

No. SC89559

IN THE MISSOURI SUPREME COURT

ICC MANAGEMENT, INC.,

Appellant,

v.

DIRECTOR OF REVENUE, STATE OF MISSOURI,

Respondent.

BRIEF OF RESPONDENT DIRECTOR OF REVENUE

CHRIS KOSTER
Attorney General

GARY L. GARDNER
Assistant Attorney General

P.O. Box 899
Jefferson City, Missouri 65102
(573) 751-3321
(573) 751-9456 (facsimile)
gary.gardner@ago.mo.gov

ATTORNEYS FOR RESPONDENT
DIRECTOR OF REVENUE

TABLE OF CONTENTS

Statement of Facts5

Argument

ICC Management, Inc. is not entitled to a resale exclusion or resale exemption from sales and use tax on its purchase of tangible personal property that it provides to persons it confines for municipalities in its private jail, because ICC is providing non-taxable detention services, not transferring tangible personal property; if ICC is transferring property, there is no sale at retail of that property to municipalities.

Standard of review7

The resale exclusion and exemption8

No resale exclusion or exemption.....10

Conclusion17

Certificates of Service and Compliance.....18

Appendix

Table of Contents of Appendix

Decision of Administrative Hearing Commission.....A1

Section 144.010, Cum. Supp. RSMo 2008.....A13

Section 144.605, RSMo 2000.....A16

TABLE OF AUTHORITIES

Cases

<i>Aladdin’s Castle, Inc. v. Director of Revenue,</i> 916 S.W.2d 196 (Mo. banc 1996)	11
<i>Dean Machinery Co. v. Director of Revenue,</i> 918 S.W.2d 244 (Mo. banc 1996)	11, 12
<i>Kansas City Power and Light Co. v. Director of Revenue,</i> 83 S.W.3d 548 (Mo. banc 2002)	8, 9, 10
<i>Kansas City Royals Baseball Corp. v. Director of Revenue,</i> 32 S.W.3d 560 (Mo. banc 2000)	9, 10
<i>McDonnell Douglas Corp. v. Director of Revenue,</i> 945 S.W.2d 437 (Mo. banc 1997)	14, 15, 16
<i>Sipco, Inc. v. Director of Revenue,</i> 875 S.W.2d 539 (Mo. banc 1994)	11
<i>Six Flags Theme Parks, Inc. v. Director of Revenue,</i> 102 S.W.3d 526, 527 (Mo. banc 2003)	7, 11
<i>Westwood Country Club v. Director of Revenue,</i> 6 S.W.3d 885 (Mo. banc 1999)	7, 12, 15, 16

Statutes & Rules

§ 144.010, RSMo 8, 12, 16

§ 144.020, RSMo 8, 10, 11, 12, 15

§ 144.030, RSMo 10, 13, 15, 16

§ 144.605, RSMo9

§ 144.610, RSMo8

§ 144.615, RSMo9

12 CSR 10–112.30014

Other Authorities

Mo. Const. Art. III, § 3913

STATEMENT OF FACTS

The Director of Revenue adds the following facts:

ICC Management, Inc. (ICC) contracts with Missouri municipalities and one county in Kansas to provide for them at its private jail in Centerview, Missouri, detention, transportation, food, clothing, medical services, shelter, and “other usual services for low level custody inmates.” (Tr. 17, 20–25; ICC Ex. 2 at 78; Ex. 3 at 91; Ex. 5 at 102; Ex. 6 at 108, 115, 122) ICC charges a per diem amount under its contracts for each inmate it confines. (Tr. 42–43, 46–47) ICC purchases from in–state and out–of–state vendors food, utensils, clothing, bedding, and medical and personal hygiene supplies. (Tr. 37, 40–41, 82) ICC orders, receives, and pays for these items. (Tr. 52–55, 84) Then, ICC provides these items to the inmates it confines in its private jail. (Tr. 17–18, 25)

The Director of Revenue’s auditor discovered that ICC purchased these items under a claim of exemption or deducted sales tax from invoices before payment. (Tr. 88–89) ICC filed sales tax returns, but “was actually taking their revenues and zeroing out them out 100% as though they had had exemptions from the municipalities.” (Tr. 86; Director’s Ex. AO) The auditor discovered that the municipalities had not issued certificates of exemption. (Tr. 89) The exemption certificates that ICC provided its in–state vendors include exemption as a social organization, charitable organization, penal institution, manufacturer utilizing

materials that become component parts, and a retail sales license. (Tr. 82–83; Director’s Ex. AF1) The director assessed ICC \$14,056.25 in sales tax and \$5,459.79 in use tax, plus interest. (Tr. 82; Director’s Ex. D8)

ICC’s contracts provide for no third party beneficiary enforcement. (ICC Ex. 2 at 79; Ex. 3 at 92; Ex. 5 at 103; Ex. 6 at 109, 116, 123)

ARGUMENT

ICC Management, Inc. is not entitled to a resale exclusion or resale exemption from sales and use tax on its purchase of tangible personal property that it provides to persons it confines for municipalities in its private jail, because ICC is providing non-taxable detention services, not transferring tangible personal property; if ICC is transferring property, there is no sale at retail of that property to municipalities.

Standard of review

This court reviews de novo the Administrative Hearing Commission's (AHC) interpretation of revenue laws. *Six Flags Theme Parks, Inc. v. Director of Revenue*, 102 S.W.3d 526, 527 (Mo. banc 2003). This court defers to the AHC's factual findings if they are supported by the law and substantial evidence on the entire record. *Id.*

The burden of proving a tax liability rests upon the director. *Id.* at 529. This court construes tax liabilities strictly against the taxing authority in favor of the taxpayer. *Id.* The burden of proving a tax exemption rests upon the taxpayer. *Id.* This court construes tax exemptions strictly against the taxpayer. *Westwood Country Club v. Director of Revenue*, 6 S.W.3d 885, 887 (Mo. banc 1999).

The resale exclusion and exemption

Section 144.020.1, RSMo, imposes a sales tax upon sellers of tangible personal property or taxable services at retail in this state. When a sale of a tangible or intangible product is not for the purchaser's use or consumption, but rather for the purpose of selling it to another, the sale is not taxable. This is known as the "sale for resale exclusion" from taxation. *Kansas City Power and Light Co. v. Director of Revenue*, 83 S.W.3d 548, 550–51 (Mo. banc 2002) (*KCPL*). The resale exclusion is derived from the text of the statutory definition of sale at retail.

"Sale at retail" means any transfer made by any person engaged in business as defined herein of the ownership of, or title to, tangible personal property to the purchaser, for use or consumption and not for resale in any form as tangible personal property, for a valuable consideration[.]

§ 144.010.1(10), App. A14; *KCPL*, 83 S.W.3d at 550. "A 'sale at retail,' which by this definition is a sale 'not for resale,' is subject to tax under section 144.020.1..., and by implication, a sale for resale is excluded from tax." *KCPL*, 83 S.W.3d at 551, quoting *Westwood*, 6 S.W.3d at 889–90.

Similarly, § 144.610.1 imposes a use tax upon the purchase outside of this state of tangible personal property that is stored, used, or consumed within this state. The sale of tangible personal property in the regular course of business is

excluded from the definition of “use” of property. § 144.605(13), App. A17.

Moreover, the use tax statutes provide for a specific exemption from taxation for tangible personal property held “solely for resale in the regular course of business.”

§ 144.615(6). The use tax statutes do not define the term “sale at retail,” but they do define the word “sale” as follows:

“**Sale**”, any transfer, barter or exchange of the title or ownership of tangible personal property, or the right to use, store or consume the same, for a consideration paid or to be paid[.]

§ 144.605(7), App. A16.

Thus, relying upon the statutory definitions of “sale at retail” and “sale,” this court has said that three elements are needed to find a resale: 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. *KCPL*, 83 S.W.3d at 551 (sales tax); *Kansas City Royals Baseball Corp. v. Director of Revenue*, 32 S.W.3d 560, 562 (Mo. banc 2000) (use tax).¹

¹ A statutory exemption from sales tax, different from the resale exclusion and resale exemption and known as the component part or ingredient exemption, is authorized when materials that are used in manufacturing or processing “become a component part or ingredient of the new personal property” resulting from the

In this case, however, there is no resale because there is no transfer of tangible personal property, but of non-taxable detention services. If there is a transfer of tangible personal property, there is no resale because the transfer is not taxable.

No resale exclusion or exemption

ICC says that the three-element test for a resale is enough for it to qualify for the resale exclusion and resale exemption and that the AHC, when it decided that any resale must be a taxable sale (App. A8–A10), “added a new fourth part” to the three element test. (ICC Brief at 7) But the AHC merely recognized that this court has applied the three-element test when there is a taxable, subsequent sale at retail. In other words, this court has applied the resale exclusion and resale exemption when tax could be imposed at a later stage in the stream of commerce. In *KCPL*, where this court held that a power company’s sale of electricity to a hotel was for resale, sales tax could be imposed upon the subsequent sale at retail of electricity by the hotel to its guests. 83 S.W.3d at 550; § 144.020.1(3). In *Kansas City Royals*, where this court held that a baseball club’s purchase of promotional items was for resale, sales tax was collected and remitted upon the subsequent sale at retail of admission tickets. 32 S.W.3d at 561, 562. Where this court held that an manufacturing or processing, and the new personal property is intended to be sold for use or consumption. § 144.030.2(2).

arcade's purchase of prizes was for resale, sales tax was paid upon the subsequent sale at retail of tokens. *Aladdin's Castle, Inc. v. Director of Revenue*, 916 S.W.2d 196, 197, 198 (Mo. banc 1996).

Moreover, this court has recognized that the exclusions and exemptions from sales and use taxation serve to avoid double taxation. The resale exclusion from sales taxation "taxes property only once, not at every transaction in the stream of commerce." *Dean Machinery Co. v. Director of Revenue*, 918 S.W.2d 244, 246 (Mo. banc 1996) (heavy equipment dealer's purchase of rework parts was for resale when their cost was included in price charged for new parts). The exclusions and exemptions from sales and use taxation "avoid multiple taxation of the same property as it passes through the chain of commerce[.]" *Sipco, Inc. v. Director of Revenue*, 875 S.W.2d 539, 541, 542 (Mo. banc 1994) (meat packer's purchase of dry ice to preserve meat during delivery, though no explicit charge for ice, was for resale). "[O]ne need not be an accountant to understand," *Sipco*, 875 S.W.2d at 542, that sales tax was collected upon the subsequent, sale at retail of packaged meat and new heavy equipment parts.²

² Another double taxation avoidance provision exists in § 144.020.1(8). "The purpose of Missouri's sales tax system is to tax property once and not at various stages in the stream of commerce, regardless of who is receiving the benefit of the property." *Six Flags*, 102 S.W.2d at 530.

The converse — the other side of the coin — of avoiding double taxation is taxing property in the stream of commerce at least once. “The purpose of Missouri’s sales tax system is to tax property once and not at various stages in the stream of commerce.” *Westwood*, 6 S.W.3d at 888, citing *Dean Machinery*, 918 S.W.2d at 245–46. This court has recognized that the resale exclusion does not apply where there is no taxable, subsequent sale of tangible personal property at retail. In *Westwood*, the country club’s purchase of food and drink for its members was taxable and not purchased in a sale for resale. Its subsequent service of the food and drink to its members was not a sale at retail or a resale because it was not a taxable sale of tangible personal property to the public. 6 S.W.3d at 887–88; § 144.020.1(6).

[S]ince *Westwood*’s service of food and beverage is not a sale at retail, *Westwood*’s purchases do not fit the exclusion. ... The exclusion of goods for resale is contained in section 144.010.1(9)³], which defines “sale at retail.” Put simply, there must be a “sale at retail” in order for the “resale” exclusion of the section to apply.

Westwood, 6 S.W.3d at 887–88. The sale at retail was the country club’s purchase of food and drink, not its service of food and drink. Nor was the country club entitled to the component part exemption because the country club was attempting

³ The statute has since been renumbered.

to use the principle of avoiding double taxation “to avoid being taxed even once.”

Id.

In this case, too, ICC seeks to avoid being taxed and asks that the sale of property in the stream of commerce not be taxed even once. ICC says that it sells tangible personal property — food, utensils, clothing, bedding, and medical and personal hygiene supplies that are consumed by inmates — to the municipalities with which it contracts and that these sales are not taxable. ICC says that these sales of tangible personal property are exempt from taxation under Missouri statute, § 144.030.1, and constitution, Mo. Const. Art. III, § 39(10). (ICC Brief at 8-9) Rather, there is no sale of these items because they are part of a non-taxable service, the detention services, that ICC provides municipalities. Because ICC is providing non-taxable detention services to municipalities, there is no sale at retail or resale of tangible personal property. The sale at retail was ICC’s purchases of these items. And even if ICC were selling tangible personal property to municipalities, as explained below, there still would be no sale at retail or resale because the sales are exempt from taxation. The sale at retail remains ICC’s purchases of these items.

ICC says that the AHC created a conflict with *McDonnell Douglas*. (ICC Brief at 8) But that case is limited to the unique area of federal contracting, where by operation of federal law, title to tangible personal property purchased by federal

contractors for use in performance of their contracts (in that case, manufacturing military aircraft and missiles) vests in the government even *before* the property is used or consumed in performance. *McDonnell Douglas Corp. v. Director of Revenue*, 945 S.W.2d 437, 439, 440 (Mo. banc 1997).⁴ Here, municipalities are not purchasing tangible personal property, but inmate detention services. Here, municipalities never obtained ownership of or title to the food, utensils, clothing, bedding, and medical and personal hygiene supplies ICC purchased. Nor did the municipalities or their inmates obtain the *right* to use, store, or consume that property. *Sisney v. State*, 754 N.W.2d 639, 644 (S.D. 2008) (inmates lacked standing to enforce contract to provide food services). Though inmates ate food, wore clothes, and used soap, that property always remained under the control of ICC, as it should in a detention facility. ICC used these items by providing them to the municipalities' inmates as part of its detention services.

To resolve the purported conflict, though, ICC says that in *McDonnell Douglas*, as here, a retail sale of tangible personal property to a governmental

⁴ For the same reason, the director's regulation does not conflict with the AHC decision, as ICC says. (ICC Brief at 12) The director's regulation is based on the unique title vesting provisions of federal law. 12 CSR 10–112.300 (3)(B)(1).

entity was exempt from taxation, whereas in *Westwood* there was no sale at retail.⁵ ICC distinguishes between transactions that are not subject to tax because the taxing statute does not impose liability and, thus, does not create a sale at retail, *Westwood* and § 144.020.1(6), and transactions that are not subject to tax because of an exemption from a “retail sale,” *McDonnell Douglas* and § 144.030.1. (ICC Brief at 9–11)

ICC’s distinction serves only to avoid taxation entirely and loses sight of the difference between the sale of tangible personal property and the sale of non-taxable services. Here, as in *Westwood*, the resale exclusion and resale exemption do not apply because a non-taxable service, rather than tangible personal property, is being provided. In *Westwood*, the taxing statute did not impose liability upon the service of food and drink to persons who were not members of the public. In this case, the taxing statute does not impose liability upon the transfer of detention services.

Moreover, even if ICC were transferring tangible personal property, as the AHC decided (App. A5–A8), the resale exclusion and resale exemption would not

⁵ ICC also says that the AHC decided that *Westwood* overruled *McDonnell Douglas* (ICC Brief at 9), but the AHC only noted that the case was decided before *Westwood* and did not discuss whether the subsequent sale must be subject to taxation to be a sale at retail. (App. A10)

apply. Section 144.030.1's characterization of sales of tangible personal property that Missouri is prohibited from taxing by the federal and state constitutions as "retail sales" does not control whether a "sale at retail" has occurred. A "sale at retail" occurs when the statutory three-elements are met, § 144.010.1(10), and when the sale is taxable. (App. A8–A10) Moreover, how the absence of taxation comes about — no statutory imposition of liability, constitutional prohibition against liability, or statutory exemption from liability — is irrelevant. Here, as in *Westwood*, the absence of a taxable sale, regardless of the reason, results in no "sale at retail." Insofar as *Westwood* conflicts with *McDonnell Douglas*, that conflict should be resolved by applying Missouri's policy of both avoiding double taxation and taxing the sale or use of property in the stream of commerce at least once. Missouri's policy should prevail.

CONCLUSION

For the reasons stated above, the decision of the Administrative Hearing Commission should be affirmed.

Respectfully submitted,

CHRIS KOSTER
Attorney General

GARY L. GARDNER
Assistant Attorney General
Missouri Bar No. 24779

Post Office Box 899
Jefferson City, Missouri 65102
(573) 751-3321
(573) 751-9456 (facsimile)
gary.gardner@ago.mo.gov

ATTORNEYS FOR RESPONDENT
DIRECTOR OF REVENUE

CERTIFICATES OF SERVICE AND COMPLIANCE

I hereby certify that 1 copy and 1 computer diskette of the foregoing was served by first-class mail, postage prepaid, this 18th day of February, 2009, upon:

John W. Simpson
Shook, Hardy & Bacon L.L.P.
2555 Grand Boulevard
Kansas City, MO. 64108

Roger Freudenberg
Department of Revenue
P.O. Box 475
Jefferson City, MO 65105-0475

I hereby certify that this brief contains the information required by Rule 55.03, complies with the limitations contained in Rule 84.06(b), and contains 2910 words and that the diskettes provided this court and counsel have been scanned for viruses and are virus-free.

Assistant Attorney General

APPENDIX

Table of Contents of Appendix

Decision of Administrative Hearing Commission.....	A1
Section 144.010, RSMo Cum. Supp. 2008	A13
Section 144.605, RSMo 2000	A16