

SC93083

IN THE SUPREME COURT OF MISSOURI

UNION ELECTRIC CO.,

Appellant,

vs.

DIRECTOR OF REVENUE,

Respondent.

**Appeal from the Administrative Hearing Commission
The Honorable Sreenivasa Rao Dandamudi, Commissioner**

BRIEF OF RESPONDENT

**CHRIS KOSTER
Attorney General**

**JEREMIAH J. MORGAN
Mo. Bar No. 50387
Deputy Solicitor General
P.O. Box 899
Jefferson City, MO 65102-0899
(573) 751-1800
(573) 751-0774 (Facsimile)
Jeremiah.Morgan@ago.mo.gov**

**ATTORNEYS FOR
RESPONDENT**

TABLE OF CONTENTS

TABLE OF AUTHORITIES	ii
STATEMENT OF FACTS	1
SUMMARY OF THE ARGUMENT	5
ARGUMENT	7
I. The Statutory Language and Controlling Caselaw Do Not Support the Refund Claim in This Case Because Heating Up Frozen Items for Retail Sale at a Grocery Store is Not Manufacturing or Processing Within the Meaning of § 144.054. – Responding to Appellant’s Point Relied On.	8
A. The Statutory Language Does Not Support an Exemption for Grocery Stores Heating Up Frozen Items for Retail Sale.	9
B. This Court’s Decision in <i>Aquila</i> is Controlling.	11
II. An Example in a Regulation Does Not Control Over the Supreme Court’s Decision Interpreting the Actual Statutory Language. – Responding to Appellant’s Point Relied On.	18
CONCLUSION.....	21
CERTIFICATE OF SERVICE AND COMPLIANCE	22

TABLE OF AUTHORITIES

CASES

<i>Aquila Foreign Qualifications Corp. v. Dir. of Revenue,</i>	
362 S.W.3d 1 (Mo. banc 2012)	<i>passim</i>
<i>Arizona Dep’t of Revenue v. Blue Line Distrib., Inc.,</i>	
43 P.3d 214 (Az. App. 2002)	16
<i>Branson Properties USA, L.P. v. Dir. of Revenue,</i>	
110 S.W.3d 824 (Mo. banc 2003)	7
<i>Brinker Mo., Inc. v. Dir. of Revenue,</i>	
319 S.W.3d 433 (Mo. banc 2010)	7, 9, 10, 14
<i>Cook Tractor Co., Inc. v. Dir. of Revenue,</i>	
187 S.W.3d 870 (Mo. banc 2006)	8
<i>Dir. of Revenue v. Armco, Inc.,</i>	
787 S.W.2d 722 (Mo. banc 1990)	7
<i>Finnegan v. Old Republic Title Co. of St. Louis, Inc.,</i>	
246 S.W.3d 928 (Mo. banc 2008)	7
<i>Foremost-McKesson, Inc. v. Davis,</i>	
488 S.W.2d 193 (Mo. banc 1972)	20
<i>Galamet, Inc. v. Dir. of Revenue,</i>	
915 S.W.2d 331 (Mo. banc 1996)	12

<i>Golden Skillet Corp. v. Commonwealth,</i>	
199 S.E.2d 511 (Va. 1973)	17
<i>Hansen v. State, Dep't of Soc. Servs., Family Support Div.,</i>	
226 S.W.3d 137 (Mo. banc 2007)	19
<i>HED, Inc. v. Powers,</i> 352 S.E.2d 265 (N.C. App. 1987)	17
<i>McDonald's Corp. v. Okla. Tax Comm'n,</i>	
563 P.2d 635 (Okla. 1977)	16
<i>Mo. Pub. Serv. Comm'n v. Dir. of Revenue,</i>	
733 S.W.2d 448 (Mo. banc 1987)	7
<i>PharmFlex, Inc. v. Div. of Emp't Sec.,</i>	
964 S.W.2d 825 (Mo. App. W.D. 1997)	19
<i>Roberts v. Bowers,</i>	
162 N.E.2d 858 (Ohio 1959)	16
<i>Stop 'N Save, Inc. v. Dep't of Revenue Servs.,</i>	
562 A.2d 512 (Conn. 1989)	17
<i>York Steak House Sys., Inc. v. Commissioner of Revenue,</i>	
472 N.E.2d 230 (Mass. 1984)	16

STATUTES

§ 144.020	7
§ 144.030	9, 11

§ 144.054.....	<i>passim</i>
----------------	---------------

OTHER AUTHORITIES

12 CSR 10-110.621(4)	1, 6, 13, 18
Mo. R. of Civ. P. 84.04 (f)	1

STATEMENT OF FACTS

In accordance with Mo. R. of Civ. P. 84.04 (f), the Director of Revenue provides the following additional facts for the Court's consideration.

Schnucks owns and operates retail grocery stores throughout the state of Missouri. (LF 2). Union Electric Co. d/b/a Ameren Missouri, in turn, provides electricity and natural gas to Schnucks for its grocery stores.^{1/} (LF 2). After years of paying taxes on its purchases of electricity and natural gas, in 2009 Schnucks, through Union Electric, sought a refund under § 144.054 for alleged “manufacturing, processing, compounding, mining or producing” in its grocery stores. (1 Tr.83:14 – 84:11, 86:10-18). The refund claim originally sought \$135,733.36 in taxes on electricity, and \$1,094.12 for natural gas. (LF 505-06). The claim was later revised to a total claim of \$106,073.38. (Hr'g Exs. 18, 21; 1 Tr. 116:5-10, 122:16-22).

The basis for Schnucks seeking an exemption from taxes under § 144.054, is a bakery example provided in a regulation – one of sixteen examples in the regulation. *See* 12 CSR 10-110.621(4)(O).

^{1/} For clarity, and the convenience of the Court, all references to Petitioner/Appellant Union Electric Co. d/b/a Ameren Missouri will be to Schnucks as the entity for which the tax refund is sought.

A. The “Bakery Department” Heats Up Frozen Items.

Each of Schnucks’ grocery stores includes a section designated “the bakery department.” (LF 4). In this portion of the grocery store, Schnucks sells baked items that are prepared in a backroom by store employees and then placed on the sales floor. (1 Tr. 25, 41–42). The employees do not mix flour and water, or anything of the sort; instead, all items are pre-formed and frozen, and then delivered to Schnucks in cases. (1 Tr. 31). Many of the frozen food items are already baked and need only to be thawed (1 Tr. 66), while others are frozen but uncooked (1 Tr. 27). Schnucks also purchases some of the frozen items from other vendors. (1 Tr. 51, 69). These items are then prepared for retail sale by employees. (1 Tr. 25).

The employees who heat up frozen items are paid hourly, like other grocery store employees. (1 Tr. 75). They receive 24 hours of training in the preparation of the items by another employee at the grocery store. (1 Tr. 77–78). Only one employee is required to perform each of the steps in preparing the items for retail sale. (1 Tr. 74). And in the process, the employees use a freezer, proofer, a refrigerator unit, an oven, a mixer, and a fryer. (1 Tr. 33–47, 69). The testimony of Schnucks’ witnesses indicate that these appliances perform the same functions as those found in the average home kitchen. (1 Tr. 33–47, 69).

As an example of Schnucks' simple baking activities, cookies are prepared for retail sale in the grocery stores. (Hr'g Ex. 1, pp. 4–7). The cookies come frozen and pre-made, and are simply removed from the freezer, placed on pans, and put in a 350-degree oven for 12 to 15 minutes. (1 Tr. 27–28). The cookies are then either packaged and labeled for the sales floor or put in self-service bins also located on the sales floor. (1 Tr. 28).

Similarly, donuts are prepared for sale by Schnucks' employees in the grocery store. (Hr'g Ex. 1, pp. 9–25). They come frozen and pre-made. (1 Tr. 33). The donuts are removed from the freezer, placed on pans and left overnight in a refrigerated unit. (1 Tr. 33–34). The donuts are then placed in the proofer, which is a temperature and humidity controlled container, for 30 minutes. (1 Tr. 34). The donuts are then fried in the frying well for approximately 35 seconds on each side. (1 Tr. 35). After the donuts cool and various toppings are added, the donuts are put on the sales floor. (1 Tr. 36). The preparation of other items is virtually identical, including stollens (1 Tr. 43), danishes and mini-danishes (1 Tr. 47), coffee cakes (1 Tr. 47), various puff pastries (1 Tr. 51–52), bagels (1 Tr. 57), breads (1 Tr. 60–62), pies (1 Tr. 60), and sheet cakes (1 Tr. 66, 69).

**B. The Administrative Hearing Commission Followed
the Supreme Court.**

The Director of Revenue denied the refund claim filed by Schnucks, and Schnucks appealed. (Hr’g Exs. 17, 20). The Administrative Hearing Commission also denied the refund claim. In its decision, the AHC found that “Schnucks prepared its baked goods for retail consumption” and was therefore not a manufacturer or processor as contemplated by § 144.054. (LF 509).

In support of its decision, the AHC concluded that this Court’s decision in *Aquila Foreign Qualifications Corp. v. Dir. of Revenue*, 362 S.W.3d 1 (Mo. banc 2012) controls the case, rather than a stray example in a regulation. (LF 511). Indeed, the AHC recognized that all of the examples in the regulation “[e]xcept for the bakery . . . share a common theme—they explicitly involve manufacturing or constructing activities.” (LF 517) (noting that even the hobby shop and telecommunications company examples are engaged in building something) (emphasis added). Accordingly, the AHC determined that this Court’s decision in *Aquila*, rendered the example in the regulation essentially inapplicable.

SUMMARY OF THE ARGUMENT

Unable to satisfy either the language of the statute or controlling caselaw, Schnucks resorts to an avoidance strategy in this case. Schnucks claims that instead of the statute or controlling caselaw, a regulation should control whether it is entitled to a tax exemption under § 144.054.2, and not just a regulation but a mere example in a regulation, and one of sixteen examples at that. This effort to avoid the law and controlling caselaw, however, fails.

In *Aquila Foreign Qualifications Corp. v. Dir. of Revenue*, 362 S.W.3d 1 (Mo. banc 2012), this Court considered a nearly identical claim made by Casey's for a tax exemption under § 144.054.2. Casey's, a convenience store that sells grocery items as well as baked items such as donuts and pizzas, argued that its preparation of food items made it a manufacturer or processor for purposes of the statute. Casey's even raised the same example in the regulation that Schnucks raises in this case. But to no avail. This Court, correctly, held that the manufacturing exemption in § 144.054.2 suggests "industrial-type" activities and not the "preparation of food for retail consumption." *Aquila*, 362 S.W.3d at *5 & 6.

While the factual circumstances are similar to those in *Aquila*, they are even more compelling in this case. Casey's at least mixed the flour and water to make their donuts and pizza crusts. Schnucks, in contrast, merely takes

frozen items that are pre-made and often pre-cooked and simply heats them up or bakes them. This type of food preparation for purposes of retail consumption does not satisfy the statute. And Schnucks knows that. As such, Schnucks' argument focuses on an example in a regulation.

The example provided in the regulation is one of a "bakery" that "creates baked goods for sale directly to the public or through retailers." 12 CSR 10-110.621(4)(O). On the strength of this example and the fact that Schnucks has a "bakery department" where its baked items are available for retail consumption, Schnucks claims the exemption in § 144.054.2. However, regulations cannot expand or modify statutes, and the statute in this case is limited to industrial-type food preparation. As such, the type of bakery that would satisfy the statute is not a grocery store that merely takes frozen pre-made, and often pre-cooked items and heats them up or bakes them for retail consumption. Schnucks is not an "industrial-type" bakery and its claim was properly rejected by the AHC.

ARGUMENT

Standard of Review

The only issues in this case are legal issues, and they involve the interpretation of a revenue law – § 144.054.2. This Court reviews the Administrative Hearing Commission’s interpretation of revenue laws *de novo*. *Brinker Mo., Inc. v. Dir. of Revenue*, 319 S.W.3d 433, 436 (Mo. banc 2010) (“Statutory interpretation is an issue of law that this Court reviews *de novo*.”); *Finnegan v. Old Republic Title Co. of St. Louis, Inc.*, 246 S.W.3d 928, 930 (Mo. banc 2008).

Purchases of electricity and natural gas by Schnucks are subject to tax imposed by § 144.020.1(3), while § 144.054 provides for certain sales and use tax exemptions. See § 144.054 (“Additional sales tax exemptions for various industries and political subdivisions.”). Tax exemptions are “strictly construed against the taxpayer.” *Branson Properties USA, L.P. v. Dir. of Revenue*, 110 S.W.3d 824, 825 (Mo. banc 2003); *Dir. of Revenue v. Armco, Inc.*, 787 S.W.2d 722, 724 (Mo. banc 1990) (noting that “strict construction is mandated for statutes establishing conditions for claiming an exemption”) (citing *Mo. Pub. Serv. Comm’n v. Dir. of Revenue*, 733 S.W.2d 448, 449 (Mo. banc 1987)). Indeed, an exemption is allowed “only upon clear and unequivocal proof, and doubts are resolved against the party claiming it.” *Id.* As such, the burden is on the taxpayer claiming the exemption “to show that

it fits the statutory language exactly.” *Cook Tractor Co., Inc. v. Dir. of Revenue*, 187 S.W.3d 870, 872 (Mo. banc 2006).

In this case, Schnucks cannot satisfy the burden to show that it fits the statutory exemption at all, much less exactly. Accordingly, the AHC’s decision to deny a refund under the exemption in § 144.054.2 should be affirmed.

I. The Statutory Language and Controlling Caselaw Do Not Support the Refund Claim in This Case Because Heating Up Frozen Items for Retail Sale at a Grocery Store is Not Manufacturing or Processing Within the Meaning of § 144.054. – Responding to Appellant’s Point Relied On.

In order to establish that it fits exactly the exemption in § 144.054, Schnucks must show that heating up frozen items at a grocery store solely for retail sales is “manufacturing, processing, compounding, mining, or producing” at a “production facility.” Schnucks cannot establish that it fits exactly the language of the manufacturing exemption here. What is more, Schnucks does not even attempt to do so. Instead, Schnucks quite obviously attempts to side-step the language of the statutory exemption and the controlling decision in *Aquila Foreign Qualifications Corp. v. Dir. of Revenue*, 362 S.W.3d 1 (Mo. banc 2012).

**A. The Statutory Language Does Not Support an
Exemption for Grocery Stores Heating Up Frozen
Items for Retail Sale.**

No one thinks of a restaurant or grocery store as a place where manufacturing, processing, compounding, mining, or producing occurs within the meaning of § 144.054, or that heating up frozen items for retail sale constitutes processing at a production facility. Schnucks, after all, is a retail merchant and not a manufacturer. (LF 2; 1 Tr. 72:13–15). The distinction between retailers and manufacturers in chapter 144 was considered and affirmed in *Brinker Mo., Inc. v. Dir. of Revenue*, 319 S.W.3d 433 (Mo. banc 2010).

In *Brinker*, this Court held that the manufacturing exemptions provided in § 144.030 apply only to manufacturers and not to retailers or merchants selling prepared food. *Brinker*, 319 S.W.3d at 436. The Court's decision interpreted the language of the statute, which is shared in many of the manufacturing exemptions in Chapter 144. The Court further found that "Brinker does not qualify for the exemptions under sections 144.030.2(4) and (5) because its restaurants are not 'plants' and because it prepares and serves food rather than manufactures a product." *Id* at 434.

Similar to the language of § 144.030.2(5) and (6), the language of the manufacturing exemption under § 144.054 is unmistakably associated with

entities whose purpose is production rather than retail sales. The term “manufacturing” or “processing” cannot be uprooted from this context; Schnucks is not a manufacturing or production facility; rather, Schnucks prepares pre-made food items only insofar as needed for immediate retail sale. Necessarily, the meaning of “manufacturing” and “processing” does not include the preparation activities of a grocery store, which are incidental to its operation as a retailer of food items.

What is more, the activity of heating up frozen items for immediate retail sale is not “manufacturing” or “processing” within the meaning of § 144.054. Indeed, the fallacy of Schnucks’ argument is demonstrated by its limitless expansion of the exemption. As Schnucks would have the Court read § 144.054.2, apparently every citizen of Missouri who bakes or prepares food, cookies, and bread is “processing,” and therefore exempt on purchases of electricity, materials, and equipment used in preparing meals. Likewise, heating up a soft pretzel at a ballgame would be manufacturing or processing. If the Missouri General Assembly intended such a broad exemption, one assumes that the General Assembly would have made it clear. Yet, the exemption is not to be broadly construed, but strictly construed. *Brinker*, 319 S.W.3d at 437 (“This Court will give the language used in the statute a narrow construction, not the exceedingly broad and peculiar meaning argued for by Brinker.”).

B. This Court's Decision in *Aquila* is Controlling.

The particular issue confronting the Court in this case was decisively determined in *Aquila Foreign Qualifications Corp. v. Dir. of Revenue*, 362 S.W.3d 1 (Mo. banc 2012). The Court held:

Giving effect to the legislative intent and strictly construing the exemption against the taxpayer, this Court holds that the preparation of food for retail consumption is not “processing” within the meaning of section 144.054.2.

Id. at 5-6. Schnucks, like the Casey's stores at issue in *Aquila*, is a retail store engaged in the retail sale of grocery items and prepared foods. Schnucks concedes that its food preparation takes place within its retail stores, and that its prepared items are put on the sales floor for retail consumption. (1 Tr. 28).

In *Aquila*, this Court reaffirmed its decision in *Brinker* and held that the in-store preparation of food for retail consumption by a retail store engaged in the sale of grocery items and prepared foods is not “processing” under § 144.054.2. *Aquila*, 362 S.W.3d at *4. This Court interpreted “processing” under § 144.054, in light of the judicial meaning given to the term in § 144.030, as “ordinarily included within the meaning of the more general and inclusive term “manufacturing,” and in accordance with the

“industrial-type terms” that surround it. *Id.* at *4 n10. The holding makes it clear that the tax exemption claimed by Schnucks in this case is intended for processors and manufacturers that produce products in industrial plants and processing facilities, and not retail stores, such as Schnucks, which simply prepare food items for sale on their sales floor.

The *Aquila* decision recognizes that extending the manufacturing exemptions to retailers, or to any person performing activities that merely contain aspects of manufacturing or processing, defies the General Assembly’s intent to encourage the growth of the manufacturing industry within the state. See *Galamet, Inc. v. Dir. of Revenue*, 915 S.W.2d 331 (Mo. banc 1996). It follows that, as retail grocery stores are not industrial businesses, but rather provide and prepare food items for retail consumption, the industrial exemptions under § 144.054.2 do not extend to the in-store food preparation of Schnucks any more than they extend to the activities of Casey’s in preparing food for sale on its retail sales floor.

Schnucks and Casey’s are both retail stores engaged in the retail sale of grocery items and prepared foods. *Aquila*, 362 S.W.3d at *1. Like Schnucks’ grocery stores, Casey’s stores compete with local and national grocery store chains, supermarkets, and discount food stores. The retail stores of Schnucks and Casey’s also share many of the same retail features. Schnucks’ grocery stores are comprised primarily of a sales floor, which is divided into retail

sections, similar to Casey's. (Hr'g Ex. 22). Also like Schnucks, Casey's described its business as a "bakery." *Aquila*, Case No. 09-0376 RS, pg. 3 ¶ 7. And just as Casey's food preparation occurs within its stores, in a kitchen behind the retail food section, Schnucks' food preparation also takes place within its stores, in a backroom located behind "the bakery department" sales floor. (Hr'g Ex. 23).

Furthermore, Casey's and Schnucks prepare many of the same baked items, such as donuts, cookies, apple fritters, turnovers, and puff pastry items. (Hr'g Ex. 1). Casey's also cited the bakery example within the Director's regulation – 12 CSR 10-110.621(4)(O) – in support of its position that the in-store preparation of baked items for retail sale constituted "processing." Brief of Appellant, *Aquila Foreign Qualifications Corp. v. Dir. of Revenue*, SC91784, 2012 WL 724745, 16 (Mo. Mar. 6, 2012). This Court was not persuaded by Casey's self-designated status as a "bakery," nor the regulation example, but instead conducted a threshold examination of the business activities of Casey's convenience stores to determine whether its operations were industrial or retail-oriented. *Aquila*, 362 S.W.3d at *3–4.

Consistent with its status as a retail grocery store, Schnucks presented no evidence at the hearing that its in-store food preparation occurred in an industrial production facility or plant. The appliances used in the backroom of Schnucks are not sophisticated or specialized machinery and equipment

requiring a skilled workforce, in contrast to that associated with industrial plants and production facilities. (1 Tr. 33–47, 69). In fact, the testimony of Schnucks’ witnesses indicates that most of the appliances in the store, such as the freezer, oven, mixer, retarder (which maintains temperatures equal to that of the average refrigerator), and counters, perform the same functions as those found in the average home kitchen. (1 Tr. 33–47, 69). The retail attributes shared by Casey’s and Schnucks are virtually indistinguishable.

What is more, the food preparation of Schnucks is substantially less extensive than that of the convenience stores in *Aquila* and the restaurants in *Brinker*. In *Brinker*, for example, the preparation activities of employees included cutting, cooking, mixing, and blending ingredients; baking, frying or otherwise cooking raw foods; and keeping food items chilled or warm during their preparation to keep from spoiling. *Brinker*, 319 S.W.3d at 435. Similarly, in Casey’s stores, several raw ingredients are cut, mixed, and then cooked, fried or baked.

In contrast, Schnucks employees do not cut, mix or blend ingredients. (Hr’g Ex. 1). Nor do they form the shape of the baked items. All of Schnucks’ baked items arrive as pre-made and pre-formed frozen items. (Hr’g Ex. 1). Schnucks’ preparation activities generally consist of removing frozen, pre-formed, and uncooked food items from the freezer and thawing the items. (Hr’g Ex. 1). After baking, a Schnucks employee places the items in a self-

service bin on the sales floor, or packages the items for its sales floor. (1 Tr. 28.) Like Casey's baked items, Schnucks' baked items are sold at retail in the grocery stores at which they are prepared, and are ready to eat without further preparation by the customer. (1 Tr. 50:25–51:3).

Casey's baked items, in fact, involve more preparation than Schnucks' baked items. For example, Casey's employees prepare donuts by mixing flour and water to form dough, which is then poured into machinery that cuts and shapes the donut, and then releases the donuts into the fryer. *Aquila*, 362 S.W.3d at *1. Schnucks employees simply remove pre-made, frozen donuts from the freezer to thaw and put them in the fryer. (1 Tr. 31, 35). The flour and water prepared by Casey's employees undergo a far greater transformation than the frozen, pre-made donuts cooked by Schnucks.

Casey's also prepares its pizza by mixing flour and water to form dough, which is then shaped into the pizza crust, topped, and cooked. *Aquila*, 362 S.W.3d at *1). In contrast, Schnucks' bread loaves begin as frozen bread loaves, which arrive pre-made and pre-formed. (Hr'g Ex. 1, pp. 69–94). The bread loaves are removed from the freezer, thawed, and baked. (1 Tr. 60). Once again, the flour and water prepared by Casey's employees undergo a greater transformation in becoming a pizza crust than Schnucks' frozen, pre-made bread loaf undergoes in becoming a loaf of bread.

Both Casey's and Schnucks are retail stores in which employees take raw, frozen items, prepare them for consumption by cooking or baking, and package them for immediate retail sale to customers in the store. It would be a direct departure from this Court's decision in *Aquila* to find that the food preparation of Schnucks in its retail stores constitutes "processing," when it held in *Aquila* that the more extensive food preparation of Casey's is not "processing." *Aquila*, 362 S.W.3d at *1.

Missouri caselaw is in accord with states throughout the country, which consistently hold that retail establishments preparing food for immediate sale are not manufacturing entities, and therefore, do not qualify for manufacturing exemptions.^{2/} The Connecticut Supreme Court, for

^{2/} See, e.g., *McDonald's Corp. v. Okla. Tax Comm'n*, 563 P.2d 635 (Okla. 1977) (holding that fast-food retailer's preparation of food for immediate retail sale was not manufacturing or processing); *York Steak House Sys., Inc. v. Commissioner of Revenue*, 472 N.E.2d 230 (Mass. 1984) (thawing and cooking a steak in a restaurant is not manufacturing); *Arizona Dep't of Revenue v. Blue Line Distrib., Inc.*, 43 P.3d 214 (Az. App. 2002) (holding that dough mixer was not exempt as manufacturing or processing equipment when purchased by a pizzeria); *Roberts v. Bowers*, 162 N.E.2d 858 (Ohio 1959) (holding that restaurateur was not a manufacturer); *Golden Skillet*

example, has specifically addressed the issue of whether a retail grocery store may claim a manufacturing exemption for its in-store preparation of baked items. *See Stop 'N Save, Inc. v. Dep't of Revenue Servs.*, 212 Conn. 454, 562 A.2d 512 (Conn. 1989).

The facts in *Stop 'N Save* are identical to the facts of this case. Like Schnucks, the taxpayer in *Stop 'N Save* operated retail grocery stores, which included in-store bakeries that prepare baked goods for immediate retail sale. *Id.* The court held that “baking products on the premises of the supermarkets did not change the primary purposes of the store from retail establishments to industrial plants and that, therefore, the manufacturing aspect of the baking did not qualify for the [manufacturing] exemption.” *Id.*

Here, the language of the statute as interpreted by this Court in *Aquila* is controlling – a retail grocery store that heats up frozen items is not manufacturing or processing within the meaning of § 144.054.

Corp. v. Commonwealth, 199 S.E.2d 511 (Va. 1973) (holding that equipment used in preparation and cooking of chicken for sale at retail was not exempt as processing or manufacturing); *HED, Inc. v. Powers*, 352 S.E.2d 265 (N.C. App. 1987) (holding that a restaurant is not a manufacturer).

II. An Example in a Regulation Does Not Control Over the Supreme Court's Decision Interpreting the Actual Statutory Language. – Responding to Appellant's Point Relied On.

Attempting to entirely sidestep controlling authority from this Court, not to mention the actual language of the statute, Schnucks relies entirely on a single example in the Director's regulation. The regulation – 12 CSR 10-110.621(4) – actually provides sixteen examples of circumstances in which the exemption in § 144.054 may be claimed, including “[a] bakery that creates baked goods for sale directly to the public or through retailers.” 12 CSR 10-110.621(4)(O). Schnucks asserts that because it heats up or bakes items to be sold directly to customers, and because it made the marketing decision to designate a particular retail section of its grocery stores as “the bakery department,” that it follows that Schnucks qualifies for the exemption for manufacturers under § 144.054.^{3/} It does not.

^{3/} The AHC, as an aside, suggested that Schnucks is a bakery, “whether for purposes of 12 CSR 10-110.621(4)(O) or any other statute or regulation.” (LF 518). While Schnucks certainly bakes items, such a conclusion does not mean that Schnucks is a “bakery” in accordance with the regulation or that it satisfies the statutory exemption. The fundamental question to be answered

The lynchpin of Schnucks' argument, and its effort to avoid *Aquila* and the statutory language, is this Court's conclusion in *Aquila* that the term "processing" in § 144.054 is ambiguous. *Aquila*, 362 S.W.3d at *3. On this basis, Schnucks asserts that the example in the regulation should control and not this Court's actual interpretation of the statutory language. But this entirely misses the point of a regulation.

Regulations are intended to clarify statutory provisions, not to expand the statutory provisions. Indeed, regulations of a state agency are invalid if "they attempt to expand or modify statutes." *Hansen v. State, Dep't of Soc. Servs., Family Support Div.*, 226 S.W.3d 137, 144 (Mo. banc 2007) (quoting *PharmFlex, Inc. v. Div. of Emp't Sec.*, 964 S.W.2d 825, 829 (Mo. App. W.D. 1997) ("Further, regulations may not conflict with the statutes and if a regulation does, it must fail."). This should be particularly true if the statute is a tax exemption and is to be strictly construed.

It is, therefore, unavailing for Schnucks to attempt to avoid this Court's interpretation of § 144.054 in *Aquila*, because the law requires that any

is how should the regulation be interpreted in light of the statute. Just because a person or entity bakes something does not mean it is a bakery in accordance with the regulation, much less that it satisfies the statutory exemption.

regulation be interpreted consistently with the statute. A regulation that expands or modifies the statute is “plainly inconsistent with the act.” *Foremost-McKesson, Inc. v. Davis*, 488 S.W.2d 193, 197 (Mo. banc 1972). As such, the reference to a bakery in the regulation’s example must be interpreted consistent with this Court’s decision in *Aquila*, which would require that the bakery be an industrial-type bakery and not merely a convenience store (Casey’s) or grocery store (Schnucks) that happens to heat up or bake items for retail sale. Otherwise, any person or entity could call itself a bakery, put in a toaster, and claim the exemption.

Casey’s raised this same argument in *Aquila*, and also cited to the bakery example in the regulation. *See* Respondent’s Brief, 2011 WL 7004828, *16. Not only did this Court not accept the example as controlling, but in fact the Court relied upon another example from the same regulation to demonstrate that preparing food for retail sale was not intended to be exempt. *Aquila*, 362 S.W.3d at *5. Because the language of the statute requires industrial-type manufacturing and processing to qualify for the tax exemption, then the same type of industrial-type manufacturing or processing is required to satisfy the example in the regulation. Simply because an item is baked at Schnucks does not mean that it satisfies the example in the regulation, much less the actual statutory language.

CONCLUSION

For the foregoing reasons, this Court should affirm the Administrative Hearing Commission's holding that heating up frozen items for retail sale at a grocery store is not manufacturing or processing within the meaning of § 144.054.

Respectfully submitted,

CHRIS KOSTER
Attorney General

By: /s/ Jeremiah J. Morgan
Jeremiah J. Morgan
Mo. Bar No. 50387
Deputy Solicitor General
P.O. Box 899
Jefferson City, MO 65102-0899
(573) 751-1800
(573) 751-0774 (facsimile)
Jeremiah.Morgan@ago.mo.gov

**ATTORNEYS FOR
RESPONDENT**

CERTIFICATE OF SERVICE AND COMPLIANCE

I hereby certify that a true and correct copy of the foregoing was filed and served electronically via Missouri CaseNet on July 15, 2013, to:

Erwin O. Switzer
Jennifer Mann Bortnick
GREENFELDER, HEMKER & GALE, P.C.
10 S. Broadway, Suite 2000
St. Louis, MO 63102
eos@greensfelder.com
jm@greensfelder.com

Attorneys for Appellant

and a copy of the foregoing was sent via interagency mail to:

Administrative Hearing Commission
Truman State Office Bldg.
Room 640
Jefferson City, MO 65101

The undersigned further certifies that the foregoing brief complies with the limitations contained in Rule No. 84.06(b) and that the brief contains 4,854 words.

/s/ Jeremiah J. Morgan
Deputy Solicitor General