commissioner