

No. 89559

In the
Supreme Court of Missouri

ICC MANAGEMENT, INC.)	On Appeal from the
)	Missouri Administrative Hearing
Appellant,)	Commission
)	
v.)	
)	
DIRECTOR OF REVENUE,)	No. 07-0355RS
STATE OF MISSOURI)	
)	
Respondent.)	Commissioner Douglas M. Ommen

REPLY BRIEF OF APPELLANT

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I. Introduction.

Based on the points raised in the Brief of Appellant ICC Management (“Appellant’s Brief”) and the Brief of Respondent Director of Revenue (“Respondent’s Brief”), this case can be boiled down to two issues:

Issue 1: Did Appellant “resell” the food, clothing and personal hygiene items (the “Inmate Consumables”) to the cities and counties with which it does business (the “Municipalities”)?; and

Issue 2: Assuming Appellant did “resell” the Inmate Consumables to the Municipalities, does the fact that the “resales” to the Municipalities were exempt from the Missouri sales and use tax preclude Appellant from relying on the “resale” exclusion/exemption with respect to its purchases of the Inmate Consumables?

Regarding Issue 1, even though the Administrative Hearing Commission (the “Commission”) found specifically that Appellant did “resell” the Inmate Consumables to the Municipalities, Respondent now takes the position that because the transfer of the Inmate Consumables to the Municipalities occurred in connection with the detention services provided by Appellant, the transfer of the Inmate Consumables could not qualify as a “resale.” Respondent’s Brief at pp. 10, 13. Regarding Issue 2, Respondent disregards the plain language of his own regulation (*Reg. 12 C.S.R. 10-112.300(3)(B)*) and takes the position that a retailer’s purchase of an item of property cannot qualify for the “resale” exclusion/exemption if the retailer’s subsequent “resale” transaction is to an exempt entity, such as the government. Respondent’s Brief at p. 16. As discussed in

more detail below, Respondent's positions are not supported by Missouri law and also jeopardize the policy behind the Missouri statutes that allow governmental and other exempt entities to purchase items of property without paying Missouri sales and use tax. For these reasons, this Court should reject Respondent's positions and reverse the Commission's decision.

II. Appellant Did "Resell" the Inmate Consumables to the Municipalities.

A. The Commission found that Appellant "resold" the Inmate Consumables.

Appellant and Respondent agree, of course, that in order for a taxpayer/purchaser to qualify its purchases of property under either (a) the resale exclusion/exemption under the sales and use tax laws (RSMo § 144.010.1(10); RSMo § 144.615(6)) or (b) the ingredient or component part exemption (RSMo § 144.030.2(2); RSMo § 144.615(3)), the taxpayer/purchaser must "resell" the property to another party. (For example, the taxpayer's purchase will not qualify for the resale exclusion/exemption if the taxpayer consumes the purchased item itself rather than selling the item to a subsequent buyer.)

On this point, the Commission found, without reservation, that Appellant "resold" the Inmate Consumables to the Municipalities. As stated by the Commission in its decision:

[Appellant] purchased the food, clothing and consumable items from its vendors, and then transferred title or ownership, or the right to use, store or consume the property, for a consideration. The fact that inmates actually consumed

most of the items and were not the party that paid the consideration does not defeat the resale claim. The definition of “sale at retail” requires the “transfer . . . to the purchaser, for use or consumption.” Each element of a sale is met . . .

Commission’s Decision of August 4, 2008 (“Decision”) at p. 8 [R-30] (emphasis added). Despite this finding, however, Respondent now contends that Appellant did not “resell” the Inmate Consumables. According to Respondent, “there is no resale because there is no transfer of tangible personal property, but of non-taxable detention services,” and “there is no sale of [the Inmate Consumables] because they are part of a non-taxable service, the detention services, that [Appellant] provides municipalities.” Respondent’s Brief at pp. 10, 13.

Respondent’s argument misses the point, for at least two reasons. First, Respondent ignores the Commission’s factual findings in the case. The Commission found specifically that Appellant’s contracts with the Municipalities not only required Appellant to provide detention services but also required Appellant to supply food and the other Inmate Consumables:

ICC contracts with certain municipalities and counties . . . to provide jail services. . . . Pursuant to the contracts, ICC provides three meals per day, as well as clothing and consumable items such as soap, shampoo, and medical supplies, to the inmates.

Decision at p. 2 [R-24]. Second, Respondent’s argument is inconsistent with

Respondent's own "Statement of Facts," in which Respondent states that Appellant provided "detention" services but also the Inmate Consumables. Specifically, Respondent states: "ICC contracts with Missouri municipalities and one county in Kansas to provide for them . . . detention, transportation, food, clothing, medical services, shelter" Respondent's Brief at p. 5 (emphasis added). Based on Respondent's own statements – and based on the Commission's findings -- Appellant did "resell" the Inmate Consumables to the Municipalities.

B. The fact that Appellant also provided a detention service does not negate the fact that Appellant "resold" the Inmate Consumables.

Although Respondent's argument on this point is not entirely clear, it appears that Respondent may also be taking the position that Appellant cannot be treated as having "resold" the Inmate Consumables, due to the fact that Appellant also provided a non-taxable service to the Municipalities. *See* Respondent's Brief at p. 13. If this is, in fact, Respondent's argument, there is no support under the Missouri sales tax laws for this position.

It is true that the Appellant, in addition to transferring/selling the Inmate Consumables to the Municipalities, does provide services to the Municipalities (i.e., the detention of inmates). Nonetheless, Respondent has not cited even one case in which a Missouri court has held that the transfer of tangible personal property should be disregarded – and not treated as a sale (in this case, a "resale") -- merely because the overall transaction between the seller and the buyer also involves a service element. In

fact, to the contrary, the Missouri Supreme Court “has repeatedly held that Missouri’s sales tax scheme does not contain a de minimis exemption for sales of tangible personal property where services dominate and [tangible] components constitute only a small percentage of the total sales price.” *See Sneary v. Director of Revenue*, 865 S.W. 2d 342, 347-48 (Mo. banc 1993). *See also Kilbane v. Director of Revenue*, 544 S.W. 2d 9, 12 (Mo. banc 1976) (“We find nothing in the Sales Tax Act which indicates that whether sales taxes is due depends on the respective percentages of labor and materials in the product sold.”)

There are numerous cases – and even regulations and letter rulings issued by Respondent himself-- in which the transfer of tangible personal property was treated as a “resale” even though the transfer of the property occurred in a transaction that also involved a service element. *See, e.g., Dean Machinery Co. v. Director of Revenue*, 918 S.W. 2d 244 (Mo. banc 1996) (the taxpayer transferred certain repair parts to its customers in connection with repair work that the taxpayer performed on equipment owned by its customers; the court held that there was a “resale” of the repair parts, even though (a) the repair parts were only part of the larger repair service transaction and (b) the taxpayer did not charge a separate fee for the repair work or the repair parts, due to the fact that the cost of the repair work and the repair parts had been factored into prior sale and service transactions with the taxpayer’s customers); *Mar D.’s Management Services, Inc. v. Director of Revenue*, Missouri Administrative Hearing Commission, No. 98-2205RV (September 27, 1999) (App. A1-A8) (the taxpayer, a catering company, charged a lump sum fee for facility rental, set-up service, clean-up service and food; the

entire charge was taxable even though the food element of the transaction was only a part of a larger transaction that also involved services). *See also* 12 C.S.R. 10-103.600(4)(J) (an auto mechanic performs a brake repair service and charges the customer \$110 total for the job, of which \$60 is for the brake parts and \$50 is for labor; regardless of whether the mechanic itemizes the bill for \$60 parts and \$50 labor, or simply presents a total lump sum bill of \$110, the auto mechanic is treated as reselling the brake parts to his/her customers, even though there is also a service element of the transaction); Letter Ruling No. LR2413 (May 20, 2005) (App. A16-A18) (transfer or lease of tangible security equipment was a resale even though coupled with the provision of security monitoring services, and even though the charge for the equipment was not separately stated on the bill); Letter Ruling No. LR3054 (May 26, 2006) (App. A14-A15) (the taxpayer provided the service of refilling printer cartridges with ink; Respondent ruled that there was a resale of the ink, even if the charge for the ink was not separately stated on the bill).

The Director's position is similar to arguing that a restaurant or caterer cannot purchase food items under a "resale" exclusion/exemption because it uses or consumes such items in its "service" of providing meals, rather than "reselling" such items to customers of the restaurant or catering business. This argument, of course, is not persuasive because, under long-standing Missouri law, it is clear that a restaurant or catering business is, in fact, entitled to claim a "resale" exclusion/exemption with respect to its purchases of food items, due to the fact that the restaurant or catering business does, in fact, "resell" such items to its customers. *See A1-Tom Investment, Inc. v. Director of Revenue*, 774 S.W.2d 131 (Mo. 1989); *Souffle, Inc. v. Director of Revenue*, Missouri

Administrative Hearing Commission, No. 92-001068RV (June 7, 1993) (App. A9-A13). Thus, just as a restaurant or catering business “resells” food items to its customers, Appellant in this case “resells” the Inmate Consumables to the Municipalities.

III. The Fact That Appellant’s “Resales” to the Municipalities Were Exempt From the Missouri Sales and Use Tax Does Not Preclude Appellant From Relying on the “Resale” Exclusion/Exemption With Respect to Its Purchases of the Inmate Consumables.

This Court has stated that in order for a “resale” to exist (which would allow the taxpayer to qualify for the “resale” exclusion/exemption), the following three elements must exist with respect to the taxpayer’s purported “resale” transaction: (1) a transfer, barter or exchange, (2) of the title or ownership of tangible personal property or the right to use, store or consume the same, (3) for a consideration paid or to be paid. *Aladdin’s Castle, Inc. v. Director of Revenue*, 916 S.W. 2d 196, 197-98 (Mo. banc 1996). There is no dispute in this case that Appellant’s transfers of the Inmate Consumables to the Municipalities satisfied this three-part “resale” test. In fact, the Commission agreed, stating as follows:

[Appellant] purchased the food, clothing and consumable items from its vendors, and then transferred title or ownership, or the right to use, store or consume the property, for a consideration.

Decision at p. 8 [R-30].

Nonetheless, despite the fact that Appellant met the *Aladdin's Castle* “resale” test, Respondent now argues, and the Commission held, that *Westwood Country Club v. Director of Revenue*, 6 S.W. 3d 885 (Mo. banc 1999) added a fourth part to the “resale” test, and that this fourth part requires the taxpayer to “resell” the property in a taxable transaction. *Westwood* did establish a new fourth part for the *Aladdin's Castle* “resale” test, but, even under *Westwood*, a taxable “resale” is not required.

In *Westwood*, the taxpayer was a private country club. The taxpayer purchased food items from its vendors but did not transfer these items in a subsequent “sale at retail.” Instead, the taxpayer simply served the food to its club members. Taking into account these facts, the Court held that purchases by a taxpayer do not qualify for the “resale” exclusion/exemption unless the taxpayer subsequently resells the purchased items in a “sale at retail.” This holding, in essence, added a new fourth part to the *Aladdin's Castle* “resale” test (i.e., the subsequent transfer by the taxpayer must be a “sale at retail”). The taxpayer/club in *Westwood* did not sell the food items at “retail,” but rather simply served the food items to its members. Thus, the taxpayer’s purchases did not qualify for the “resale” exclusion.

It is critical to note that -- in deciding *Westwood* -- this Court did not hold that the taxpayer’s subsequent “resale” transaction must be a taxable “sale at retail.” In fact, as noted in Appellant’s Brief (at pp. 9-11), the Court, in *Westwood*, cited *McDonnell Douglas Corporation v. Director of Revenue*, 945 S.W. 2d 437 (Mo. banc 1997) with approval and stated simply that *Westwood* was “not governed by *McDonnell Douglas*.” This is significant because the ultimate “resale” transaction with the federal government

in *McDonnell Douglas*, although constituting a “sale at retail,” was not a taxable transaction. Yet, even in the absence of a taxable “sale at retail,” the court held that the taxpayer’s purchases in *McDonnell Douglas* qualified for the “resale” exemption/exclusion. In short, applying both *Westwood* and *McDonnell Douglas*, there is a fourth part to the *Aladdin’s Castle* “resale” test, but that fourth part requires only a subsequent “sale at retail” by the taxpayer, not a subsequent taxable “sale at retail.”

The relevant facts in the present case are identical to the facts in *McDonnell Douglas*. The Commission found specifically (a) that Appellant “resold” the Inmate Consumables to the Municipalities in “sales at retail” (a fact that did not exist in *Westwood*) and (b) that these “resales” were not subject to tax due to the exemption provided under Article III, Section 39(10) of the Missouri Constitution. Decision at pp. 8, 10 [R-30; R-32]. Thus, like the taxpayer’s purchases in *McDonnell Douglas*, Appellant’s purchases of the Inmate Consumables also qualified for the “resale” exclusion/exemption.

Even though the facts in *McDonnell Douglas* and the present case are nearly identical, Respondent argues that *McDonnell Douglas* does not support Appellant’s position. According to Respondent, *McDonnell Douglas* “is limited to the unique area of federal contracting, where by operation of federal law, title to tangible personal property purchased by federal contractors for use in performance of their contracts . . . vests in the government even before property is used or consumed in performance.” Respondent’s Brief at pp. 13-14. The contract between the federal government and the taxpayer in *McDonnell Douglas* did involve the federal contracting regulations, but that was an

important issue in that case only because the taxpayer had purchased certain “overhead materials and supplies” under a resale exemption certificate and then had used and consumed those overhead items—itself--in performing its contract with the federal government. The Court noted that in order to qualify its purchases under the “resale” exclusion/exemption, the taxpayer was required to show that it either (a) transferred “title or ownership of tangible personal property” or (b) transferred “the right to use, store or consume the same” to its customer. 945 S.W. 2d at 440. (This is simply a restatement of the second part of the *Aladdin’s Castle* “resale” test.) In *McDonnell Douglas*, it was clear that the taxpayer was not transferring the “right to use, store or consume the same” because the taxpayer—itself--consumed the “overhead materials and supplies.” 945 S.W. 2d at 440. Thus, in order to qualify its purchases under the second part of the *Aladdin’s Castle* “resale” test, the taxpayer had to show that it transferred “title” of the purchased items to the government. The taxpayer met this requirement by citing a provision in the federal government contract regulations which specified that title to all property purchased by the taxpayer would vest immediately in the government. That particular aspect of the *McDonnell Douglas* case is irrelevant in the present case because, in this case, Appellant does not need to show that it transferred “title” to the Municipalities. Appellant, of course, transferred “the right to use, store or consume” the Inmate Consumables to the Municipalities, as found by the Commission. Decision at p. 8 [R-30]. Thus, although the federal contracting issue was important in *McDonnell Douglas*, it is not a factor in this case.

IV. Affirming the Commission’s Decision Would Be Inconsistent With Standard Industry Practice in Missouri and Would Frustrate the Policy of Allowing Governmental and Other Exempt Entities to Purchase Property Exempt From the Missouri Sales and Use Tax.

In the proceedings below, the Commission held—in essence—that that a Missouri retailer may not purchase property from its suppliers under a valid “resale” exclusion/exemption unless the retailer subsequently sells such property in a taxable “sale at retail.” This result, if affirmed by the Court, would be entirely inconsistent with long-standing industry practice. Under standard industry practice, a retailer purchases all of its inventory under a resale exclusion/exemption certificate. In so doing, the retailer does not differentiate between property that might, or might not, be resold to a governmental or other exempt entity at a later date. If the Court were to affirm the Commission’s decision, every Missouri retailer would be required to (A) track whether particular inventory items are later “resold” to governmental or other entities in transactions that are exempt from the Missouri sales tax, (B) review its initial purchases from its suppliers and determine the amount of Missouri sales/use tax that would have been collected by the suppliers but for the “resale” exclusion/exemption claimed by the retailer, and (C) self-assess, and pay to Respondent, an amount of additional sales tax equal to the amount of sales/use tax that, because of the claimed “resale” exclusion/exemption, was not paid at

the time of the purchases from the suppliers.¹ It is extremely doubtful that this is a desired result, and it is certainly not consistent with current industry practice.

Finally, it is clear that when the Missouri legislature enacted the sales and use tax exemptions for purchases by governmental and other exempt entities (*see, e.g.*, Section 144.030.1, and Article III, Section 39(10) of the Missouri Constitution), it intended to allow such exempt entities to make their purchases free of Missouri sales and use tax throughout the entire stream of commerce, thereby reducing the overall financial burden on the exempt entities. The concurring/dissenting opinion in *Westwood* described the rationale behind these tax exemptions:

[T]he legislature has often seen fit to exempt certain kinds of transactions, or certain kinds of products, from sales tax throughout the entire stream of commerce. For example, in *McDonnell Douglas Corp. v. Director of Revenue*, 945 S.W. 2d 437 (Mo. banc 1997), the sale for resale exclusion applied on McDonnell Douglas' purchases of certain materials even though the resale of those materials was to an exempt entity –

¹ Under R.S. Mo. § 144.210.1, if (1) a retailer purchases property from a supplier and gives a resale certificate, (2) the supplier accepts the resale certificate and does not charge Missouri sales/use tax, and (3) it is later determined that the “resale” exclusion/exemption did not apply, the retailer is required to self-assess (and pay) Missouri sales tax with respect to such purchases.

the federal government – so that no tax was imposed on either of the transactions. In fact, Section 144.030.2 sets out 36 categories of exemptions for transactions and products that similarly will avoid taxation throughout the entire stream of commerce. In each instance, sales tax is avoided by application of the sale for resale exclusion in tandem with a resale that is exempt from tax. 6 S.W.3d at 890.

This public policy would be impaired if businesses—such as Appellant, and all other retailers operating in Missouri--were required to pay Missouri sales/use tax with respect to all items purchased by them for resale to governmental and other exempt entities. Undoubtedly, if the retailers were required to pay Missouri sales/use tax with respect to their purchases, they would attempt to recoup all or a portion of these additional inventory costs by passing the costs along to the governmental/exempt entities in the form of price increases. This would increase the financial burden for the governmental/exempt entities, thereby frustrating the policy behind the enactment of the exemption provisions in the first instance.

For the foregoing reasons, the Commission's decision is unauthorized by law and should be reversed.

Respectfully submitted,

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RULE 84.06(c) CERTIFICATION

I hereby certify that this brief (a) contains the information required by Rule 55.03 of the Missouri Rules of Civil Procedure and (b) complies with the limitations of Rule 84.06(b) of the Missouri Rules of Civil Procedure. This brief was prepared in Microsoft Word 2003 and contains 3,255 words, excluding those portions of the brief listed in Rule 84.06(b) of the Missouri Rules of Civil Procedure. The font is Times New Roman, proportional spacing, 13-point type. A 3 ½ inch computer diskette (which has been scanned for viruses and is virus free) containing the full text of this brief has been served on each party separately represented by counsel and is filed herewith with the clerk.

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CERTIFICATE OF SERVICE

I hereby certify a copy of the foregoing was sent via First Class Mail, postage pre-paid, this 4th day of March, 2009, addressed to the following:

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APPENDIX

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