

SUPERIOR COURT OF ARIZONA  
MARICOPA COUNTY

TX 2005-050288

06/29/2007

HON. THOMAS DUNEVANT, III

CLERK OF THE COURT  
S. Brown  
Deputy

RR DONNELLEY & SONS COMPANY, et al.

PATRICK DERDENGER

v.

ARIZONA STATE DEPARTMENT OF  
REVENUE

KIMBERLY J CYGAN

**UNDER ADVISEMENT RULING**

**(Plaintiff's Motion For Summary Judgment, Defendant's Motion For Summary Judgment and Plaintiff's Motion To Compel)**

R.R. Donnelley & Sons Company (Donnelley), a printing business, owns three relevant subsidiaries: R.R. Donnelley Receivables, Inc., which as the name suggests deals with its parent's accounts receivable, Caslon Incorporated, which provides investment services, and Heritage Preservation Corporation, which owns the various trademarks used by Donnelley. The Department of Revenue seeks to tax all three subsidiaries as part of a unitary business with Donnelley. Plaintiffs in turn seek a finding that each subsidiary is to be taxed separately only on its own Arizona source income.

A.R.S. § 43-942 and § 43-947(C) give the Department of Revenue, in the first instance, the authority to require combined returns when necessary to accurately determine Arizona source income; such is the case here. This, however, is a distinct issue of law from whether the subsidiaries included in a single return with the parent are properly subject to unitary taxation. In determining which, if any, of the related companies are to be treated as unitary with Donnelley, the Court is guided by the analysis in *State ex rel. Arizona Dept. of Revenue v. Talley Industries, Inc.*, 182 Ariz. 17 (App. 1994). The Court of Appeals focused in that case on transfer pricing, and in particular the ability to establish, at least *pro forma*, arm's length prices for the intracompany services provided. It found that in general, management functions can be

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accounted for by generally accepted accounting principles. *Id.* at 25. However, it recognized in some cases an “inability to establish fair arm’s-length prices for goods transferred, or basic operational services rendered, between controlled branches or subsidiaries of an enterprise.” *Id.* (quoting I Jerome R. Hellerstein and Walter Hellerstein, *State Taxation* ¶ 8.[4][b] (2d ed. 1993)). In such cases, taxation as a unitary business is appropriate. Additionally, in the context of a manufacturing, producing, or mercantile business such as Donnelley, A.A.C. R15-2D-401(G) (the Court uses the current version of the regulation, as amended and renumbered in 2000; there are no material differences between this version and that effective in the 1990s, as cited by the parties), which prevents a finding of a unitary business unless there is “a substantial transfer of material, products, goods, technological data and processes, or machinery and equipment” among the related entities.

A distinction can be made among the three Donnelley subsidiaries. The services provided to Donnelley by Receivables and Caslon, factoring and investment services respectively, are management services. Under *Talley*, they do not create a unitary relationship because their value, being equivalent to services available in the market, can be ascertained using generally accepted accounting principles. *Id.* Their income therefore cannot be taxed on a unitary basis with that of Donnelley.

Heritage is different. It owns the trademarks identifying Donnelley’s products. It has been recognized from the infancy of trademark law that a trademark has no cognizable existence distinct from the product to which it is attached. *See, e.g., Kidd v. Johnson*, 100 U.S. (10 Otto) 617, 620 (1879). It is an identifier of property rather than property in its own right. *TMT North America, Inc. v. Magic Touch GmbH*, 124 F.3d 876, 882 (7<sup>th</sup> Cir. 1997). “A trademark symbolizes the public’s confidence or ‘goodwill’ in a particular product. However, it is no more than that, and is insignificant if separated from that confidence. Therefore, a trademark is not the subject of property except in connection with an existing business.” *Premier Dental Products Co. v. Darby Dental Supply Co., Inc.*, 794 F.2d 850, 853 (3d Cir. 1986) (internal footnote and quotation marks omitted). Heritage’s trademark assets thus have no value independent of the Donnelley products to which they are attached. Moreover, while no contracts or other documents have been presented addressing the parties’ rights in this regard, it is inconceivable to the Court that Donnelley would allow Heritage either to withdraw the use of the Donnelley trademarks from it or to license them to a competitor. Even were that unlikely event to occur, a license to an entity unconnected with the historical user of the Donnelley trademarks would constitute an impermissible assignment in gross. *Mister Donut of America, Inc. v. Mr. Donut, Inc.*, 418 F.2d 838, 842 (9<sup>th</sup> Cir. 1969). Donnelley, in short, is the only possible purchaser of Heritage’s assets, making it a monopsony with respect to Heritage. Where a single buyer or seller controls one side of the market, to establish an arm’s length, fair market price is an impossibility. This special situation is addressed by the *Talley* analysis of the purpose behind the unitary taxation rule, to attribute the proper amount of income where the market mechanism and

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accounting rules fail. 182 Ariz. at 25. Nor does the language of the regulation prevent the unitary taxation of Heritage. From Donnelley's perspective, the Donnelley name is the consumer's guarantee of reliable quality, a shorthand for the entirety of the finished good. The trademark placed on the product, then, is no less integral to it than the paper and ink. The trademark therefore acts more as a material incorporated into the product than an ancillary service. Heritage supplies Donnelley with the trademarks it places on its products. The trademarks can properly be treated as a material transferred between Heritage and Donnelley. Thus, under R15-2D-401(G), Heritage is to be taxed as unitary with Donnelley. It is not necessary to calculate a percentage of the value of the product which can be ascribed to the Donnelley trademarks; while the regulation creates a presumption that a 20 percent transfer creates a unitary business, it is clear that a smaller percentage if other characteristics indicating substantial operational integration are present. As the only assets possessed by Heritage are those under exclusive monopsony license to Donnelley, and Heritage's asset in turn is incorporated indivisibly into Donnelley's products, this test is met.

With this decision, the Motion to Compel Production of Documents becomes moot with respect to receivables and Caslon, as Plaintiff prevails with respect to those two subsidiaries. It is also moot with respect to Heritage. Plaintiffs' Complaint does not raise the issue of disparate treatment of trademark licensing subsidiaries under either the Uniformity Clause of the Arizona Constitution, A.R.S. Const. Art. IX § 1, or under the Equal Protection Clause of the Fourteenth Amendment. Whether the Department of Revenue has treated other trademark licensing subsidiaries as non-unitary with their parent/licensees is thus not raised. Nor do Plaintiffs appear to contest the amount of additional tax liability created by Heritage's inclusion in Donnelley's unitary business; in any event, the documents Plaintiffs seek and Defendant refuses to provide would not seem to be germane to ascertaining the amount. There is no other issue for which the contents of the Audit File would have any apparent relevance, or be likely to lead to relevant evidence.

Therefore, IT IS ORDERED:

1. Granting Plaintiff's Motion For Summary Judgment with respect to Receivables and Caslon, Inc., and denying Defendants' Motion For Summary Judgment with respect Caslon, Inc., and Receivables.
2. Granting Defendant's Motion For Summary Judgment with respect to Heritage and denying Plaintiff's Motion For Summary Judgment with respect to Heritage.
3. Plaintiffs' Motion To Compel Production Of Documents is denied.