

IN THE SUPREME COURT OF MISSOURI

No. SC90463

BRINKER MISSOURI, INC., APPELLANT,

v.

DIRECTOR OF REVENUE, RESPONDENT.

ON PETITION FOR REVIEW
FROM THE MISSOURI ADMINISTRATIVE HEARING COMMISSION
THE HONORABLE NIMROD T. CHAPEL, JR., COMMISSIONER

REPLY BRIEF OF APPELLANT

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ARGUMENT

I. The Machinery, Equipment and Parts are Exempt Production Equipment

Introduction

The issue before this Court is whether Brinker is engaged in manufacturing, fabricating, or producing under section 144.030.2(4) and (5) (Production Exemptions). In deciding this issue, this Court should follow its well-established analytical framework for applying the Production Exemptions. That framework focuses on the manner in which the machinery and equipment are used—not the identity of the user. *Concord Publishing House, Inc. v. Director of Revenue*, 916 S.W.2d 186, 196 (Mo. banc 1996) (the production exemption “does not refer to the identity of the user, but only to a use for a designated purpose.”) As the Director concedes, “the identity of the user is indeed irrelevant.” Dir. Br. 27. In spite of this concession, the Director ignores the established elements of the exemptions, focusing instead on the identity of the taxpayer as retailer or restaurant operator. In essence, the Director argues that the uses of the subject machinery and equipment are not relevant.

The Director does not dispute that Brinker has established the following elements of the Production Exemptions: (1) the purchases at issue are machinery, equipment or parts; (2) Brinker’s output is either taxable tangible personal property or taxable services; and (3) the purchases at issue either replaced like property or were used to establish a new facility or expand an existing facility. Nor does the Director dispute that Brinker’s facilities employ people and produce outputs having a substantially higher taxable value than the product inputs—two of the purposes of the Production Exemptions.

Southwestern Bell Telephone Co. v. Director of Revenue, 182 S.W.3d 226, 230 (Mo. banc 2005). Moreover, nowhere does the Director dispute that under her interpretation of the law, the tax will be pyramided, prevention of which is another purpose of the exemptions. *Southwestern Bell Telephone Co., supra.*, 182 S.W.3d at 230. Double taxation may be the goal of the Director, but it was clearly not the goal of the General Assembly in enacting these laws.

The Director argues that the Production Exemptions apply only where the taxpayer meets “traditional notions” of manufacturing, fabricating or producing at a “plant.” Dir. Br. 14. But the Director never applies this Court’s, nor the dictionary’s, definitions of “manufacturing, fabricating or producing” to the key fact that Brinker uses the various machinery and equipment to change or transform food product inputs into food products having a separate and distinct identity, use and value. Rather, the Director: (1) ignores the statutory definition of product; (2) argues “facts” that are outside of the record; (3) misconstrues decisions of this Court; (4) improperly and inaccurately argues the impact of a decision against the Director; and (5) relies on decisions from sister states having different statutory exemptions. In short, the Director’s brief is long on hyperbole and short on accurate statutory analysis or discussion of this Court’s precedents.

A. Brinker Manufactures, Fabricates or Produces “Products”

1. Brinker Produces a “Product”

The Director argues that Brinker cannot qualify for the Production Exemptions because it retails its products.¹ Dir. Br. 14, 17-18. She grounds this argument in the word “ultimately” found in the Production Exemptions’ phrase for “product” (“product which is intended to be sold ultimately for final use or consumption”). In making this argument, the Director wholly ignores section 144.010.1(14)’s statutory definition of “product which is intended to be sold ultimately for final use or consumption.” Section 144.010.1(14) provides that the above-quoted phrase means “tangible personal property, or any service that is subject to state or local sales or use taxes[.]” The word “retail” or “retailer” does not appear in section 144.010.1(14). Further, there is no room for construing the word “ultimately” since the phrase using that word is already defined by section 144.010.1(14). Because Brinker’s products are tangible personal property or taxable services under section 144.020, its outputs are taxable “products” within the meaning of section 144.010.1(14) and 144.030.2(4) and (5) (Brinker collected and remitted over \$5M in Missouri sales tax on its sales of food products during the 14-month tax period). *See* L.F. 14 and section 144.020.1(1) and (6).

Nor, on this point, does the Director make any meaningful attempt to distinguish the numerous decisions of this Court concluding that the Production Exemptions applied

¹ The Director does not address the undisputed fact that one of Brinker’s facilities wholesaled its products. *See* App. Br. 17, n. 5.

to entities that retailed their products. *See* App. Br. 20-21 (noting decisions of this Court applying the Production Exemptions to producers who were also retailers of newspapers and telephone services, and also noting decisions applying the component part production exemption to a Kentucky Fried Chicken restaurant that retailed its product). *See Concord Publishing House, Inc., supra.*; *Southwestern Bell Telephone Co. v. Director of Revenue, supra.*; and *Al-Tom Investment v. Director of Revenue*, 774 S.W.2d 131 (Mo. banc 1989). Clearly neither the statutes nor this Court’s opinions disqualify a taxpayer from invoking the Production Exemptions merely because the taxpayer retails its own products. These decisions all focused on the use of the equipment at issue.

2. Brinker Manufactures, Fabricates and Produces

The Director quotes numerous dictionary definitions (Dir. Br. 11-12), but never applies them, and for good reason. For instance, as the Director notes, the dictionary definition of “manufacturing” is “to make (as raw material) into a product suitable for use” or “to make from raw materials by hand or machinery.” To “fabricate” is “to form by art and labor: manufacture, produce” and “to make, shape, or prepare (parts) according to standardized specifications so as to be interchangeable.” To “produce” is “to give being, form, or shaped to: make often from raw materials; manufacture” or “to make more economically valuable.” Webster’s Third New International Dictionary (1993). These dictionary definitions are entirely consistent with the decisions of this Court defining these terms to mean a “clear and identifiable transformation of an input into an output with a separate and distinct use, identity or value.” *Branson Properties USA v.*

Director of Revenue, 110 S.W.3d 824, 827 (Mo. banc 2003).² Brinker is manufacturing, fabricating and producing because it clearly transforms product inputs (food or drink ingredients) into product outputs (meals and drinks) that have a different use and identity, and a much higher value (over twice the value of the ingredients (L.F. 39)). For instance, Brinker mixes water, carbon dioxide, and syrup to produce soft drinks. Would the Director, or this Court, deny that the mixing operation was exempt if conducted at the Coca-Cola bottling facility? Brinker, mixes, cooks and fries various food components to produce new food products. Would the Director, or this Court, deny that those operations were exempt if conducted at the Banquet frozen dinner facility? There is no language in the Production Exemptions disqualifying **these operations** merely because they occur at a facility labeled a restaurant.

Rather than apply the law to the undisputed facts of this case, the Director plays word games in an effort to pyramid the sales tax. She argues that the Production Exemptions should be limited to “traditional notions of manufacturing, mining, fabricating, or producing [that] have occurred in actual plants that are normally recognized as such” such as “mass-production” that occurs on “assembly lines.” Dir. Br. 14-15. Presumably the Director would determine what those “traditional notions” were. But nowhere in the production exemption statutes, or the statutory definition of product,

² The Director apparently agrees that producing, manufacturing, and fabricating mean the same thing. Dir. Br. 13.

are these limitations found. Nowhere in this Court's many decisions are these limitations found.

Indeed, as indicated in Brinker's opening brief, this Court found that the Production Exemptions applied in a number of contexts where the Director's limitations are absent. For example, these exemptions were found to apply to the production of newspapers, data for mutual funds, purified water, and telephone signals. *See Concord Publishing House, Inc., supra.*; *DST Systems, Inc. v. Director of Revenue*, 43 S.W.3d 799 (Mo. banc 2001); *International Business Machines Corporation*, 958 S.W.2d 554 (Mo. banc 1997); *Jackson Excavating Co. v. Administrative Hearing Comm'n*, 646 S.W.2d 48, 51 (Mo. 1983); and *Southwestern Bell Telephone Co., supra*. And the Commission found that the Production Exemptions applied to a concrete mixer. *See Capitol Con Crete, Inc., v. Director of Revenue*, No. RS-85-0259 (Mo. Admin. Hrg. Comm'n, July 17, 1987). Would these operations meet the Director's current "notions?" They certainly did not at the time of these litigations (otherwise there would have been no appeals to review).

As explained in Brinker's opening brief (App. Br. 13-14) the Missouri General Assembly has considered and expanded the Production Exemptions even though it had ample opportunity to undo this Court's decisions in the event that it disagreed with them. This Court's decisions on the Production Exemptions are presumed to have been adopted by the General Assembly. *Medicine Shoppe International, Inc. v. Director of Revenue*, 156 S.W.3d 333, 338, n.2 (Mo. banc 2005).

Furthermore, both this Court and the Commission have already applied the component part production exemption of section 144.030.2(2) **to restaurants**. *See Al-*

Tom Investment v. Director of Revenue, 774 S.W.2d 131 (Mo. banc 1989) (Kentucky Fried Chicken restaurant entitled to the component part exemption for cooking oil). This Court adopted “the rule that if any part of a material is intended to and does remain as an essential or necessary element of the finished product then the entire purchase is exempt. This includes the material that is used or consumed **in the manufacturing process.**” (emphasis added) *Id.*, 774 S.W.2d at 134. In explaining this holding, this Court stated:

We do not believe that the legislature either intended or believed that the Director should or could go into the field and make such measurements and computations. In the establishments herein, the cooking oil would be but the first step. Only a portion of the flour and spices end up in the **final product**. Only a portion of the potatoes end up as **finished product**. Chicken trimmings are consigned to the garbage. The same is true for the component parts of the salad. (emphasis added) *Id.*, 774 S.W.2d at 135.

The Director wholly mischaracterizes *Al-Tom* when she states (Dir. Br. 29) “[t]he true issue was whether the cooking oil was purchased for resale, and not purchased at retail, by KFC.” This Court cited and discussed the component part production exemption statute and the Court of Appeals decisions construing that exemption statute, and *Al-Tom* addressed the cooking oil that was not in fact transferred to, or used by, customers (so it could not have been resold to them).

Brinker is mindful that the Court did not directly address whether a Kentucky Fried Chicken restaurant was “manufacturing, processing, compounding, mining, producing or fabricating ... new personal property” under section 144.030.2(2), but that

was only because that was not a contested issue in the case. The reason that was not contested is because the Director's "notion" at that time must have been that the restaurant met that requirement of the law.

That "notion" of manufacturing, processing, compounding, mining, producing or fabricating can be found as early as 1985, when the Commission concluded that cooking oil qualified for the component part production exemption in *Hardee's of Springfield, Inc. v. Director of Revenue*, Nos. RS-82-2181 and RS-82-2250 (Mo. Admin. Hearing Comm'n, June 11, 1985). And later, in 1993, in *Souffle, Inc. d/b/a Café Allegro v. Director of Revenue*, No. 92-001068RV (Mo. Admin. Hearing Comm'n, June 7, 1993), the Commission found that the component part production exemption applied to a restaurant's smoking of meat in that wood particles entered and remained in the meat. The Director misinterprets that decision when she asserts (Dir. Br. 30) that the Commission did not consider whether the restaurant was a manufacturer. In fact, the Commission's first finding of fact was that Souffle did business as a "restaurant" and the Commission noted that this Court's decision in *Al-Tom* implicitly recognized that frying chicken was "manufacturing, processing, compounding, producing or fabricating":

Souffle's activity is one of the listed activities in the exemption. In *Al-Tom Inv., Inc. v. Director of Revenue* [citation omitted], the Supreme Court did not specify whether frying chicken was manufacturing, processing, compounding, producing or fabricating, but it did apply the exemption at issue to the purchase of cooking oil used in frying chicken. We conclude that smoking meats is a process that produces new personal property.

As the Director notes, she did not appeal that decision.

Finally, the undisputed facts show that Brinker’s “notions” appear to have been adopted by the Director in numerous related cases. The record in this case shows that the Director has allowed the Production Exemptions for equipment used to bake bagels, for rotisserie ovens used to bake chickens, for equipment used to bake bread products at a retailer grocer’s centralized baking facility, for equipment used to make fully-cooked, ready-to-eat hot dogs and sausages, and for equipment used to make dairy products like cheese and ice cream at a retailer’s dairy processing center. L.F. 98-101. None of these facilities would appear to qualify under the Director’s “notions” articulated in this case.

Last, the Director argues (Dir. Br. 16) that because restaurants were not specifically identified in the Production Exemptions, no restaurants may qualify for the exemption. But, as indicated in Brinker’s opening brief (App. Br. 19), the Production Exemptions are written in the passive voice. No particular actor is named. The same is true for the general part of the component part production exemption in section 144.030.2(2); no particular actor is mentioned. Yet, as indicated above, both the Commission and this Court have applied that exemption to restaurants.

3. Missouri Law Does not Require an Industrial Plant

Nowhere in the production exemption statutes, or in the statutory definition of product, does the word “industrial” appear. The word “plant” appears only in the expansion production exemption, section 144.030.2(5); it does not appear in the replacement production exemption, section 144.030.2(4).

Other than the Commission's 1982 decision in *Wendy's of Mid-Missouri, Inc. v. Director of Revenue*, No. RS-79-0222 (Mo. Admin Hearing Comm'n, July 22, 1982), the Director cites no Missouri cases limiting the expansion production exemption, section 144.030.2(5), to an "industrial plant." And the Director cites no Missouri cases limiting the replacement production exemption, section 144.030.2(4), to an "industrial plant."

As for the 1982 *Wendy's* case, the Director argues that at no time has the Missouri General Assembly amended the law to undo the *Wendy's* decision. But no authority provides that the General Assembly is presumed to know what the Commission has held. Moreover, if the General Assembly is presumed to know what the Commission has decided, then it would have known that the Commission allowed the component part production exemption for a Hardee's restaurant in 1985, a Kentucky Fried Chicken restaurant in 1988, and the Souffle restaurant in 1993. And the General Assembly would have known that this Court allowed the component part production exemption for a Kentucky Fried Chicken restaurant in 1989. The General Assembly is presumed to know what this Court, as a court of last resort, has held. *Medicine Shoppe International, Inc., supra.*

No decision of this Court has limited the Production Exemptions to an industrial plant or factory, as the Director argues it should. As explained in *Concord Publishing House, Inc., supra.*, the goal of the Production Exemptions is not to "fill the Missouri landscape with towering industrial plants ... but rather to increase the number of products on which sales tax could be assessed." And, as indicated above, the Commission concluded that a concrete mixing truck qualified as a "plant" in *Capitol Con Crete, Inc.,*

v. Director of Revenue, No. RS-85-0259 (Mo. Admin. Hrg. Comm'n, July 17, 1987), a more recent decision than *Wendy's*.

Merriam Webster's Collegiate Dictionary, 890 (10th ed. 1997), defines plant as:

2 a: the land, buildings, machinery, apparatus, and fixtures employed in carrying on a trade or an industrial business **b:** a factory or workshop for the manufacture of a particular product **c:** the total facilities available for production or service[.] [emphasis original]

Brinker's restaurants meet these definitions in that they include buildings, machinery, apparatus, and fixtures that the restaurants use in carrying on their trade and include facilities for production or service. Given that the definition of "product" in section 144.010.1(14) includes services, it would be unreasonable to conclude that only operators of industrial factories may qualify for the expansion production exemption. Few, if any, services taxable in Missouri or elsewhere are produced in an industrial factory, at least the way the Director would define that term.

In summary, it is the Director who seeks a sea change under the Production Exemption law.

B. The Director, Rather than Brinker, Seeks an Absurd and Illogical Result

1. Brinker's Construction is Faithful to the Purposes of the Exemptions

This Court recognized that the purposes of the Production Exemptions were to encourage the location of business in Missouri and the resultant employment of Missourians, to encourage the production of products with a higher taxable value than the

product inputs, and to avoid multiple taxation. *Southwestern Bell Telephone, supra.* 182 S.W.3d at 230. The undisputed facts show that allowing the Production Exemptions in this case furthers all three legislative purposes.

It is undisputed that each of Brinker's facilities employs on average 40 people. (L.F. 15, ¶ 12), that Brinker collected and remitted over \$5M in sales tax on its sales of products during the 14-month tax period at issue, and that the cost of the food ingredients were less than half of the selling price of its products. (L.F. 13, ¶ 6; L.F. 14, ¶ 9; and L.F. 15 ¶ 10). And if Brinker is not allowed the Production Exemptions, there will be a pyramiding of the tax in that tax paid on production equipment will be built into the purchase price upon which tax will again be collected. The facts clearly show that the purposes of the exemptions are furthered in this case by allowing Brinker the Production Exemptions.

By denying the exemptions, this Court would be discouraging the employment of Missourians, discouraging the production of products having a higher taxable value, and encouraging multiple taxation. That would be the absurd or illogical result.

2. The Director's "Parade of Horribles" is Unsupported and Wrong

Ignoring appellate procedure, the Director testifies in her brief and argues alleged facts that are not in the record nor subject to judicial notice. The record does not show how other restaurants file their tax returns or how the Director treats them. The record does not show whether they are, or are not, paying tax on their purchases of production equipment. The record does not include the other taxpayers' refund applications that the

Director addresses in her brief and included in her Appendix. This Court should strike both the argument and the documents (Dir. Appendix A9 and A44).

The Director focuses on only the cost side of the ledger (again assuming that all restaurants pay tax on their production equipment) and ignores the revenue side (Brinker alone generated over \$5M in sales tax collections over a 14-month period). She then argues that the state will lose “millions and millions of dollars in taxes.” Dir Br. 19-21. Her rank speculation is clearly beyond the scope of the record. She does not limit herself to restaurants, does not limit herself to the exemptions at issue, and appears to even misstate her own position on one issue.

As explained above, the General Assembly set the tax policy of granting exemptions for the purchase of machinery and equipment that produces products having a higher taxable value. It knowingly sacrificed the tax on the purchase of the equipment in order to encourage more tax collections on the higher value of the resulting products, and to encourage the location and expansion of business and employment in Missouri. The Director invites this Court to second-guess that legislative policy in the context of a taxpayer that clearly meets every element, and furthers every purpose, of the Production Exemptions. This Court should reject the Director’s invitation to do so. Otherwise, in the next case, the Director will recite the same “parade of horrors” to deny the Production Exemptions to automobile assembly plants, jet fighter manufacturers, and breweries.

Paint mixing equipment has no relevance to this appeal. Yet, in an effort to support her imagined “parade of horrors,” the Director makes the perplexing claim that

a decision in Brinker’s favor will open the door for retail stores to claim exemption for paint-mixing equipment that perform the key final process in producing paint products--determining and mixing the color of the paint to the customer’s specifications. In the event that the Court does not strike this “testimony” (Dir. Br. 20-21) and the document found in the Director’s Appendix A-44, this Court should know that the Director has in fact issued letter ruling 2143, dated April 7, 2000, concluding that such paint mixing at a retail store is in fact manufacturing and that the replacement equipment is exempt production equipment. That published letter ruling runs counter to the Director’s “parade of horrors” argument and also to her argument that retailers are excluded from claiming the Production Exemptions. A copy of that letter ruling is attached to this brief as an Appendix.

C. Decisions From Sister States are Not Instructive

The Director cites a number of decisions from other states and argues that courts throughout the country have “rejected such a broad construction of the statute.” Dir. Br. 21 (emphasis added). It should come as no surprise that none of those courts construed “the statute,” namely Missouri’s Production Exemptions. Those cases are inapposite as each state’s production exemption statute differs in material respects from the Production Exemptions, sections 144.030.2(4) and (5). Not one other state decision cited by the Director addresses a production exemption like Missouri’s, where the product can be a **taxable service** as well as tangible personal property. Many of these cases are also distinguishable because their exemption statutes focus on the identity of the user rather than the use of the property. In Missouri, the identity of the user is irrelevant so long as

the property is used in an exempt manner. *See Concord Publishing, supra.*, 916 S.W.2d at 196.

For instance, in *McDonald's Corp. v. Ok. Tax Comm'n*, 563 P.2d 635 (Ok. 1977), the Oklahoma court denied the exemption because the restaurant was not deemed to meet two requirements of that exemption statute not found in Missouri's statute: (1) that the establishment must be "primarily engaged in manufacturing" and; (2) that the establishment must be "generally recognized as a 'manufacturing plant.'" Neither was held to be the case for the McDonald's restaurant because the court viewed McDonald's as primarily a retailer rather than a manufacturer, and because the restaurant would not be generally recognized as a manufacturing plant. In rejecting the taxpayer's claim, the Oklahoma court distinguished *KFC of Ohio, Inc., d/b/a Kentucky Fried Chicken v. Kosydar*, Ohio Bd. of Tax Appeals, No. A-408, Oct. 1, 1973, Ohio Tax Reports, p. 11, 313 sections 200-682 (granting the manufacturing exemption for fryers and other equipment), because the Ohio exemption statute, like Missouri's, did not include the above two conditions of entitlement.

Arizona Department of Revenue, v. Blue Line Distributing, Inc., 43 P.3d 214 (Az. Ct. App. 2002) is inapposite for the reason that Arizona's exemption statute, similar to Oklahoma's, applies only to operations that are "commonly understood" to be engaged in "manufacturing" and "processing." Missouri's Production Exemptions contain no such requirements and, indeed, to graft the "common understanding" requirement onto Missouri's Production Exemptions would be to judicially repeal the General Assembly's definition of "product" in section 144.010.1(14) **as including taxable services**. Would

the “common understanding” of “product” include taxable services? This Court debated that very issue in *GTE Automatic Elec. v. Director of Revenue*, 780 S.W.2d 49, 50 (Mo. banc 1989) and *Bridge Data Co. v. Director of Revenue*, 794 S.W.2d 204, 205 (Mo. banc 1990).

A decision relied on by the Oklahoma court and also cited by the Director herein is *Kansas City v. Manor Baking Company*, 377 S.W.2d 545 (Mo. App. 1964), a case determining whether the taxpayer was primarily a “manufacturer” or a “merchant” retailer under a city license tax. As explained in Brinker’s opening brief, that case is inapposite as nothing in the Production Exemptions disqualifies the taxpayer should it retail its products. *Roberts v. Bowers*, 162 N.E.2d 858 (Ohio 1959) is inapposite for the same reason—the court refused to apply a reduced property tax rate on restaurant equipment because it found the taxpayer to be a “merchant.” As discussed below, in a later decision, the Ohio Tax Court granted the production exemption for restaurant production equipment under the Ohio sales and use tax law.

Burger King, Inc. v. State Tax Commission, 416 N.E.2d 1024 (N.Y. App. 1980) and *Marriott Family Restaurants, Inc. v. Tax Appeals Tribunal*, 570 N.Y.S.2d 741 (N.Y. Sup. Ct., App. Div. 1991), are also inapposite. There, the courts rejected the taxpayers’ production equipment exemption claims, not because they concluded that the restaurants were not manufacturing or producing, but because they concluded the restaurants sold services. New York’s exemption statute was limited to the “exclusive” production of “tangible personal property.” Again, Missouri’s definition of manufactured product in

section 144.010.1(14) includes both tangible personal property **and** taxable services, so it does not matter whether Petitioner's product is deemed tangible personal property.

Golden Skillet Corporation v. Commonwealth of Virginia, 199 S.E.2d 511, 514 (Va. 1973) is inapposite because the exemption statute at issue used the word "industrial," thus requiring manufacturing to occur in an "industrial" setting: "[w]hen so interpreted and read, [the exemption statute] is intended ... to provide exemption ... only in an industrial sense." With little analysis, the court found that "common sense" dictates that the restaurant was not an "industrial" operation. Sections 144.030.2(4) and (5) have no such "industrial" limitation, so whether Brinker's operations are "industrial" is beside the point. The Virginia Court did recognize, as this Court should recognize, that reviewing other states' decisions interpreting different statutes is of marginal benefit:

Nor have we overlooked the various decisions from other jurisdictions cited by counsel. Those decisions, however, deal with differently-worded statutory provisions. Indeed, they show no definite trend among the states and are, even in some instances within the same jurisdiction, conflicting. They have been, therefore, of no aid in the task which is ultimately our own—the interpretation of the Virginia sales and use tax statutes.

Id., 199 S.E.2d at 514.

For the same reason, *HED, Inc. v. Powers*, 352 S.E.2d 265 (N.C. Ct. App. 1987), is inapposite since the manufacturing exemption applied to a "manufacturing industry or plant." In denying the exemption, the court concluded that the "essence of" the taxpayer's operation was selling, not producing. Missouri's Production Exemptions

express no exclusion where the taxpayer is a retailer, as evidenced by this Court's decisions allowing the exemption to retailers who produce their products.

Finally, *York Steak House Systems, Inc. v. Commissioner of Revenue*, 472 N.E.2d 230 (Mass. 1984) is inapposite. There, the question was whether a property tax exemption for a "manufacturing corporation" applied. The court concluded that thawing and cooking a steak did not constitute manufacturing. That conclusion would appear to be at odds with this Court's decision in *Hudson Foods, Inc. v. Director of Revenue*, 924 S.W.2d 277 (Mo. banc 1996) (concluding that cooling, freezing, and crusting, of processed turkeys each constituted a sufficient transformation to constitute "processing").

As explained above, courts that have construed exemption statutes more like Missouri's have concluded that the exemptions apply. For instance, in *KFC of Ohio, Inc., d/b/a Kentucky Fried Chicken v. Kosydar, supra*, the Ohio Bd. of Tax Appeals allowed the sales and use tax manufacturing exemption for a restaurant's chicken fryers and other equipment. There, the exemption applied to purchases of property used "directly in the production of tangible personal property for sale by manufacturing, processing, refining or mining[.]" The definition of "manufacturing" or "processing" was statutorily defined as:

The transformation or conversion of material or things into a different state or form from that in which they originally existed and ... includes the adjuncts used during and in, and necessary to carry on and continue, production to complete a product at the same location after such transformation or converting has commenced.

And, in *Indianapolis Fruit Co. v. Department of State Revenue*, 691 N.E.2d 1379 (Ind. Tax Ct. 1998), the Indiana Tax Court determined that equipment used to ripen bananas qualified for the exemption for “manufacturing machinery, tools and equipment used to produce ‘other tangible personal property.’” There, the taxpayer used equipment and gas to chemically ripen bananas. The court granted the exemption because the process transformed the bananas from an unmarketable state to a marketable state that was of a substantially different “form, composition or character[.]” That taxpayer’s processes caused a much smaller change in the value of the food product than Brinker’s herein. These statutory schemes more closely mirror Missouri’s than those schemes of the states whose decisions the Director cites.³

³ Some states have no need for the courts to resolve this dispute. For instance, the state of Alabama treats restaurants as manufacturers in Regulation 810-6-2-.79.04(1) (“Restaurants and cafeterias are considered to be processors and compounders of food products for sale; therefore, they are entitled to purchase machines used in processing and compounding at the reduced rate[.]”). The same is true for the state of Texas. *See* Texas Tax Code section 151.318(a)(2), which exempts tangible personal property used directly in or during the manufacturing of tangible personal property for sale if the use of the property is necessary or essential to the manufacturing, processing, or fabrication operation and directly makes or causes a chemical or physical change to the product being manufactured, processed, or fabricated for ultimate sale (qualifying equipment includes equipment used to cook, mix, chop, brew, or blend food or beverages for sale).

In summary, the decisions from other states are either irrelevant because the courts addressed entirely different exemption schemes, or they support Brinker's construction of Missouri law, as in the case of the decisions from Ohio and Indiana. And Brinker is aware of no production exemption statute in any other state that defines a "product" as broadly as section 144.010.1(14) does, to include taxable services.

II. The Property Used by Brinker’s Customers is Resold

Introduction

The Director does not dispute, nor could she, that the purpose of the resale exclusion (and also the resale exemption) is to prevent multiple taxation. Nor does she dispute that under her position in this case, the property that customers use (Dining Property) will be subject to multiple taxation—first, when Brinker buys it, and again when Brinker makes the bundled sale of meals and drinks and the right to use that property.

The Director acknowledges that the definition of “resale” is the same as the definition of “sale” (Dir. Br. 37). Brinker’s transfer of the right to use the Dining Property is clearly a “sale” under section 144.605(7), so it is clearly a “resale.” If Brinker, for a charge, provided its customers solely the temporary use of the Dining Property, without also the bundled sale of the food and drink, would there be any question that such transfer was a taxable “sale” of tangible personal property? Of course the Director would claim that the transfer was a taxable sale. If the transaction is a “sale” for purposes of taxation, then the transaction is a “resale” for purposes of the resale exclusion.

A. Petitioner’s Dining Property Meets All Three Elements for a Resale

The use tax law excludes from tax (Sections 144.610, 144.605(10) and (13)) and also exempts from tax (section 144.615(6)) a purchase for resale. Brinker has clearly asserted both the exclusion and the exemption, but emphasized the exclusion because to construe the exclusion is to construe the words of the tax imposition statute. The Director

has ignored the exclusion in her brief, largely because tax imposition statutes are strictly construed against the Director. *Moore Leasing, Inc. v. Director of Revenue*, 869 S.W.2d 760 (Mo. banc 1994). Either way, Brinker's purchases of the Dining Property were for resale.

The parties agree that in order to have a resale, the following is required: (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 consideration paid. Section 144.605(7); *Sipco, Inc. v. Director of Revenue*, 875 S.W.2d 539, 541 (Mo. banc 1994). Dir. Br. 37. The Director does not contest that Brinker meets the first two elements in that it transfers the right to use tangible personal property. Dir. Br. 37. Rather, the Director, like the Commission, disputes whether Brinker receives consideration for the transfer.

Brinker's transfer of the right to use the Dining Property is for consideration under section 144.605(7) because, as a condition of such transfer, Brinker's customers are required to buy its food and drink products, the price of which includes the cost of the Dining Property. The Director's basis for disputing the existence of consideration is not entirely clear, but appears to be based at least in part on an incorrect factual assumption, namely that Brinker does not really factor the cost of the Dining Property into the cost of its food and drink products that its customers are required to buy. In essence, the Director contends that the use of that Dining Property is free. However, the undisputed facts in the record, as found by the Commission, refute that claim. Brinker's customers were required to make purchases of food and drink products in order to use the Dining

Property (L.F. 20, ¶¶ 23-4; L.F. 372, ¶16) and the cost of that property was indeed factored into the price Brinker charged for the food and drink products (L.F. 372, ¶17). Between 3 percent and 12 percent of Brinker's sales are take-out and the remainder are dine-in (L.F. 360, ¶ 3). It is true that the imbedded cost of the take-out property (like disposable plates, bowls and covers, cups and lids, plastic utensils, single-serving condiments and bags) provided to customers who did not use the Dining Property was the same as the imbedded cost of the Dining Property for those customers who did not receive take-out property, and thus customers were charged the same price for their food and drink products whether they dined in or took the food products to go. But that does not mean that the customers using the Dining Property were not paying for such use by their required purchase of food and drink products, the cost of which included the cost of the Dining Property. Nor does that mean that the customers who received take-out property were not paying for the same by their required purchase of food and drink products, the cost of which included the cost of the dine-out property. It merely means that the "higher price" was the same, because in neither case were customers given only food and drink products. In one case, they were also given the right to use the Dining Property and, in the other case, they were also given the take-out property. That imbedded charge was a very real 7 to 10 percent of the charge for the food and drink products (L.F. 351, ¶ 2).

The Director argues that there are two lines of cases, with two different standards, to determine whether consideration exists. She argues that a required purchase is all that is needed when a vendor permanently transfers the subject resold property. Dir. Br 41.

However, the Director claims that where the right to use the subject resold property is transferred, it is not enough that the vendor show a required purchase; the vendor must also show that customers who use the subject resold property paid “a higher price” for their required purchases. Dir. Br. 45. It is unclear what the Director means since Brinker’s customers are clearly paying for the use of the Dining Property as its cost is reflected in the price of the required food and drink purchases. To the extent that the Director advocates two standards for consideration, she does not trace these different standards to any language in section 144.605(7)’s definition of “sale” nor to any construction of “consideration.” Rather, the Director claims that such a requirement is implied by this Court’s decisions. As explained below, the Director has misconstrued these decisions.

This Courts’ decisions are clear that consideration exists where the recipient of the subject property is required to make a purchase in order to receive the subject property and the cost of the subject property was factored into the price of the required purchase. Thus, it did not matter in *Kansas City Royals Baseball Corp. v. Director of Revenue*, 32 S.W.3d 560, 562 (Mo. banc 2000), that some fans who purchased tickets did not receive the “free” promotional item. That is because the fans who did receive the promotional items were required to purchase a ticket to the game, the cost of which included the cost of promotional items. Likewise, in *Aladdin’s Castle v. Director of Revenue*, . 916 S.W.2d 196 (Mo. banc 1996), it did not matter that some patrons who purchased tokens received no “plush” since all patrons receiving plush were required to purchase tokens.

The Director opines (Dir. Br. 43-4) that in *Ronnoco Coffee Co., Inc. v. Director of Revenue*, 185 S.W.3d 676 (Mo. banc 2006), this Court required, as proof of consideration, that customers receiving use of the subject property must meet a different standard for consideration. This Court held no such thing. This Court merely recognized that when the cost of the subject property was factored into the price of the goods required to be purchased, there was consideration: “there is no stated extra charge for customers’ use of the equipment, but consideration is given insofar as the customers’ cost for the products used with the equipment reflects the cost of the use of the equipment itself.” *Id.*, 185 S.W.3d at 680. In other words, the coffee equipment was resold because Ronnoco’s customers were required to buy coffee, and the price of the coffee reflected, among other things, the cost of the equipment. Here, Brinker’s customers using the Dining Property were required to purchase food and drink products that they consumed by use of such Dining Property, and the cost of those food and drink products included the cost of the Dining Property.⁴

⁴ Although unclear, the Director appears to believe (Dir. Br. 38) that Brinker claims the resale exclusion for all property it purchases merely because all purchases are factored into the price of its products. That is an incorrect. Brinker claims the exclusion only for property that, in the words of section 144.605(7), is transferred to and used by its customers.

This Court should resist the Director's invitation to revise this Court's decisions in the Director's quest for multiple taxation.⁵

B. Section 144.011.1(10) Does Not Alter the Result

As indicated in Brinker's opening brief, section 144.011.1(10) (which excludes certain purchases of nonreusable property from "sales at retail") is silent as to the tax treatment of reusable property resold by restaurants. Despite that, the Director relies on that section to conclude that all reusable items provided to customers by restaurants are subject to Missouri use tax, regardless of whether they are resold. Although practically invited to do so in Brinker's opening brief, the Director fails to note any provision of the

⁵ The Director's citation and discussion of two Commission decisions addressing the resale exemption at hotels is completely off the mark. *Chase Hotel, Inc. v. Director of Revenue*, No. RS-80-0042 (Mo. Admin. Hearing Comm'n, July 28, 1982) (concluding factually that hotels, rather than their guests, used hotel room furnishings such as drapes and air conditioners) and *Drury Supply Co. v. Director of Revenue*, No. 95-000870 RV (Mo. Admin. Hearing Comm'n, October 8, 1996) (concluding factually that hotels resold "free" breakfasts that were included in the room rate but that property like towels were not resold to guests because the guests' right to use the same was limited) do not address the issues herein and are not helpful. If the issue of resales at hotels were before this Court, it would be well to consider *Kansas City Power and Light Co. v. Director of Revenue*, 83 S.W.3d 548 (Mo. banc 2002) (concluding that a hotel resold electricity to its patrons).

use tax law employing the terms “retail sale” or “sale at retail.” That is because those terms are not used. Nevertheless, the Director divines a legislative intent to expand the use tax imposition statute to tax all reusable property provided by restaurants to their customers, even if that property is purchased for resale. Such was clearly not the intent.

Under sections 144.605 and 144.610, property held for resale is simply not subject to the use tax because it is not included under the definitions of “storage,” “use,” or “consumption.” Section 144.011.1(10), on its face, does not define or in any way alter the use tax imposition statute, a statute that is to be strictly construed in favor of the taxpayer. Section 144.011 has the clear purpose of identifying transactions that are not taxable. It is not a tax imposition statute; nowhere in section 144.011 is any sales or use tax imposed. Nowhere does section 144.011.1(10) indicate that **reusable** property sold by restaurants to their guests are not in fact sold for purposes of the resale exclusion and exemption. Yet, the Director reads that conclusion into the statute. The Director’s construction is simply not supported by the words of the statute and makes no sense.

The Director fails to address *Smith Beverage Co. of Columbia v. Reiss*, 568 S.W.2d 61, 67-8 (Mo. banc 1978) (section 144.011(9) exclusion for reusable bottles for which a deposit is required did not trump the use tax resale provisions), a case that Brinker relied on in its opening brief (App. Br. 37-8). There, this Court concluded that the resale exemption was not otherwise trumped because, like here:

Section 144.011 makes no reference to or restricts in any way ...
§ 144.615(6).... And nothing appears from which it may reasonably be
inferred the legislature intended to ... restrict § 144.615(6) as it had been

formerly construed. To the contrary, it may be fairly inferred no change or restriction of the Use Tax exemption statute was intended for if it were otherwise the legislature could readily have expressed that intention in the statute.

Moreover, as explained in Brinker's opening brief and not addressed in the Director's brief, the Director's offered construction of section 144.011.1 would lead to absurd results on multiple levels. With respect to section 144.011.1(10), the Commission's construction would render taxable, merely because they are reusable property, a restaurant's purchases of reusable property like glasses, plastic cups or mugs (normally inscribed with the restaurant's name) that are **permanently transferred** by restaurants to customers as part of their taxable food and drink purchases. And with respect to section 144.011.1(9), the Commission's construction would deny the resale exclusion for purchases of reusable bottles by bottlers simply because no deposit was required on the ultimate sale of the bottles and their contents. Similarly, such a construction would deny the resale exclusion for the purchase of nonreusable containers like aluminum cans or bottles simply because the containers are nonreusable. That would be an odd result for a statute obviously designed to exclude various sales from Missouri sales and use tax.

This Court should resist the Director's invitation to transform a tax exclusion statute into a tax imposition statute, particularly where, as here, such a construction would lead to multiple taxation of the same property.

CONCLUSION

For all of the foregoing reasons, this Court should reverse the decision of the Commission and remand with instructions to grant the subject refund claim.

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CERTIFICATE OF SERVICE AND COMPLIANCE

The undersigned hereby certifies that a true and correct copy of the foregoing, as well as a labeled disk containing the same, were served by first class mail, postage prepaid, or hand-delivered this ____ day of April, 2010, to:

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I hereby further certify that the foregoing brief complies with Rule 55.03 and with the limitations contained in Rule 84.06(b), in that it contains 7,724 words.

I hereby further certify that the labeled disk, simultaneously filed with the hard copies of the briefs, has been scanned for viruses and is virus-free.

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