IN THE COURT OF APPEALS OF TENNESSEE

SCHOOL CALENDAR COMPANY, INC., Plaintiff-Appellee, v. JOE HUDDLESTON, in his official capacity as COMMISSIONER OF REVENUE, STATE OF TENNESSEE, Defendant-Appellant.	C/A NO. 03A01-9603-CH-00090 HAMBLEN COUNTY CHANCERY COURT HONORABLE WILLIAM L. JENKINS, JUDGE, Sitting by Interchange AFFIRMED AND REMANDED
MORRISON PRINTING COMPANY, INC., Plaintiff-Appellee, v. JOE HUDDLESTON, in his official capacity as COMMISSIONER OF REVENUE, STATE OF TENNESSEE, Defendant-Appellant.	C/A NO. 03A01-9603-CH-00091 HAMBLEN COUNTY CHANCERY COURT HONORABLE WILLIAM L. JENKINS, JUDGE, Sitting by Interchange AFFIRMED AND REMANDED

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O P I N I O N

Susano, J.

These consolidated cases involve sales and use tax deficiencies assessed by the Commissioner of Revenue (Commissioner). The taxpayers, School Calendar Company (SCC) and

Morrison Printing Company, Inc. (Morrison), filed separate actions against the Commissioner pursuant to T.C.A. § 67-1-1801[1] seeking a determination that the assessments were improperly made. These suits were heard by the trial judge at a joint bench trial on August 22 and 23, 1995. He found that the assessments were not legally justified and entered judgment for the taxpayers. The Commissioner appealed. We affirm.

The pivotal issue in this case is whether SCC sells its products or gives them away, free of charge. The Commissioner claims that SCC simply sells advertising for the poster-size athletic calendars and pocket-size schedule cards that it produces for schools and colleges around the country; and that it then distributes the calendars and schedule cards without charge. He contends that since SCC does not sell a product, it is responsible for sales and use tax on paper, ink and other supplies that are blended into the calendars and schedule cards. He also assessed a tax on machinery purchased by SCC. He further contends that Morrison, a general commercial printing company, is obligated for sales tax on press time it sells to SCC for the printing of the latter's products.

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[1]As pertinent here, T.C.A. § 67-1-1801 provides as follows:

> (a)(1) In all cases in which any officer, charged by law with the authority to assess taxes which are collected or administered by the commissioner of revenue, shall assess a tax alleged or claimed to be due, if the taxpayer against whom the assessment is made believes the assessment to be unjust, illegal or incorrect, the taxpayer's remedies shall be as follows:
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> * * *
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> (B) The taxpayer may file suit against the commissioner in chancery court in the appropriate county in this state, challenging all or any portion of the assessment . . .

On the other hand, the taxpayers argue that SCC does sell its products "for a consideration" and that the transactions taxed by the Commissioner are exempt from sales and use taxes under a number of statutory exemptions. SCC contends that it is a "specially niched printer." It vigorously disputes the Commissioner's contention that it is nothing more than a typical advertising agency.

"Our review of findings of fact in tax cases, as in other civil actions, is 'de novo upon the record of the trial court, accompanied by a presumption of correctness of the finding, unless the preponderance of the evidence is otherwise.'" ***Hearthstone, Inc. v. Hardy Moyers***, 809 S.W.2d 888, 890 (Tenn. 1991) (citing Rule 13(d), T.R.A.P.). *See also* ***Sears Roebuck & Co. v. Woods***, 708 S.W.2d 374, 378 (Tenn. 1986).

I. *Facts*

The operative facts are essentially undisputed; however, the legal effect of those facts is sharply contested.

SCC and Morrison are wholly-owned subsidiaries of Morrison Communications, Inc., a family-owned corporation. All three businesses are located in the same facility in Morristown. They share a number of employees.

Morrison is a general commercial printer. It has a printing press; SCC does not. SCC contracts with Morrison for

press time. Morrison also provides printing services to other companies.

The vast majority--over 90%--of SCC's revenues comes from advertisers and sponsors whose advertisements or names appear on the calendars and schedule cards produced by the company. The schedule cards represent a small part of the company's total business; the bulk of its business is the production of school athletic calendars. During the audit period--December 31, 1988 to December 31, 1991--SCC distributed 3.8 million calendars. It received $16.5 million in revenues from calendars and schedule cards during the audit period.

SCC's customers are schools and colleges. 97% of the revenues associated with those customers come from out-of-state educational institutions.

SCC's representatives attend coaches' clinics to promote the company's products. Most of its leads come from these clinics. Coaches at the clinics who are interested in SCC's calendars and/or schedule cards fill out information cards directed to SCC. The company then contacts the interested parties by phone or by on-site visits from company representatives.

The company maintains a price list setting forth the prices for various types of calendars. The cost of the calendars is dependent upon their size, number of colors, quantity ordered, and other features. Once a school selects a calendar with the

desired features, SCC quotes a price for that product from its published price list. When all of this is agreed upon, SCC and the school enter into a contract for the production and delivery of a certain quantity of calendars.

The educational institutions pay the full contract price in only five percent of the cases. In the other cases, funds must be raised in the community to pay for the calendars. Sometimes, the schools do their own fund raising; but in most instances, the schools avail themselves of SCC's offer to have its field representatives contact potential advertisers and sponsors to seek advertisements or sponsorships to finance the cost of the calendars. Typically, one advertiser or sponsor is selected to fund the production of the schedule cards.

The testimony at trial indicates that in over half of the cases, the schools have to make up the difference between the cost of the product selected by the school and the funds secured from advertisers and sponsors.

The calendars and schedule cards are not shipped to the schools until the full contract price has been paid by the advertisers, sponsors, schools, or other source.

SCC is directly involved in all phases of the printing of the calendars and schedule cards except the actual putting of the ink on the paper. This latter function is contracted out to Morrison, but is supervised by SCC. SCC maintains equipment and facilities to do all of the pre-press functions as well as the

functions that occur after ink is put on the paper by Morrison. The various functions of the total printing process were described by the President of SCC:

> Q. Explain to the Court the components of the printing industry and where you get this term pre-press operation.
>
> A. The printing industry has three basic processes. The first is the pre-press operation, which is where all the of [sic] work is assembled to make up the final product. The type is set. The picture is either scanned in or shot on the camera. The design work is done. The stripping is done, and the plate making is done. So it is a department that's -- and it's in a lot of change right now. It's going from a manual to an electronic system. At any rate, that's the first part.
>
> The second part is the plate part. That's where the metal plate is actually attached to the press. The paper is loaded into the press and ink into the press, and then the product is then put through the press.
>
> The third operation is the bindery and finishing. Anything that needs to be done to make a final product is done in that area. It could be trimmed on the cutter. It could be folded on the folding machine. It could be gathered on a saddle gatherer. It could have holes punched in it. Whatever needs to happen happens in that bindery and finishing area.
>
> Q. Are all three parts of those part of the printing industry?
>
> A. Yes, they are.

SCC's part of the printing process as to a given calendar is completed in three days; Morrison's function takes only about 20 minutes.

According to its President, SCC produces the plate, takes it along with the paper and other supplies to the part of the building housing Morrison's press, and then supervises the putting of the ink on the paper. Once the product comes off the press, SCC takes it back to its part of the building for binding and other necessary completion work, after which it is mailed to the schools. Generally, the advertisers and sponsors also receive some quantity of the products.

Typically, the calendars contain team and/or other pictures, schedules, advertisements or sponsors' names, and a calendar.

At the time of trial, there remained an unresolved assessment as to SCC of $50,696.06 for materials purchased on resale certificates and $10,965.02 for machinery purchases. The unresolved assessment as to Morrison amounted to $133,901.

II. *Law*

As pertinent to this appeal, a sales or use tax is imposed in Tennessee pursuant to the following statutory authority:

> It is declared to be the legislative intent that every person is exercising a taxable privilege who:
>
> (1) Engages in the business of selling tangible personal property at retail in this state;
> (2) Uses or consumes in this state any item or article of tangible personal property as defined in this chapter, . . .

T.C.A. § 67-6-201 (1) and (2). All such covered transactions are taxable unless they are exempt from tax under one or more of the statutory exemptions.

Taxing legislation is strictly construed against the taxing authority. ***Hearthstone***, 809 S.W.2d at 890; ***Sears, Roebuck & Co***., 708 S.W.2d at 378; however, exemptions are strictly construed against the taxpayer. ***Kingsport Publishing Corporation v. Olsen***, 667 S.W.2d 745, 746 (Tenn. 1984); ***Shearin v. Woods***, 597 S.W.2d 895, 896 (Tenn. 1980). "An exemption must not be broadened beyond the command of the provision." ***Sears, Roebuck & Co***., 708 S.W.2d at 378.

"[I]n a suit against the state by a taxpayer claiming an exemption from taxation the burden is on the taxpayer to establish his exemption; every presumption is against it and a well-founded doubt is fatal to the claim." ***Woods v. General Oils, Inc.***, 558 S.W.2d 433, 435 (Tenn. 1977). *See also* ***Kingsport Publishing Corporation***, 667 S.W.2d at 746; ***Sears Roebuck & Co***., 708 S.W.2d at 378. "The burden of proof is upon the taxpayer to prove that the assessment made is incorrect and to prove its right to recovery by clear and convincing evidence." ***Edmondson Mgt. Service, Inc. v. Woods***, 603 S.W.2d 716, 717 (Tenn. 1980).

III. *Analysis*

SCC claims that it *sells* calendars and schedule cards to the schools and colleges with whom it contracts. It claims a right to the "sale for resale" exemption[2] found at T.C.A. § 67-6-102(23)(A);[3] the exemption stated at T.C.A. § 67-6-102(23)(E)(i);[4] and the exemption at T.C.A. § 67-6-313(a).[5] As to the assessment made by the Commissioner on its machinery purchases, it claims an exemption under T.C.A. § 67-6-102(12)(A).[6] Morrison claims that its charges for press time are likewise exempt since the press time is a part of the manufacturing of products for resale.

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[2]Some of the code sections applicable to this case have been renumbered since the audit period. Since there have been no changes in substance, we have used the code sections in effect at the present time.

[3]T.C.A. § 67-6-102(23)(A) provides, in pertinent part, as follows:

> "Retail sales" or "sale at retail" means a taxable sale of tangible personal property or specifically taxable services to a consumer or to any person for any purpose *other than for resale.*

(Emphasis added.)

[4]T.C.A. § 67-6-102(23)(E)(i) provides, in pertinent part, as follows:

> "Sale at retail," "use," "storage," and "consumption" do not include the sale, use, storage or consumption of: (i) industrial materials...for future processing, manufacture or conversion into articles of tangible personal property *for resale*...

(Emphasis added).

[5]T.C.A. § 67-6-313(a) provides, in pertinent part, as follows:

> It is not the intention of this chapter to levy a tax upon articles of tangible personal property...produced or manufactured in this state *for export*.

(Emphasis added). This statute provides an exemption "for personal property exported *for resale*." ***Hearthstone***, 809 S.W.2d at 891 (emphasis addded).

[6]T.C.A. § 67-6-102(12)(A) provides, in pertinent part, as follows:

> "Industrial machinery" means:
> (A) Machinery, apparatus and equipment...which is necessary to, and primarily for the fabrication or processing of tangible personal property *for resale*...

(Emphasis added).

As previously indicated, the Commissioner takes a contrary view. He strenuously argues that SCC's sole business is the selling of advertising. He contends that SCC is not in the printing business, but is rather nothing more or less than an advertising agency. He asserts that "there is no actual sale of the calendars [and the schedule cards] to anyone." He contends that SCC "makes a finished product which is then distributed free of charge."

It is clear that the critical determination in this case is whether SCC is selling a product. If it is not, then the purchases at issue in this case are for the end use of SCC and neither it nor Morrison is entitled to any of the claimed exemptions. If it is selling a product, its purchases, under the facts of this case, are either sales for resale or materials purchased and thereafter blended into a product for resale; and, in either event, not subject to sales or use tax. By the same token, if SCC is engaged in the printing business and specifically incorporates raw materials into a finished product that is sold to others, then the machinery purchased by it, again under the facts of this case, is "industrial machinery" and those purchases are likewise exempt. Under SCC's theory of this case, its purchases of materials and press time in connection with out-of-state sales would also be exempt as sales for export under T.C.A. § 67-6-313(a).

Is SCC selling a product? This question causes us to focus on T.C.A. § 67-6-102(24)(A), the sales and use tax code provision defining a "sale":

> “Sale” means any transfer of title or possession, or both,...of tangible personal property for a consideration,...

The elements of a sale have been addressed by the Supreme Court:

> The elements necessary to constitute a sale are (1) transfer of title or possession, or both of (2) tangible personal property, for a (3) consideration.

Volunteer Val-Pak v. Celauro, 767 S.W.2d 635, 636 (Tenn. 1989). *See also* ***Hearthstone***, 809 S.W.2d at 890.

The taxpayers’ entitlement to each of the claimed exemptions is contingent upon SCC showing, by clear and convincing evidence, that it sells the calendars and cards. The statutes clearly contain

> ...a requirement that the dealer actually resell goods and services or manufacture products for resale. Otherwise the dealer’s purchases are taxable. (citation omitted)

Nasco, Inc. v. Jackson, 748 S.W.2d 193, 196 (Tenn. 1988). *See also* ***Scholl, Inc. v. Jackson***, 731 S.W.2d 893, 895-96 (Tenn. 1987). “Where goods or services do become component parts of ‘articles of tangible personal property for resale’...their acquisitions from vendors are not included in the definition of ‘retail sales.’” *Id*. at 195.

The Commissioner concedes the existence of the first two elements of the statutory definition of a “sale”; but he

argues that the third element--"consideration"--is lacking. We disagree.

The process that ends with the shipment of calendars and/or schedule cards to a school begins with a contract between SCC and the school. We believe this contractual relationship is a critical factor that distinguishes this case from those involving advertising--financed "throwaways" that are distributed free of charge. *Cf.* ***Shoppers Guide Pub. Co. Inc. v. Woods***, 547 S.W.2d 561 (Tenn. 1977). The contracts between SCC and the schools are based upon a set price for a specified type and quantity of product. That set price is the total of all the separate charges for the various features, i.e., size, number of colors, etc., and quantity of product, ordered by the school. The calendars and schedule cards are not shipped to the school *unless and until* that full price is contracted for or paid from some source.

It is true that in a majority of the cases, the contract price comes from advertising or sponsorships. It is likewise true that most of those advertisements and sponsorships are secured by solicitations from SCC *acting on behalf of the school*.[7] We do not understand how the mode of securing the advertisments and sponsorship--whether by the school directly or by SCC acting on the school's behalf--affects the issue of whether there is a sale of tangible personal property as

[7]SCC receives a written authorization to solicit on behalf of the schools.

contemplated by T.C.A. § 67-6-102(24)(A).[8] That section does not define "consideration" in a way that would limit that concept in this case to direct payments from the schools. We do not believe there is any reason to eliminate from the concept of "consideration," advertising and sponsorship dollars, regardless of how and by whom those funds are secured, in a case where a school has contracted to take a product at a specified price.

It is also significant that over half of the schools directly contribute some portion of the contract price. This is some further indication that the Commissioner's characterization of SCC's business as a typical advertising agency without a paid-for product is not substantiated by the record in these cases.

We recognize that the sample contract in the record before us contains a provision that "[s]ervices, products and material supplied by SCC will be at no cost to the school." We do not understand this provision to mean that a school is without any obligation under the contract. If the necessary funds to purchase the calendars or schedule cards are secured through the

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[8]Susan Myers Keebler, the Department of Revenue's audit manager for East Tennessee, conceded in her testimony that if the schools themselves sell the advertising and then remit the contract price to SCC, a sale of tangible personal property has occurred:

> Q. Now, can the schools themselves like in this instance -- we didn't sell any advertising on this one. The school just sent us a check.
>
> A. That's correct.
>
> Q. Can the schools go out and sell advertising themselves, get the sponsors themselves, get the money themselves and then pay us for this calendar?
>
> A. Yes, sir.
>
> Q. Would that be a sale of tangible personal product?
>
> A. Yes.

efforts of SCC, the school, or both, the school is contractually obligated to take delivery. By the same token, this provision does not preclude a school from paying monies directly to SCC, as is done in over half of the cases, in the event others do not provide the funds to cover the purchase price or the school wants additional calendars or cards or other features not earlier contracted for. In any event, product--tangible personal product--flows to the schools and "consideration" for that product flows to SCC.

We find and hold that the evidence does not preponderate against the Chancellor's judgment that SCC sells calendars and schedule cards "for a consideration." This being the case, it follows that we find clear and convincing evidence in the record to support the exemptions claimed by SCC and Morrison as to the transactions for which the Commissioner made a deficiency assessment.

In view of our finding that the taxpayers are entitled to the claimed exemptions, it is not necessary for us to reach the taxpayers' issue that because no assessments were made as a result of earlier audits, they are entitled to the benefit of T.C.A. § 67-1-108, the section of the code that prohibits retroactive application by the Commissioner of a change of policy. *Cf.* ***Memphis Shoppers News, Inc. v. Woods***, 584 S.W.2d 196, 200 (Tenn. 1979).

The judgment of the trial court is affirmed. Costs on appeal are taxed to the appellant. This case is remanded for

such further proceedings as may be necessary consistent with this opinion.

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Charles D. Susano, Jr., J.

CONCUR:

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Houston M. Goddard, P.J.

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Don T. McMurray, J.