

SC87192

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IN THE SUPREME COURT OF MISSOURI

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KIDDE AMERICA, INC. *et al.*,

Petitioners/Appellants

v.

DIRECTOR OF REVENUE,

Respondent

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On Petition for Review from the Administrative Hearing Commission

Karen A. Winn, Commissioner

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PETITIONERS' OPENING BRIEF

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## *JURISDICTIONAL STATEMENT*

Kidde America, Inc. (“Kidde”) was part of the Kidde Group, which consisted of Kidde and its 37 direct or indirect subsidiaries. L.F. 2. The Kidde Group filed a consolidated federal corporate income tax return for the tax year 2000. L.F. 2, 3. Masterchem Industries, Inc. was one of Kidde America, Inc. indirect subsidiaries. The Kidde Group sold Masterchem in 2000. L.F. 2. On September 28, 2001, Masterchem timely filed a separate Missouri corporate income tax return for the tax year 2000, reporting the gain from the sale. L.F. 3.

On March 12, 2004, within Missouri’s applicable statute of limitations, Kidde filed an amended Missouri corporate income tax return for the tax year 2000 on behalf of the Kidde Group, in which it made an election to file a Missouri consolidated corporate income tax return. L.F. 4. The Kidde Group claimed a refund of \$5,792,993 (after adjustments for a subsequent federal audit). L.F. 5.

The Director of Revenue denied the Kidde Group’s refund request on the grounds that an election to file a Missouri consolidated corporate income tax return must be made by the due date or extended due date of the original return, and cannot be made through the filing of an amended return within the applicable statute of limitations. L.F. 15-20. The Kidde Group appealed to the Administrative Hearing Commission, and on September 22, 2005, the Commission upheld the Director’s decision. L.F. 156-173.

The resolution of this Petition for Review requires the construction of the revenue laws of this State, in particular, §§ 143.431.3(1), 143.801.1 and 143.961.2 RSMo 2000.

Accordingly, the jurisdiction of this Court is invoked under Article V, Section 3 of the Missouri Constitution and § 621.189 RSMo 2000.

*STATEMENT OF FACTS*

A.

Kidde America, Inc. is the parent corporation of the Kidde Group, an affiliated group of corporations that included Masterchem Industries, Inc., a manufacturer of various specialty paint products headquartered in Missouri. L.F. 2, 10-14. (All of the companies within the group are petitioners, and they are listed in Exhibit 1 to the Petition for Review). L.F. 24.

On May 8, 2000, the Kidde Group sold Masterchem to Masco, Inc. L.F. 2. The parties made a timely election to treat the stock sale as if it were an asset sale for federal income tax purposes pursuant to § 338(h)(10) of the Internal Revenue Code of 1986, as amended. L.F. 2-3. Accordingly, for federal income tax purposes, Masterchem's deemed sale of its assets to Masco resulted in a net gain to Masterchem of \$215,307,906. L.F. 3. The gain was timely reported on the Kidde Group's 2000 consolidated federal corporate income tax return. L.F. 3. Through its consolidated election and the agreement under which Masterchem's stock was sold, Kidde was required to pay Masterchem's taxes. L.F. 3. Therefore, Kidde stepped into Masterchem's shoes as the party in interest with respect to Masterchem's tax return for reporting this transaction. L.F. 3.

Masterchem made separate Missouri estimated tax payments for the 2000 tax year of \$196,000 on April 15, 2000, \$148,000 on June 15, 2000 and \$9,760,000 on September 15, 2000. Exs. A-3, A-4, A-5, L.F. 79-84. The due date of Masterchem's Missouri

corporate income tax return for the 2000 tax year was April 15, 2001. On March 21, 2001 Masterchem filed a request for an extension of time to file its separate Missouri corporate income tax return, which was granted. Ex. A-1, L.F. 58. Masterchem timely filed a separate Missouri corporate income tax return for the 2000 tax year on October 15, 2001, reporting total estimated tax payments (plus credited overpayments from the prior year) of \$10,156,268. Ex. A-2, L.F. 59-78.

Masterchem reported Missouri taxable income of \$196,511,354 for the 2000 tax year. L.F. 59. Because Masterchem's federal income was reported in the Kidde Group's federal consolidated corporate income tax return, Masterchem did not file a separate federal income tax return for that year. L.F. 4. Masterchem's income was reported to Missouri as \$218,126,060 of federal taxable income on a "pro-forma" federal schedule as required by Missouri law. L.F. 4. Masterchem elected to apportion its income to Missouri based on Missouri's single factor apportionment method, which resulted in a Missouri apportionment factor of 51.520% and taxable income apportioned to Missouri of \$101,242,650. L.F. 4.

The Department accepted this return as timely filed and applied \$6,327,666 of Masterchem's payments to its Missouri corporate income tax liability. L.F. 56. Masterchem received a refund of the remaining \$3,828,602. L.F. 56, 85.

*B.*

Until mid-2001, Kidde did not maintain an in-house federal, state and local tax reporting and compliance function in the United States. Kidde outsourced virtually this entire function to its auditor, the certified public accounting firm of

PricewaterhouseCoopers (“PwC”). L.F. 134. PwC prepared the federal and state income tax returns for Kidde and all of its 37 subsidiaries for the 2000 tax year in its Boston office, where the entire multistate compliance effort was managed by a single individual. L.F. 135. This involved PwC’s preparing more than 200 returns for 18 states that were due over an approximate 30-day period. L.F. 134-135. PwC delivered the prepared returns to John Hannon, Kidde’s Corporate Chief Financial Officer, for signature and filing. L.F. 134-135.

Hannon’s primary responsibilities were to carry out the treasury function for Kidde and its United States subsidiaries, and to perform the legal actions that were required of the company’s corporate officers. L.F. 135. One of those responsibilities was to sign the tax returns. L.F. 135. Hannon did not have an extensive background in the preparation of federal and state income tax returns. L.F. 135. He reviewed the returns for the accuracy of the financial data they contained, but fully relied on the expertise of PwC to prepare the returns in the most advantageous manner, given the technical tax law considerations involving the 18 state jurisdictions in which Kidde’s 37 subsidiary entities filed state income tax returns. L.F. 135.

In the event that alternatives existed which significantly impacted the preparation of a state income tax return, Hannon fully relied on PwC to explain to him the alternatives so that he would be able to choose the most advantageous ones for each of the subsidiaries’ returns. L.F. 135. PwC never suggested to Hannon that Kidde should file a consolidated Missouri corporate income tax return for the tax year 2000. L.F. 135. PwC performed no calculations prior to preparing the Masterchem separate Missouri corporate income tax

return to compare the relative Missouri tax liability of a Masterchem separate return versus a Kidde Group consolidated return. L.F. 135.

PwC was given full access to all of the information, books and records of Kidde and its 37 subsidiaries for the purpose of preparing the Kidde Group's federal and state income tax returns for those entities for the 2000 tax year. L.F. 135. PwC prepared and was fully aware of Kidde's 2000 federal consolidated income tax return. L.F. 136. PwC did not advise Kidde or its subsidiaries' employees of the company's eligibility to make an election to file a Missouri consolidated corporate income tax return for its 2000 tax year. L.F. 136. PwC did not advise Kidde or its subsidiaries' employees of the company's option to file a Missouri consolidated corporate income tax return, or of the tax consequences of the Kidde Group's failure to exercise this option. L.F. 136.

### C.

In mid-2001, Kidde began to hire a staff of employees to carry out the tax reporting compliance function internally for Kidde and its subsidiaries. L.F. 136. Initially these employees were responsible for transitioning that function away from PwC. L.F. 136. Throughout the course of this transition, and thereafter, Kidde's new in-house staff reviewed the Kidde Group's previously filed returns. L.F. 136. This was necessary in order for the new employees to understand the overall tax position of the company and each of its subsidiaries so that future filings would be made in the most advantageous manner, and to identify possible errors or omissions on the previously filed returns which could be corrected within the applicable statutes of limitation. L.F. 136.

During this transition period, the Internal Revenue Service began an audit of the Kidde Group's federal consolidated corporate income tax returns for the 1998 through 2000 tax years and communicated its intention to Kidde to make adjustments. L.F. 136. These "federal changes" were required to be reported to the states on amended returns for each of the affected entities during the applicable periods, necessitating the preparation of approximately 75 amended returns in addition to the normal tax reporting requirements carried out by Kidde's in-house tax staff. L.F. 136-137. Kidde retained a third party firm, Grant McCarthy Gagnon, LLC ("GMG") to prepare the 75 federal change returns. L.F. 137.

In order to prepare the 75 federal change returns, GMG had to review all of the relevant originally filed returns for the affected entities because the original returns reported the state taxable income that had to be adjusted for the final adjustments agreed to as a result of the federal audit. L.F. 137. This also afforded Kidde and its subsidiaries an efficient means to correct any other errors or omissions in situations where an amended state income tax return had to be prepared anyway to report one or more federal changes. L.F. 137.

In the course of its review, GMG noted that Masterchem had filed a separate Missouri corporate income tax return when it appeared that a Missouri consolidated income tax return filed by the Kidde Group, including Masterchem, would have resulted in a substantially lower Missouri income tax liability. L.F. 137. Upon further review, Kidde determined that there was no known reason to justify why PwC had not recommended originally that the Kidde Group file a consolidated Missouri corporate income tax return.

Kidde's in-house tax staff directed GMG to prepare an appropriate amended return to make the consolidated return election for the Kidde Group's 2000 tax year before Missouri's statute of limitations for requesting a refund of overpaid taxes expired. L.F. 137. Thereafter, Kidde filed an amended Missouri consolidated corporate income tax return on March 12, 2004, thereby making the election to file a Missouri corporate income tax return on a consolidated basis prior to the expiration of the three year statute of limitations. L.F. 137; Ex. A-7, L.F. 87-114.

As a result of the amended Missouri corporate income tax return for the 2000 tax year, the Kidde Group's tax liability reported was reduced by \$5,798,219. L.F. 137-138. Due to the federal audit of the company's 2000 federal consolidated corporate income tax return, the Kidde Group reduced their Missouri refund claim to \$5,792,993. L.F. 138.

The Director denied the Kidde Group's claim for refund because she claimed that the return making the election "must be filed before the extended due date of the federal consolidated income tax return," or by October 15, 2001. Ex. A-8; L.F. 115. Kidde timely protested the Director's denial. L.F. 23-32. The Director issued her Final Decision upholding the denial on December 23, 2004. L.F. 15-20.

The Kidde Group filed its complaint with the Missouri Administrative Hearing Commission seeking reversal of the Director's Final Decision on January 21, 2005. L.F. 1-39. The Director filed a motion for summary determination, which the Commission granted on September 22, 2005. L.F. 156-173. The Kidde Group filed its Petition for Review in this Court on October 20, 2005.

*POINTS RELIED ON*

I.

*The Administrative Hearing Commission Erred In Ruling That The Kidde Group's Election To File A Missouri Consolidated Corporate Income Tax Return For The 2000 Tax Year Was Untimely Because the Kidde Group Could File Their Election At Any Time Before The Statute Of Limitations Expired In That §143.431.3 Establishes No Time Limit For Making An Election To File A Missouri Consolidated Corporate Income Tax Return.*

*Murphy Company Mechanical Contractors & Engineers v. Director of Revenue, 156 S.W.3d 339 (Mo. banc 2005)*

*Felt Process Co. v. State Tax Commission, 339 Mass. 651, 162 N.E.2d 76 (1959)*

§ 143.431.3(1) RSMo 2000

§ 143.461.1 RSMo 2000

## II.

*The Administrative Hearing Commission Erred In Holding That Kidde Should Not Be Allowed To Make An Election To File A Missouri Consolidated Corporate Tax Return After The Extended Due Date Of The Original Return Because § 143.961.2 RSMo 2000 Requires The Director To Follow As Nearly As Practicable The Federal Regulations And Kidde Qualified Under Federal Regulations For Relief From The Filing Deadline In That It Acted Reasonably And In Good Faith In Relying Upon PricewaterhouseCoopers, A Qualified Tax Professional That Failed To Advise Kidde Of Its Option To Elect To File A Consolidated Missouri Return.*

*Suburban Newspapers of Greater St. Louis, Inc. v. Director of Revenue*, 975 S.W.2d 107 (Mo. banc 1998)

§ 143.961.2 RSMo 2000

26 C.F.R. § 301.9100-3

§ 143.801.1 RSMo 2000

## ARGUMENT

### *Standard of Review*

The Court reviews the Commission's interpretation of the revenue laws *de novo*. *Six Flags Theme Parks, Inc. v. Director of Revenue*, \_\_\_ S.W.3d \_\_\_, 2005 WL 3111974 (Mo. banc, Nov. 22, 2005) at \*1. A decision granting a motion for summary determination in an administrative proceeding before the Commission is the equivalent of the granting of summary judgment. 1 CSR § 15-3.440(3)B.3.A. *See also Johnson v. Missouri Board of Nursing Administrators*, 130 S.W.3d 619, 626 (Mo. App., W.D. 2004) (construing a predecessor regulation on summary determination as requiring review under the summary judgment standard). Therefore, the Court reviews the Commission's decision *de novo*. *See id.* at 626-627.

## I.

*The Administrative Hearing Commission Erred In Ruling That Kidde's Election To File A Missouri Consolidated Corporate Income Tax Return For The 2000 Tax Year Was Untimely Because Kidde Could File Its Election At Any Time Before The Statute Of Limitations Expired In That §143.431.3 Establishes No Time Limit For Making The Election To File A Consolidated Corporate Income Tax Return.*

### A. Introduction

The Administrative Hearing Commission denied the Kidde Group's request for a refund because the Kidde Group did not make their election to file a Missouri consolidated corporate income tax return on or before the due date of the separate return required of the subsidiary with Missouri income. But the statute governing the right to make a Missouri consolidated return election has only one requirement — that the affiliated group of corporations file a federal consolidated corporate income tax return for the tax year of the election — a requirement the Kidde Group unquestionably met.

The Missouri statute does not prescribe a due date for making an election to file a consolidated return. A due date is decreed only by the Director's regulations. The Commission concluded that the Director had the authority to issue regulations establishing such a due date based upon her general power to promulgate regulations necessary to enforce Missouri's income tax laws.

The Director's regulations, however, must be consistent with Missouri's income tax laws. The effect of the Director's establishing a regulatory due date for making a consolidated return election is to cut off a taxpayer's right to seek a refund that the Kidde

Group is otherwise clearly entitled to pursue under Missouri law. Although the Commission held that the Director's regulatory due date had no effect on refund claims, its conclusion ignored the practical effect of this ruling. Under Missouri law, a taxpayer can seek a refund of an overpayment of income taxes within the later of three years after the return is filed or two years after such taxes were paid. The Director maintains that an affiliated group cannot make the election by filing an amended consolidated corporate income tax return after the original due date plus extensions. Accordingly, the actual, real-world effect of the Director's regulation is to *terminate* the Kidde Group's right to seek a refund of overpaid income taxes at the same moment that the controlling Missouri statute says the right to seek a refund *begins* — when the original return is filed.

The imposition of a regulatory due date for an income tax election is inconsistent with Missouri's income tax statutes and the Court's interpretation of them. Such due dates are always found in the statutes, and if there is no due date for the election, the taxpayer has until the expiration of the applicable statute of limitations to make such election. If Missouri's legislature had intended to impose a specific deadline for an otherwise qualifying affiliated group of corporations to make a consolidated return election, it would have specifically enacted such a requirement in the law as it has done in connection with other elections under the tax laws.

The Director's attempt to impose a substantive legal requirement for the making of a Missouri consolidated return election by regulatory fiat is invalid. Kidde's election was timely, and the Commission's decision should be reversed.

B. *The Only Statutory Requirement For An Election Is That The Affiliated Group File A Consolidated Federal Return*

There is only one statutory requirement that must be met in order to elect to file a consolidated Missouri corporate income tax return. Section 143.431.3(1) RSMo 2000 provides: “If an affiliated group of corporations files a consolidated income tax return for the taxable year for federal income tax purposes . . . then it may elect to file a Missouri consolidated income tax return. The federal consolidated taxable income of the electing affiliated group for the taxable year shall be its federal taxable income.” App. A19.

Prior to 1998, the statute also required that the affiliated group had to have 50% or more of Missouri-sourced income in order to be permitted to file a consolidated income tax return. But the Court in *General Motors Corp. v. Director of Revenue*, 981 S.W.2d 561 (Mo. banc 1998) held that the second statutory requirement violated the Commerce Clause of the United States Constitution. In *Eddie Bauer, Inc. v. Director of Revenue*, 70 S.W.3d 434 (Mo. banc 2002) the Court said: “As a result of this Court’s severance of the offending provision [of § 143.431.3(1)], *the only requirement for electing a consolidated return is that the taxpayer’s affiliated group file a federal consolidated return.*” *Id.* at 436. (Emphasis added.) The Kidde Group filed a federal consolidated return, and thus met Missouri’s only *statutory* requirement for making an election to file a consolidated return.

The General Assembly knows how to set a deadline for making elections with respect to the filing of income tax returns. For example, § 143.461.1, which governs the election of an apportionment factor for the division of interstate income for income tax

purposes, provides: “A corporation shall elect to determine income applicable to this state . . . by filing written notice with the director of revenue on or before the due date of the return (including extensions of time) of the taxpayer’s election.” App. A20.<sup>1</sup> A similar statutory requirement for making the election to file a consolidated income tax return is conspicuous by its absence.

The Court recently dealt with a similar situation where the Director attempted to impose a non-statutory substantive requirement on a taxpayer seeking a sales and use tax exemption. In *Murphy Company Mechanical Contractors & Engineers v. Director of Revenue*, 156 S.W.3d 339 (Mo. banc 2005), a “design/build” company that combined its engineering services with construction services sought a sales and use tax exemption for its purchase of new computers under § 144.030(28). That subsection exempted such items bought by “engineering firms.” The Director argued that the taxpayer was not an “engineering firm” because the company’s revenues were not “primarily” derived from engineering services, *i.e.*, less than half came from that aspect of the business.

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<sup>1</sup> Other examples of the legislature establishing statutory deadlines for making elections under Missouri’s income tax laws include § 143.009 (allowing taxpayers with certain fiscal periods to elect to have income tax law apply to 1972 income if it files an election to that effect on or before the due date of its return) and § 143.471.6 (allowing non-resident shareholders of Subchapter S corporations to file an agreement to file a return and pay Missouri income tax on the corporate income if the agreement is filed at or before the time the corporate return is required to be filed).

The Court noted that another subsection of the statute — § 144.030(26) — expressly limited specific exemptions to companies that “primarily” provided certain services, but the subsection for engineering firms had no such limitation. The Court concluded that the statute’s absence of a restriction to firms “primarily” engaged in engineering meant that the legislature did not intend to limit the exemption to such firms. *See id.* at 341

Similarly here, the lack of a specific, legislatively mandated “drop dead” date for exercising the election to file a consolidated return, coupled with the existence of election deadlines in other Missouri income tax statutes, is powerful evidence that Missouri’s General Assembly did not intend to impose any such deadline.

As the Court said in *Eddie Bauer*, there is only one statutory requirement that an affiliated group of corporations must meet to make an election to file a consolidated return. The group must file a federal consolidated corporate income tax return. *See id.* at 436. There is no time limit in the statute, and no basis for imposing one other than the expiration of the statute of limitations for the tax year in question. Kidde met the statutory requirements for making the election under § 143.431.3(1).

C. *The Director Lacked The Power To Issue A Regulation Requiring*

*Taxpayers To Make An Election By A Specific Date When The Statute Does*

*Not Prescribe Such A Date.*

The Director (and the Commission) relied on a regulation — not a statute — to hold that a consolidated return election made on an amended Missouri consolidated corporate income tax return filed after the due date or extended due date of the original separate return was untimely. The regulation, 12 CSR § 10-2.045(15) (2000), provided: “If an

affiliated group qualified to file a Missouri consolidated return wishes to elect to file a Missouri consolidated return, the election must be exercised by the filing of a Missouri consolidated return on or before the due date (including extensions of time) for the filing of the common parent's separate Missouri return." App. A23.<sup>2</sup>

Nothing in §143.431.3 requires that this election be made by a particular date. The consolidated return provisions of Chapter 143 do not establish a "drop dead" date for making the election, after which the right to file a consolidated return for that tax year is waived. Likewise, nothing in § 143.431, or elsewhere in the statute, authorizes the Director to issue a regulation that establishes such a drop dead date.

The Commission cited § 143.961.1 RSMo 2000, which gives the Director the authority to "make such rules and regulations and to require such facts and information to be reported, as he may deem necessary to enforce the provisions of sections 143.011 to 143.996." L.F. 166; App. A11, A22. More pertinent is § 143.431.3(5) which provides that the Director "may prescribe such regulations *not inconsistent with the provisions of this chapter* as he may deem necessary in order that the tax liability of any affiliated group of corporations making a Missouri consolidated income tax return . . . [will] clearly . . .

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<sup>2</sup> The Director amended the regulation on October 16, 2002 to reflect the result of the *General Motors* decision. The amendment did not affect the due date provision, which is currently found at 12 CSR § 10-2.045(13). App. A22. Curiously, the legislature amended § 143.431 in 2004, but did not delete the 50% requirement even though the Court declared it unconstitutional six years before. *See* § 143.431 RSMo 2004 Cum. Supp.

reflect the Missouri taxable income derived from sources within this state and in order to prevent avoidance of such tax liability.” App. A19-A20. (Emphasis added.)

Neither provision authorizes the Director to issue a regulation that establishes a final, irrevocable due date for the filing of a consolidated return that contradicts and has the effect of cutting off a taxpayer’s right to seek a refund within the applicable Missouri statute of limitations.

The question is whether setting a regulatory drop dead due date is “inconsistent with the provisions” of Chapter 143. The answer is yes.

Section 143.801.1 gives all taxpayers the option of seeking a refund of overpaid income taxes by filing a refund claim within three years of filing the return, or within two years of payment, whichever is later. App. A21. The Director’s regulatory due date, if given effect, makes the taxpayer’s statutory right to claim a refund illusory. Under 12 CSR § 10-2.045(15), the taxpayer’s right to seek a refund in this situation *terminates* at the same time that § 143.801.1 provides that the refund period *begins* — when the original return is filed.

The Court has consistently held that the Director has no authority to add language to, to remove language from, or otherwise to modify Missouri’s statutes. The Director does not have the power to change the meaning or application of Missouri’s statutes. *Matteson v. Director of Revenue*, 909 S.W.2d 356, 360 (Mo. banc 1995), *citing Bridge Data Co. v. Director of Revenue*, 794 S.W.2d 204, 207 (Mo. banc 1990); *May Department Stores, Inc. v. Director of Revenue*, 791 S.W.2d 388, 389 (Mo. banc 1990), *citing Lynn v. Director of Revenue*, 689 S.W.2d 45, 49 (Mo. banc 1985). The Court has made it clear

that “[e]rroneous regulations are a nullity as regulations may be promulgated only to the extent of and within the delegated authority of the statute involved.” *Bartlett & Co. Grain v. Director of Revenue*, 649 S.W.2d 220, 224 (Mo. 1983).

The Director’s attempt to cut off Kidde’s right to a refund contravenes §143.801.1, and is invalid. The Kidde Group had the right to file a claim for a refund for overpaid income taxes within three years of the date for filing the original return. Thus, it had the right to exercise the election provided by § 143.431.3 by filing an amended return making the claim within that time.

The Commission agreed that even if Kidde had known of the basis for its refund claim when the original return was filed, it did not thereby waive its right to seek a refund. L.F. 171; App. A16. *See Director of Revenue v. Westinghouse Credit Corp.*, 787 S.W.2d 715, 718 (Mo. banc 1990). The Commission, however, found no conflict between the regulatory due date and the statute of limitations. L.F. 171; App. A16. The Commission did not explain why there was no conflict. It merely made the unsupported statement that no conflict existed.

But it is obvious that the Director’s regulatory due date takes away the right to seek a refund of overpaid taxes based upon the filing of an amended return making the election when the original return was filed on a separate basis. If an affiliated group wants to file on a consolidated basis, the Director’s regulatory due date *is* a drop dead date, just as if the legislature had put the due date in the statute (as it did for a taxpayer’s election of its method of apportionment in §143.461.1).

Our research has disclosed that only two cases from other states have dealt with a similar situation. In both cases the courts declined to impose a due date for the filing of a consolidated state income tax return that did not have an explicit statutory basis.

In *Felt Process Co. v. State Tax Commission*, 339 Mass. 651, 162 N.E.2d 76 (1959), five affiliated corporations filed a federal consolidated tax return for the year 1955. However, each of the five corporations filed a separate Massachusetts return. Four companies reported a profit and the fifth reported a loss. Later — but within the time for seeking an abatement of the taxes — the group sought to file an election to be taxed on their combined net income.

The State argued that the “prior filing of a separate return constituted a binding election which precluded [the taxpayer] from later filing a consolidated return.” 339 Mass. at 654, 162 N.E.2d at 78. The statute lacked any provision for a due date for the making of an election to file a consolidated tax return. *See id.* The Massachusetts Supreme Judicial Court rejected the State’s contention, holding that the consolidated return statute had no such provision, “and it is not a requirement that we would read into the law. We think that the option under [the consolidated return statute] could be exercised by Felt any time within the period permitted by [statute] for applying for an abatement.” *Id.*<sup>3</sup>

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<sup>3</sup> The Massachusetts legislature amended the statute in 1988 to add a requirement that taxpayer corporations make the election on or before the due date, including any

In *Agri-Dynamics, Inc. v. Iowa State Board of Tax Review*, 1982 WL 172529 (Polk County, Iowa Dist. Ct., June 29, 1982), the taxpayer sought a refund for the year 1976. It filed an “unconsolidated” return for that year. After learning from its accounting firm of an Iowa Supreme Court decision that would allow the filing of a consolidated return, the taxpayer filed amended consolidated returns for the years 1973, 1974, 1975, and 1976.

In 1975, the Iowa legislature amended the income tax laws to add a requirement, among others, that the taxpayer could elect to file a consolidated tax return not later than the due date, including any extensions, of the corporate income tax return. *See id.* at \*2. The prior law had no statutorily prescribed due date. *See id.* The court held that the taxpayer was bound by the statutory election due date requirement for the tax year 1976, but, in *dicta*, approved the department’s allowance of consolidated amended returns for the earlier years that had no statutory date for making the election, and approved the granting of refunds on that basis. *See id.* at \*3.

In *Bartlett & Co. Grain v. Director of Revenue*, 649 S.W.2d 220 (Mo. 1983), the taxpayer sought to change its method of apportionment of interstate income after it filed its original return. Section 143.461.1 — unlike § 143.431.3 — specifically requires the taxpayer to make an election as to its method of apportionment by the due date (or extended due date) of its return. The Court held that the specific, statutorily mandated date for an election required the taxpayer to use the apportionment method it originally

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extension of time, for the filing of the return for any member of the group. *See* Mass. Gen. Laws, Ch. 63, § 32B.

elected. The taxpayer could not change its election by filing an amended return. *See id.* at 224.

The common theme in these cases is that if a *legislature* establishes a specific due date for making an election to file an income tax return on a particular basis, that due date must be met by the taxpayer. But where the legislature has not set a due date for making an election, neither the taxing agency nor the courts are authorized to establish one earlier than the expiration of the applicable statute of limitations.

D. *The Accuracy of Masterchem's Separate Tax Return Is Irrelevant*

The Commission also accepted the Director's contention that Kidde was not entitled to a refund because Kidde did not argue that Masterchem's separate tax return was incorrect. L.F. 172-173, App. A17-A18. The correctness of Masterchem's return is irrelevant. The purpose of allowing affiliated corporations to file a consolidated tax return "is to permit affiliated corporations, which may be separately incorporated for various business reasons, to be treated as a single entity for income tax purposes as if they were, in fact, one corporation." *Suburban Newspapers of Greater St. Louis, Inc. v. Director of Revenue*, 975 S.W.2d 107, 109 (Mo. banc 1998), quoting *Mid-America Television Co. v. State Tax Commission*, 652 S.W.2d 674, 680 (Mo. banc 1983) and *American Standard, Inc. v. United States*, 220 Ct. Cl. 411, 602 F.2d 256, 261 (1979).

Section 143.801.1 gives taxpayers three years in which to claim a refund for an overpayment of income taxes. The Court has refused to give the term "overpayment" an "unduly limited construction." This means that a taxpayer can seek a refund for any reason for which the tax should not be imposed. *See Homestake Lead Co. v. Director of*

*Revenue*, 759 S.W.2d 847, 848 (Mo. banc 1988). Imposing a tax on Masterchem's Missouri income as if it were a separate company does not in this instance accurately reflect the economic realities of the Masterchem sale transaction. Kidde sold Masterchem and — despite the deemed sale of assets under 26 U.S.C. § 338(h)(10) — Kidde was the company that in reality enjoyed the gain. Kidde sought to file on a consolidated Missouri basis (as it filed on a consolidated federal basis) to more accurately report the economic realities of the transaction. Missouri law permits Kidde to make such a filing. Only the Director's regulatory due date prevents it.

Putting aside the timeliness issue, the Director did not dispute that Kidde and its subsidiaries were eligible to elect to file a Missouri consolidated income tax return. The Director did not dispute that the amended consolidated return correctly calculated the amount of income taxes due to Missouri on a consolidated basis. The Director did not dispute that the amended return claiming a refund of overpaid income taxes was filed within the time allowed by §143.801.1 to claim an income tax refund. The Director did not dispute that the filing of an amended return by Kidde and its subsidiaries was a proper way to make the consolidated return election, when such election was not made in connection with filing the original return. Finally, the Director did not dispute that, if the Court determines that if the amended return was timely filed, the Kidde Group would be entitled to a refund of the overpayment of their income taxes, plus interest, for the 2000 tax year. L.F. 44-54.

In short, the only issue to be decided by the Court is whether the Kidde Group's Missouri consolidated return election was timely made. If it was, then the Kidde Group is

entitled to the refund it claims. Whether Masterchem's separate Missouri corporate income tax liability was properly computed has nothing to do with this issue.

Moreover, the notion that the Kidde Group could not seek a refund without having Masterchem also file such a request or somehow contest its tax liability is contrary to the Director's own regulations. 12 CSR § 10-2.045(26) requires the common parent — Kidde — to file the return. The common parent “for all purposes other than making the consent [to join in a consolidated return] . . . shall be the sole agent for each subsidiary member in the affiliated group, duly authorized to act in its own name in all matters relating to the Missouri tax liability for the Missouri consolidated return year. No subsidiary member shall have the authority to act for or to represent itself in any matter.” 12 CSR § 10-2.045(29). As for the filing of refund claims, the regulations provide that the “common parent will file claims for refund or credit and any refund or credit will be made directly to and in the name of the common parent and will discharge any liability of Missouri in respect to that refund to any subsidiary member.” *Id.*

The Kidde Group's filing of their amended return seeking a refund of overpaid corporate income taxes that resulted from their income tax liability being computed on a consolidated basis was authorized by a Missouri statute. Requiring the Kidde Group to file their consolidated return election on the extended due date of their original return such that they could never seek a refund was not.

## II.

*The Administrative Hearing Commission Erred In Holding That The Kidde Group Should Not Be Allowed To Make An Election To File A Consolidated Corporate Income Tax Return After The Due Date Of Their Original Return Because § 143.961.2 RSMo 2000 Requires The Director To Follow As Nearly As Practicable The Federal Regulations Because The Kidde Group Qualified Under Federal Regulations For Relief From The Filing Deadline In That They Acted Reasonably And In Good Faith In Relying Upon PricewaterhouseCoopers, A Qualified Tax Professional Firm That Failed To Advise The Kidde Group To Elect To File A Consolidated Missouri Return.*

The Director relied on a provision of the federal regulations governing the exercise of the election to file a consolidated federal return as her only authority for the regulatory due date in 12 CSR § 10-2.045(15) (2000). *See* 26 C.F.R. § 1.1502-75(a).<sup>4</sup> As discussed

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<sup>4</sup> We note that the federal regulations implementing 26 U.S.C. § 1502 are considered “legislative” in that Congress delegated to the Internal Revenue Service the function of writing regulations to cover “the many and differing complicated situations” that may arise in administering consolidated corporate returns. *See* S. Rep. No. 960, 70th Cong., 1st Sess. at 15 (1928), *quoted in American Standard, Inc. v. United States*, 220 Ct. Cl. 411, 602 F.2d at 260. Under federal law, the promulgation of such regulations is a legislative function. *See American Standard, Inc. v. United States*, 602 F.2d at 261. The concept of “legislative regulations” is unknown under Missouri law. To the extent that 12 CSR 10-2.045(15) was intended to follow federal legislative regulations, it is invalid for

in Point I above, the Kidde Group’s exercise of the election was not untimely under Missouri law, but if it is deemed to be so because of reliance on federal regulations, then *all* federal regulations and private letter rulings related to excusing the late filing of an election to file a federal consolidated return should be considered.<sup>5</sup>

Section 143.961.2 requires the Director’s regulations “to follow as nearly as practicable” the federal regulations “regarding income taxation.” App. A22. The purpose of this provision is to ensure uniformity between the manner in which the state and federal governments impose income taxes in comparable circumstances. To that end, the statute requires that the income tax provisions of Chapter 143 — including, of course, the provisions applicable to making elections to file consolidated corporate income tax returns — be interpreted through the use of federal precedents. § 143.961.2.

Under the applicable federal regulations, the Kidde Group clearly would qualify for relief from the federal regulatory deadline for making an election to file a consolidated return. The pertinent rules are found in 26 C.F.R. § 301.9100-3. L.F. 140-143; App. A23-A28. This regulation allows the Internal Revenue Service to grant taxpayers relief from the deadline for making an election to file a consolidated federal income tax return when

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that reason as well. *See, e.g. Armco Steel Corp. v. State Tax Commission*, 580 S.W.2d 242, 245 (Mo. banc 1979) (the Director cannot apply federal regulations if to do so will change the substantive rules of Missouri law).

<sup>5</sup> The Commission correctly concluded that the authorities cited by the Director below were based upon out of date regulations. L.F. 169; App. A14.

the taxpayers show that they “acted reasonably and in good faith.” § 301.9100-3(a), L.F. 140, App. A23.

As relevant here, a taxpayer acts reasonably and in good faith when it “[r]easonably relied on a qualified tax professional . . . and the tax professional failed to make, or failed to advise the taxpayer to make, the election.” § 301.9100-3(b)(1)(v). App. A24. The taxpayer reasonably relies on a tax professional when the tax professional is competent to render advice on the issue and is aware of all the relevant facts. § 301.9100-3(b)(2). L.F. 140, App. A24. The taxpayer acts in good faith unless it “[w]as informed in all material respects of the required election and the related tax consequences, but chose not to file the election.” § 301.9100-3(b)(3)(ii). L.F. 140, App. A24.

Under the federal relief provisions, the election cannot cause prejudice to the government, meaning in this context that the taxpayer’s tax liability would not be lower at the time of the request for relief than it would have been had the taxpayer made the election by the due date (plus extensions) of the original return, § 301.9100-3(3)(i), and the request for relief is made before the expiration of the applicable statute of limitations. § 301.9100-3(b)(3)(ii). L.F. 141, App. A25. *See also* Examples 1 and 2. § 301.9100-3(f). L.F. 142, App. A27-A28.

Kidde retained PwC to prepare all of the Kidde Group’s federal and state income tax returns for the 2000 tax year. L.F. 134. PwC is a qualified tax professional that is competent to provide advice on whether and when an affiliated group of taxpayers must make an election to file a Missouri consolidated corporate income tax return, the tax consequences of such an election and the tax consequences of the failure to make such an

election. PwC was given access to all of the information needed to prepare the returns. L.F. 135. PwC failed to make the election to file a consolidated Missouri income tax return on the Kidde Group's behalf, failed to advise Kidde of the consequences of the Kidde Group's failure to make the election and failed to advise Kidde to make the election. L.F. 136. Therefore, Kidde was not informed of all material respects of the election and the related tax consequences. L.F. 136.

Kidde submitted the amended return making the Kidde Group's election to file a Missouri consolidated corporate income tax return and made its claim for refund on March 12, 2004, L.F. 137; Ex. A-7, L.F. 87-114 — less than three years after the original return was filed on October 15, 2001, and thus well within the three year period for claiming a refund under § 143.801.1. The Kidde Group's income tax liability on a consolidated basis at the time it submitted the amended return for the 2000 tax year was the same as it would have been had the Kidde Group filed a consolidated return on October 15, 2001.

Kidde's situation is analogous to the taxpayers in three federal private letter rulings, P.L.R. 200431002 (April 15, 2004), P.L.R. 200022036 (Mar. 6, 2000), P.L.R. 199909009 (Nov. 20, 1998) L.F. 144-155. In Ruling P.L.R. 200431002, the parent corporation received permission to make a late election to file a consolidated tax return where the parent merged with a subsidiary that was the common parent of another affiliated group. L.F. 144-147. In Ruling P.L.R. 200022036, the taxpayer filed a consolidated return for two affiliated corporations but inadvertently left the common parent company off the return. L.F. 148-151. In Ruling P.L.R. 199909009, the taxpayer intended to file a

consolidated return, but failed to do so by the extended original due date. In each of these rulings the taxpayer received federal relief because a qualified tax professional failed to advise the parent corporation to make the federal election to file a consolidated return. L.F. 152-155.

Thus, the Kidde Group met both of the requirements of § 301.9100-3, and under the federal rules, would have been granted the right to file an amended return to make an election to file on a consolidated basis for federal income tax purposes.

The Commission expressed doubt that § 143.961.2 would require the Director to import all of the federal regulations on the subject of making an election to file a consolidated return. L.F. 170; App. A15. However, the Director's regulatory due date is taken from the part of the federal regulations that sets a federal regulatory due date (in the federal system, the equivalent of a due date enacted by Congress). The state regulations will follow the federal regulations "as nearly as practicable" only if they also follow the corresponding federal regulations providing for relief from the regulatory due date. The Director's approach in adopting only part of the federal regulation violates the statutory command that the state's regulations mirror the federal government's so as to simplify the preparation of tax returns, "aid in their interpretation through the use of federal precedents, and improve their enforcement." § 143.961.2.

### *CONCLUSION*

The Kidde Group's election to file on a consolidated basis and its resulting refund claim, both made on their amended consolidated income tax return, were timely filed. Given these facts, there is no other reason offered by the Director as to why the refund

should not be paid. If the federal regulation as to the timing of making the election is relevant, then § 143.961.2 requires that all regulations related to the timing of making the election should be considered in determining which federal precedent to follow. Under the federal regulations, there is no dispute that the Kidde Group acted reasonably and in good faith in filing their amended consolidated income tax return, and that their election (if late) should be permitted.

For the foregoing reasons, Kidde and its 37 subsidiaries request that this Court reverse the Commission's order, direct that the Kidde Group's request for refund of the overpayment of Missouri corporate income taxes and all applicable interest be granted, and grant such other relief as this Court deems proper in the circumstances.

Respectfully submitted,

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*CERTIFICATE OF COMPLIANCE*

The undersigned hereby certifies that this brief contains the information required by Rule 55.03, complies with the limitations in Rule 84.06(b), and it contains 7,051 words, excluding the parts of the brief exempted; has been prepared in proportionally spaced typeface using Microsoft Word 2003 in 13 point Times New Roman font; and includes a virus free 3.5" floppy disk in Microsoft Word 2003 format.

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*CERTIFICATE OF SERVICE*

The undersigned hereby certifies that two copies of the foregoing and a virus-free diskette were mailed, first class postage prepaid this \_\_\_\_ day of January 2006 to:

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## APPENDIX

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