IN THE
SUPREME COURT OF MISSOURI

No. SC88605

MICHAEL JAUDES FITNESS EDGE, INC.,

Appellant,

v.

DIRECTOR OF REVENUE,

Respondent.

Petition For Review
From The Administrative Hearing Commission,
The Honorable June Striegel Doughty, Commissioner

APPELLANT'S REPLY BRIEF

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ARGUMENT

As set forth in our opening brief, Appellant's sales tax refund claims filed for the tax periods beginning July 1, 2002 through and including December 31, 2004 should be granted. The issue before this Court can best be framed as whether the hourly charges made by Appellant to its clients for the following personal services:

1) health and physical screenings and evaluations;

2) strength training instruction and program development;

3) cardiovascular training programs; and

4) nutritional counseling

are subject to a levy of Missouri state and local sales tax. Appellant can most aptly be characterized as a seller of personal services. Since the types of services rendered by Appellant are not subjected to tax by §144.020.1, Appellant's charges to its clients should be excluded from the imposition of a Missouri state and local sales tax.

It appears from its brief that Respondent asserts that the consideration paid to Appellant for its services is subject to tax because the fees are paid to Appellant and that Appellant should be treated as a "place of amusement, entertainment or recreation, games and athletic events." In support of its position, Respondent is relying wholly on the decision in *Wilson's Total Fitness v. Director of Revenue*, 38 S.W.3d 424 (Mo. banc 2001). However, Respondent's position is overly simple, that it misconstrues and misapplies the holding in *Wilson's* and that it

ignores the fundamental nature and character of the services rendered by Appellant to its clients. In response to the state's assertions in its brief, we provide the following discussion and analysis.

In its brief, Respondent discusses §144.020.1, RSMo.[1] Section 144.020.1(2) imposes:

> A tax equivalent to four percent of the amount paid for admission and seating accommodations, or fees paid to, or in any place of amusement, entertainment or recreation, games and athletic events.

Respondent is correct in stating that based on the plain language of §144.010.1(2) and §144.020.1(2), for the personal training fees at issue to be subject to sales tax, the following requirements must be satisfied: (1) Appellant must be found to operate a place of amusement, entertainment or recreation; (2) the personal training fees must constitute "fees paid to, or in a place of amusement, entertainment or recreation"; and (3) Appellant must be a "seller" engaged in "the business of . . . rendering a taxable service at retail in this state. As noted by Respondent, we concede that Appellant did receive compensation for its services in the form of hourly fees paid to Fitness Edge, Inc.

However, contrary to Respondent's argument starting on page 15 of its brief, we do not believe Appellant operates a "place of amusement or recreation."

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[1] All statutory references are to the Revised Statutes of Missouri (2000) (as amended) unless otherwise noted.

Respondent's entire argument as set forth in its brief is founded on the conclusory assumption that Appellant's facility is a "place of amusement."

(a) Relitigating *Wilson's*

On the bottom of page 8 of its brief, Respondent states that Appellant is seeking to relitigate *Wilson's*. This is not true.

First, the holding and bright-line rule set forth in *Wilson's* states as follows:

> "athletic and exercise or fitness **clubs** are places of recreation for purposes of section 144.020.1(2), and the fees paid to them are subject to sales tax."

This rule only seems only to apply upon a showing that an athletic and exercise or fitness facility constitutes a "club." Characterization as an "athletic and exercise or fitness club" is a condition precedent to application of the *Wilson's* rule. "Club" is a term of art with a specific definition for purposes of Chapter 144, and the significance of the Missouri Supreme Court's use of the term "club" cannot be minimized or rationalized away.[2] The facts in this case demonstrate that Appellant does not operate a "club." Because of this significant factual distinction, the rule of *Wilson's* should not be deemed controlling in our case.

A distinction must be made between "athletic and exercise or fitness clubs" that maintain a membership and where recreation is a significant or primary focus like the taxpayers in *Wilson's* and Appellant's business, which provides "pure"

[2] Appellant has set forth its definition of "club" for purposes of Chapter 144 in footnote 3 on page 35 of its opening brief.

personal services in the areas of health and fitness screenings and evaluations, strength training instruction and program development and nutritional counseling in exchange for an hourly fee. There are striking differences in the relevant fact patterns in *Wilson's* and this appeal. Three key differences are: 1) the taxpayer in *Wilson's* sells and maintains a membership/Appellant does not; 2) the members in *Wilson's* were entitled to access and full use of the facility for their own subjective purposes in exchange for membership fees/Appellant's clients have no right to enter or use Appellant's facility except as part of a private, scheduled appointment with such client's trainer at which the client receives objectively described services; and 3) the taxpayer in *Wilson's* maintained a facility offering activities normally considered recreational, such as swimming, basketball, volleyball, racquetball and tennis/Appellant does not provide facilities for or offer similar recreational games or athletic events or activities to its clients.

Second, contrary to the assertions in pages 16 to 19 of Respondent's brief, Appellant's argument does not require that the Court reinstitute and attempt to apply the "primary purpose" test that delineates the "fine line between exercise that is focused on health benefits and exercise that is primarily focused on recreation" that was overruled by the Missouri Supreme Court in *Wilson's*. Appellant is not arguing that the services it provides are not taxable because Appellant's clients are deriving health benefits from exercise. Rather, the evidentiary record in this case showed that Appellant is providing discrete services that can best be described as personal services in the areas of health and physical

screenings and evaluations, strength training instruction and program development, cardiovascular training programs and nutritional counseling. The fitness-related personal services being rendered by Appellant's trainer to clients involve the design of individualized, evolving programs, individual instruction and close personal performance monitoring in order to meet the needs of each client.

This case involves the sales taxation of a business that operates under a different business model and in a different manner than the fitness club in *Wilson's*. The taxpayer in *Wilson's* operated a "garden variety" fitness club. In exchange for membership and activity dues, a member was granted unfettered access to use the facility, its services and its amenities. In this context, the Missouri Supreme Court concluded that "athletic and exercise or fitness clubs are places of recreation for purposes of section 144.020.1(2), and the fees paid to them are subject to sales tax." However, Appellant does not maintain a membership and is not an "athletic and exercise or fitness club." A ruling in favor of Appellant in this case is simply a recognition that businesses that operate in fundamentally different ways may be treated differently for purposes of applying the Sales Tax Law of Missouri and should not be considered a result that turns on "idiosyncratic evidentiary details" as argued by Respondent on page 24 of its brief.

(b) Respondent's Argument that Appellant is Charging Clients for Use of Facility

On page 20 of its brief, Respondent states as follows:

> "[Appellant's] argument might have some traction if all Fitness Edge did was assess its clients' physical abilities and exercise goals and then develop an exercise and fitness program for them to follow.[3] But Fitness Edge does much more than that. It not only develops exercise programs for its clients, it also provides a complete exercise facility for its clients to use."

From pages 20 through 24 of its brief, Respondent goes on to make an argument that, in its view, the charges made by Appellant to its clients are for services and use of an exercise facility. Simply stated, this assertion completely misrepresents the business model that is used by Appellant. Appellant provides personal training services for a fee, period. Appellant does not charge its clients for use of the facility. Appellant maintains a business facility to provide such personal training services because it is more economically efficient for Appellant as compared to sending trainers to provide services at third-party locations designated by clients. Appellant's use of the location is for Appellant's own benefit and not for the convenience or subjective purposes of it clients. Appellant's use of this single facility to provide its services to clients does not automatically convert the facility to a place of recreation or amusement.

It is an often stated truism that the Missouri sales tax consequences of a transaction are form driven. See *Fall Creek Construction Co., Inc. v. Director of Revenue*, 109 S.W.3d 165 (Mo. banc 2003); *Central Cooling & Supply Co., Inc. v.*

[3] Interestingly, this is exactly what Appellant does. This is Appellant's business model.

Director of Revenue, 648 S.W.2d 546 (Mo. 1982). The decision to impose a sales tax on Appellant's charges must be made based on the form of the transaction that actually takes place between Appellant and its clients. Based on the evidence in the record, Appellant charges an hourly fee for the physical assessment, training instruction or nutritional counseling that such client receives. There is no evidence to support the assertion that Appellant charges any fee, however denominated, to any clients for the necessary use of Appellant's facility as part of the training or counseling appointment. As such, it is not appropriate for Respondent to assert that Appellant has made any charge to clients for access to and use of its facility. Like virtually all service providers, Appellant maintains a business location and tangible personal property that it "uses" and "consumes" by necessity in the course of providing its services.

(c) Denial of Appellant's Refund Claims Constitutes a Policy Change pursuant to § 32.053.

In its brief on page 30, Respondent discusses § 32.053 and its impact on the outcome of this case. Appellant believes that Respondent's discussion confuses the issue when it states that "Appellant does not explain how a rule never enacted by the Director constitutes a policy change." As indicated in pages 48 – 51 of Appellant's opening brief, we are not attempting to use the "rule never enacted" as proof of a policy change. Rather, the proposed rule, 12 CSR 10-108.100, was used as a tool in the questioning of Mr. Stan Farmer, the then Director of the Division of Taxation of the Department of Revenue. But, it is Mr. Farmer's

testimony that established that Respondent had a policy during the relevant tax periods covered by Appellant's refund claims of not subjecting the following charges to an imposition of sales tax: 1) Amounts paid for lessons; and 2) Any amount paid in a place of amusement for optional services that are not themselves an amusement, and that do not facilitate participation in or admission to an amusement.[4]

It is the Respondent's denial of Appellant's refund claim that should be deemed a "change in policy." Section 32.053 prevents Respondent from giving final decisions, including refund denials, resulting from a "change in policy" any retroactive effect. If Respondent based its review of Appellant's refund claim on its then existing policy, as represented by Mr. Farmer's testimony at hearing, Appellant's refund claims should have been granted. The refund claims should

[4] It is our belief that Respondent has failed to give any meaningful, well reasoned guidance or statements of policy on the application of § 144.020.1(2) to fact patterns substantially similar to the instant case. In the absence of any clear guidance from case law (assuming the Court accepts our argument that the holding in *Wilson's* is not controlling in the instant case) or other published guidance (i.e. regulation or letter ruling), is there any doubt that testimony under oath by a high-level, policy making employee of Respondent can be used to establish a policy for purposes of application of § 32.053?

have been granted because the services rendered by Appellant to its clients are of the type deemed non-taxable by policy as represented by Mr. Farmer's testimony.

Of course, the "change in policy" explicitly or implicitly effectuated through Respondent's denial of Appellant's refund claims that are the subject of this litigation may be given prospective effect. See § 32.053. However, the impact of such prospective application of a "change in policy" on future refund claims of Appellant is outside the scope of this litigation.

(d) Missouri Uniformity Clause

Respondent subtly misstates Appellant's constitutional argument pursuant to MO. CONST. art. X, § 3, the Missouri Uniformity Clause. In characterizing Appellant's Missouri Uniformity Clause claim, Respondent states as follows: "Fitness Edge is apparently challenging the AHC's decision finding that Fitness Edge was a place of recreation subject to sales tax. But this decision is supported by substantial evidence in the record." It is more accurate to state Respondent's interpretation of § 144.020.1(2) as applied to Appellant (*i.e.*, interpreting the scope of the tax imposition of § 144.020.1(2) broadly enough to include the services rendered by Appellant) and using such overbroad interpretation of the tax imposition as the basis for the refund denials at issue is violative of the Missouri Uniformity Clause. As stated in our opening brief, it is the disparity of the tax treatment of Appellant's services as compared to the tax treatment of the exact same services rendered by other providers that causes the Uniformity Clause violation. How can the personal training services rendered by Appellant be

subject to a levy of sales tax if the same personal training services offered at homes, studios, offices or other third-party locations are not being taxed?

Finally, Respondent's reliance on *Gammaitoni v. Director of Revenue*, 786 S.W.2d 126 (Mo. banc 1990) is misplaced. In *Gammaitoni*, the taxpayer argued that the Uniformity Clause was violated when it was denied the benefit of a sales tax exemption for sales of advertising by broadcast stations and advertising agencies. In *Gammaitoni*, the taxpayer lost its constitutional Uniformity Clause challenge because it was not in the same taxpayer class (*i.e.*, it was not a broadcast station or advertising agency) so denying the availability of the exemption at issue did not result in any unlawful discrimination. In our case, it is patent that Appellant and the providers of untaxed personal training services should be considered as the same "class" of taxpayer by any objective standard.

CONCLUSION

Our position can be summarized as follows. Appellant is in the business of providing personal services to clients in exchange for fees. These services involve "one-on-one" testing, training, instruction and coaching in the areas of health and physical screenings and evaluations, strength training instruction and program development, nutritional counseling and lifestyle advice. Respondent's apparent position is founded on the premise that because Appellant is a provider of services related to health and fitness, it is necessarily a "place of amusement or recreation." Respondent finds support for this conclusion in the *Wilson's* case. However, Respondent's reliance on *Wilson's* is misplaced. Further, in denying Appellant's

refund claims at the administrative level, Respondent ignored its own policies, as represented by the testimony of its Director of the Division of Taxation regarding the imposition of sales tax on personal services.

In view of the foregoing, Respondent's final decisions issued in denial of Appellant's refund claims should be deemed improper as such denials are nothing more than an attempt to unreasonably expand the scope of § 144.020.1(2) and the holding of *Wilson's* through administrative fiat. Accordingly, we request that this Court reverse the decision of the Administrative Hearing Commission, find in favor of Appellant and grant the sales tax refunds for the July 1, 2002 – September 30, 2002 tax period in the amount of $18,438.10 and for the October 1, 2002 – December 31, 2004 tax periods in the amount of $177,441.62, plus statutory interest as calculated pursuant to section 144. 170.

Respectfully submitted,

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CERTIFICATE OF SERVICE AND COMPLIANCE

The undersigned hereby certifies that on January ____, 2008 two true and correct copies of the foregoing brief, as well as a labeled disk containing the same, were mailed postage prepaid to:

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The undersigned further certifies that the foregoing brief complies with Rule 55.03 and with the limitations contained in Rule 84.06(b) in that it contains 2,482 words, excluding the cover, certificate of service, certificate required by Rule 84.06(c), signature block and appendix.

The undersigned further certifies that the labeled disk filed contemporaneously with the hard copies of this brief has been scanned for viruses and is virus-free.

_____
Scott R. Riley