Hearing Date and Time: November 2, 2010 at 10:00 a.m.

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	Chapter 11
Quebecor World (USA) Inc., et al.,	Case No. 08-10152 (JMP) Jointly Administered
Debtors.	Honorable James M. Peck

REORGANIZED DEBTORS' RESPONSE AND OBJECTION TO MOTION OF THE TEXAS COMPTROLLER OF PUBLIC ACCOUNTS TO DETERMINE THE DEBTORS' SALES TAX LIABILITIES PURSUANT TO THE COURT'S PROCEDURES ORDER

Quebecor World (USA) Inc. and 52 of its domestic direct and indirect subsidiaries, as reorganized debtors (collectively, the "Debtors" or "Reorganized Debtors, as applicable), state as follows in response to the Motion of the Texas Comptroller of Public Accounts to Determine the Debtors' Sales Tax Liabilities pursuant to the Court's Procedures Order (Docket No. 4161) (the "**Motion**"):

Preliminary Statement

1. As an initial matter, notwithstanding the substantial efforts that the Reorganized Debtors have made in attempting to reach agreement with Texas on certain sales tax claims, the Reorganized Debtors do not oppose the Texas Comptroller of Public Accounts' request that the Court determine the amount of the Debtors' liability to Texas for certain pre- and postpetition

sales taxes that were the subject of the Motion of the Debtors pursuant to 11 U.S.C. §§ 105(a), 502 and 505 and Federal Rule of Bankruptcy Procedure 9019 to (A) Implement Procedures to Determine Prepetition and Postpetition Sales Tax Liabilities of Certain Debtors pursuant to State and Local Voluntary Disclosure Procedures and (b) Determine the Amount of Prepetition and Postpetition Sales Tax Liability of Certain Debtors (Docket No. 1219) (the "**Sales Tax Motion**").

2. Early in these chapter 11 cases, the Debtors realized that a potentially significant impediment to their efforts to reorganize within the timeframe dictated by their DIP financing and the constraints imposed by the Bankruptcy Code was the determination of the Debtors' potential sales tax liability to virtually hundreds of state and local tax authorities. Specifically, to the extent that any such liability was entitled to be accorded priority status under section 507(a)(8) of the Bankruptcy Code, the Debtors believed that their ability to formulate and confirm a plan of reorganization might be compromised unless they resolved with certainty their aggregate potential sales tax liability to these taxing authorities. Thus, in order to resolve these potentially significant liabilities in a timeframe that would permit and facilitate their timely emergence from chapter 11, the Debtors determined to calculate their potential sales tax liability to these many taxing authorities using the applicable voluntary disclosure agreement, or "VDA," procedures available in each jurisdiction, without regard to any defenses that the Debtors might, in fact, be able to assert in respect of such liabilities, including, in the first instance, whether the Debtors had any liability to the applicable taxing authorities, whether by reason of a lack of requisite nexus for purposes of establishing sales tax liability or otherwise. Moreover, the Debtors, after consultation with, and the consent of, the Creditors' Committee, determined that it was in the best interests of the Debtors and their estates to implement the procedures set forth in

the Sales Tax Motion and approved by this Court (the "**Sales Tax Procedures**") so as to promptly fix their sales tax liability at acceptable levels, utilizing the applicable VDA procedures, in order to permit the Debtors to move forward expeditiously with the formulation and confirmation of a plan of reorganization on the timetable dictated by their DIP financing.

3. The Sales Tax Procedures were the culmination of a good faith effort by the Debtors to resolve potential sales tax liabilities of those debtor entities identified by the Debtors as not having previously registered with certain states and localities for the purpose of collecting and remitting sales tax (the "**VDA Debtors**"). Indeed, the process of resolving these liabilities began prior to the Petition Date, when the Debtors successfully came into compliance in 22 states by registering previously unregistered entities with those states pursuant to the Streamlined Sales Tax Agreement amnesty program. The Sales Tax Motion (together with a subsequent motion directed only at cities, counties and other local governmental units) sought to resolve the Debtors' liabilities with respect to 17 states and more than 400 cities, counties, municipalities and other local taxing authorities. Of the over 400 taxing authorities that were the subject of the Sales Tax Procedures, eight states objected or otherwise reserved their rights with respect to the determination of their tax claims. The claims of all other taxing authorities subject to the Sales Tax Motion were resolved and allowed at the amounts proposed by the Debtors in the Sales Tax Motion.

4. With respect to each of the eight objecting states, the Debtors provided such taxing authorities with additional documents and information supporting the Debtors' calculations of their respective sales tax claims, and engaged in numerous telephone conferences and written exchanges of information in an effort to answer all of such taxing authorities' questions. Ultimately, six of the eight objecting taxing authorities accepted the Debtors'

calculation of prepetition liabilities (or an amount very close to it), with the only sales tax liabilities remaining being the unresolved claims of Texas and Arizona.

5. The Reorganized Debtors regret that Texas has not agreed to a determination of its sales tax claims after the Debtors voluntarily disclosed potential past sales tax liabilities of certain Debtor entities, and made significant efforts to provide Texas with relevant information, including the provision of business records requested by Texas, spreadsheets and other analytical materials developed by the Reorganized Debtors' tax advisors, participation of the company and its advisors in several conference calls with Texas, and attendance by two of the company's officers and several advisors at a face-to-face meeting in Austin, Texas. The voluntary disclosure approach proposed by the Debtors is modeled on similar "VDA" procedures offered to taxpayers by many states, including Texas, which procedures are predicated on the idea that in exchange for a taxpayer's voluntarily disclosure of potential liability for unpaid taxes, and its agreement to comply with a taxing authority's tax laws going forward, the taxing authority will limit the taxpayer's liability for past taxes to a fixed period of time and forego certain penalty and interest charges.

6. Texas apparently does not accept the voluntary disclosure approach taken by the Debtors in the Sales Tax Motion, and asserts that "the allowable amount of the Comptroller's sales tax claims in this case therefore should include the entire time period the Debtors conducted business in Texas." (Motion at ¶ 12). To the extent that Texas rejects the Debtors' offer to resolve past sales tax liabilities of the VDA Debtors through the voluntary disclosure process and on the terms proposed in the Sales Tax Motion, and instead asserts claims for sales tax beyond the scope described in the Sales Tax Motion, Texas -- like any other creditor -- must now carry the ultimate burden of proof to establish such liability, including proving that the

applicable VDA Debtor entities had the requisite "nexus" for purposes of sales tax liability in Texas.

7. In this regard, Texas has filed proofs of claim related to both prepetition taxes and administrative expense claims related to postpetition taxes. In light of Texas' unwillingness to proceed with a resolution of its sales tax claims by means of a voluntary disclosure process and on the other terms provided for under the Sales Tax Procedures, Texas' sales tax claims are now more appropriately resolved in connection with a typical claim objection pursuant to section 502(b) of the Bankruptcy Code, Bankruptcy Rule 3007 and the Court's Order Authorizing the (a) Establishment of Claims Allowance, Objection, Claims Resolution and Settlement Procedures and (b) Extension of the 503(b)(9)/Reclamation Claims Objection Deadline (Docket No. 1978) (the "**Claims Procedures Order**"). Accordingly, the Reorganized Debtors intend to file formal objections to Texas' claims, and pursuant to the Sales Tax Procedures and this Court's Local Rules, the hearing on the Motion scheduled for November 2, 2010 shall constitute a status conference to discuss an appropriate schedule for discovery, motion practice and an evidentiary hearing to determine the amount, if any, of the sales tax claims asserted by Texas in the Debtors' chapter 11 proceedings.

The Sales Tax Motion

8. As noted above, the purpose of the Sales Tax Motion was to finally resolve and liquidate the VDA Debtors' potential sales tax liabilities to 17 states and more than 400 cities, counties and other localities by granting such taxing authorities allowed priority tax claims in the Debtors' chapter 11 cases pursuant to 11 U.S.C. § 507(a)(8), in an aggregate amount of approximately $10.4 million. Of this aggregate amount, the Reorganized Debtors offered to fix the amount of potential prepetition sales tax liability owing to Texas, as set forth in the Sales Tax

Motion, at $2,079,624.86, which represented what the Debtors were then willing to allow on account of sales tax liability to Texas over a four (4) year period prior to the Petition Date.[1] This amount was calculated by taking the average monthly sales tax for Texas determined for the period February 2008 to April 2008 and multiplying such amounts over the 48 month period applicable under Texas' voluntary disclosure procedures, without regard to any defenses, such as nexus, that might otherwise be available to the Debtors. Ultimately, after engaging in what amounted to an audit, Texas has now filed the Motion asserting prepetition sales tax liability of the VDA Debtors in the aggregate amount of a minimum of $11,720,422.28

9. Moreover, although the Debtors were initially prepared to resolve the potential sales tax liability of the VDA Debtors to Texas pursuant to the Sales Tax Procedures, without regard to any defenses, such as nexus, otherwise available to the Debtors, now that Texas has rejected this approach, the determination of the Debtors' sales tax liability to Texas, and the resolution of Texas' claims in these proceedings, must proceed as any other claims to be resolved in these chapter 11 cases. To that end, Texas must now meet its burden to establish that each VDA Debtor had the requisite sales tax nexus in Texas, and must otherwise establish all other elements required to impose sales tax on the VDA Debtors for the periods in question.

Debtors' Postpetition Sales Tax Compliance

10. In addition to the prepetition sales tax liability, Texas also asserts in its Motion that it has a claim for $3,566,344.46 in postpetition sales taxes, in addition to all amounts that the Debtors paid, by agreement with Texas, on account of the VDA Debtors during the pendency of their chapter 11 cases. The Debtors believe that Texas' administrative tax claim on account of

[1] The amount of Texas' claim proposed by the Debtors was approximately twice that of the next largest claims, held by Pennsylvania and New York, both of which eventually agreed to accept the Debtors' calculation of prepetition sales tax liability.

postpetition sales taxes is substantially overstated because Texas has incorrectly calculated this amount based on the same monthly run rate used by the Debtors to calculate prepetition taxes under the Sales Tax Motion. While this approach -- utilizing the monthly run rate to calculate postpetition taxes -- was proposed in the Sales Tax Motion (and accepted by many other taxing authorities) this is not the method that the Debtors and Texas agreed would be used to calculate Texas' postpetition sales taxes. Instead, the Debtors and Texas entered into an agreed-upon stipulation, so ordered by the Court on March 26, 2009 (the "**Postpetition Tax Stipulation**"), addressing this very issue.[2]

11. Pursuant to the Postpetition Tax Stipulation, the Debtors agreed to (i) promptly pay Texas $751,235.34 on account of all postpetition sales tax owed to Texas for the period January 21, 2008 through February 28, 2009, (ii) prepare and file with Texas a sales tax return for each VDA Debtor for the period from the January 21, 2008 petition date through February 28, 2009 and (iii) file all requisite sales tax returns and remit any sales tax payable in respect thereof for the month of March 2009 by April 20, 2009, and thereafter in the ordinary course of business for the remainder of the Debtors' chapter 11 cases. The Debtors complied with the Postpetition Tax Stipulation in all respects, and, during the pendency of their chapter 11 cases, filed monthly tax returns and remitted all tax shown as due thereon to Texas on account of postpetition sales taxes for the VDA Debtors. Accordingly, Texas' statement that the Debtors remitted only $828,813.82 during the pendency of their chapter 11 cases is incorrect.

[2] Stipulation between Debtors and the Texas Comptroller of Public Accounts regarding Debtors' Postpetition Sales Tax Compliance in Connection with Motion of the Debtors pursuant to 11 U.S.C. §§ 105(a), 502 and 505 and Federal Rule of Bankruptcy Procedure 9019 to (A) Implement Procedures to Determine Prepetition and Postpetition Sales Tax Liabilities of Certain Debtors pursuant to State and Local Voluntary Disclosure Procedures and (b) Determine the Amount of Prepetition and Postpetition Sales Tax Liability of Certain Debtors (Docket No. 1571).

12. In this regard, Texas has not shown any basis for its assertion that the amounts paid by the Debtors were inappropriate or that significant interest and penalties are due on account of postpetition taxes, and Texas has not challenged any of the postpetition tax returns filed by the VDA Debtors.

Implementation of the Sales Tax Procedures

13. It is the Reorganized Debtors' understanding that, in filing the Motion, Texas' intent was to initiate the process by which the Court will ultimately determine the amount, if any, of the VDA Debtors' pre- and postpetition sales tax liability to Texas. Unfortunately, by raising questions about, among other things, the Debtors' eligibility to use voluntary disclosure procedures, the time period for which the VDA Debtors' tax liability should be determined, and the application of penalties and interest to unpaid sales taxes, Texas has clouded the questions that it would have the Court resolve, and in doing so has implicated the question of whether, in the first instance, the VDA Debtors, in fact, ever conducted activities in Texas that established a nexus that would give rise to any taxable transactions in Texas -- a question that the Debtors were previously willing to reserve on in the context of a voluntary disclosure process. Because of the substantial priority and administrative tax claims now asserted by Texas, the Reorganized Debtors have an obligation to all creditors in these cases to require Texas to establish all of the necessary predicates for its claims.

14. Accordingly, in anticipation of the November 2, 2010 status conference, the Reorganized Debtors intend to reach out to Texas to see if agreement can be reached in advance of the hearing on a proposed Stipulation and Consent Order Regarding Discovery and Scheduling.

Dated: New York, New York
October 29, 2010

Respectfully submitted,

/s/ Michael J. Canning

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