

SC90463

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IN THE SUPREME COURT OF MISSOURI

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BRINKER MISSOURI, INC.,

Appellant,

vs.

DIRECTOR OF REVENUE,

Respondent.

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On Petition for Review From  
The Administrative Hearing Commission,  
The Honorable Nimrod T. Chapel, Jr., Commissioner

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RESPONDENT'S BRIEF

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## STATEMENT OF FACTS

The Director of Revenue highlights for the Court some of the statements of fact submitted by Appellant Brinker Missouri, Inc. (hereinafter “Chili’s”). Even in the statement of facts Chili’s begins to stretch the meaning of the statute when a more natural reading is appropriate:

| Statement by Chili’s   | Ordinary Meaning   |
|--|--|
| “Each of the restaurants is a business that first <u>produces</u> ” App. Br. at 1.           | Each of the restaurants is a business that first <u>prepares</u> |
| “the restaurants to <u>transform</u> food and drink ingredients into meals” <i>Id.</i> at 2. | The restaurants <u>prepare</u> food and drinks for meals         |
| “The <u>Production</u> ” <i>Id.</i>  | <u>Preparing</u> Meals   |
| “Missouri restaurants to <u>produce</u> food and drink <u>products</u> ” <i>Id.</i>          | Missouri restaurants <u>prepare</u> food and drinks              |
| “ <u>transform</u> raw ingredients into food and drink products” <i>Id.</i>                  | <u>make</u> meals from the ingredients                           |
| “[D]uring the <u>production process</u> ” <i>Id.</i>   | During <u>cooking</u>  |
| “Section 144.030.2(5) new/expanded <u>plant</u> machinery” <i>Id.</i> at 6.                  | Section 144.030.2(5) new/expanded <u>restaurant</u> equipment    |

## SUMMARY OF THE ARGUMENT

By twisting and stretching terms in this case, Chili's attempts to turn the cooking and preparation of food and drinks at a neighborhood restaurant into a sort of industrial manufacturing and fabricating process at food producing plants. Similarly, they attempt to convert their chairs, tables, plates, and silverware into temporary rental properties for customers – all in the name of seeking a tax benefit at the expense of the State of Missouri. The Administrative Hearing Commission saw through this nonsense of linguistic gymnastics, and correctly interpreted the tax exemptions at issue.

Section 144.030.2, which is the source of Chili's attempts to opportunistically industrialize itself, must be strictly construed only for “manufacturing, mining, fabricating and producing” as well as “manufacturing, mining and fabricating plants.” § 144.030.2(4)-(5). Divorced from any reasonable and common sense understanding of a restaurant, the broad interpretation suggested by Chili's is not supported by the statute and would certainly produce absurd and illogical results. Chili's suggested interpretation would mean that not only are all restaurants in Missouri manufacturing and food producing plants, but also every corner gas station could be converted into a manufacturing, fabricating and food producing plant.

Section 144.605, which is the source of Chili's attempts to convert its tangible personal property such as chairs, benches, dishes and silverware into temporary rental property for tax exemption purposes, also cannot support Chili's suggested interpretation. No customer of Chili's believes that they have actual ownership of their plate, fork, and chair while eating their meal. The notion defies logic and a plain understanding of the statute.

These efforts by Chili's to enlist broad interpretations of the statutory language in an effort to claim tax exemptions or exclusions is not supported and the Commission's decision should be affirmed.

## ARGUMENT

### I. The Commission Correctly Held that Chili's is Not Entitled to a Use Tax Exemption for Its Equipment Because the Strictly Construed Meaning of "Manufacturing, Mining, Fabricating or Producing" as well as "Manufacturing, Mining or Fabricating Plants" Does Not Include the Preparation of Food and Soft Drinks at a Restaurant – Responding to Appellant's Point I.

As with any statutory provision, "the primary rule of statutory interpretation is to give effect to legislative intent as reflected in the plain language of the statute." *Akins v. Dir. of Revenue*, --- S.W.3d ---, 2010 WL 623653, \*1 (Mo. banc Feb. 23, 2010) (citing *State ex rel. White Family Partnership v. Roldan*, 271 S.W.3d 569, 572 (Mo. banc 2008)). "In the absence of statutory definitions, the plain and ordinary meaning of a term may be derived from a dictionary ... and by considering the context of the entire statute in which it appears." *State ex rel. Burns v. Whittington*, 219 S.W.3d 224, 225 (Mo. banc 2007) (citing *Am. Healthcare Management, Inc. v. Dir. of Revenue*, 984 S.W.2d 496, 498 (Mo. banc 1999) and *Butler v. Mitchell-Hugeback, Inc.*, 895 S.W.2d 15, 19 (Mo. banc 1995)).

Courts also look at the potential consequences of the proposed interpretation. Thus, for example, if the proposed interpretation or plain

language produces an absurd or illogical result the court will not adopt that interpretation or meaning. *See Akins*, 2010 WL 623653, \*1 (“A court will look beyond the plain meaning of the statute only when the language is ambiguous or would lead to an absurd or illogical result.”) (citing *Spradlin v. City of Fulton*, 982 S.W.2d 255, 258 (Mo. banc 1998)). Furthermore, the “[c]anons of construction direct that exemption statutes be strictly construed against the taxpayer” – in this case Chili’s. *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)).

Considering each of the canons of statutory interpretation, or tools for determining legislative intent in this case, the Commission was correct in holding that “manufacturing, mining, fabricating or producing” as well as “manufacturing, mining, or fabricating plants” under § 144.030.2(4)-(5) does not include the preparation of food and soft drinks at restaurants for customers.

**A. The Plain Language of § 144.030.2(4)-(5) – Strictly Construed – Cannot Make Chili’s Into a Manufacturing or Food and Drink Producing Plant.**

The key terms in § 144.030.2(4)-(5) that are left undefined by the statute are: “manufacturing, mining, fabricating or producing” as well as “manufacturing, mining or fabricating plants.” § 144.030.2(4)-(5). The dictionary provides the following relevant definitions for each of these terms:<sup>1/</sup>

**Manufacturing – 1:** to make (as raw material) into a product suitable for use **2a:** to make from raw materials by hand or by machinery **b:** to produce according to an organized plan and with division of labor **4a:** to produce as if by manufacturing: create

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<sup>1/</sup> The Code of State Regulations also provides definitions of “fabrication”; “manufacturing”; “mining”; and “producing.” 12 CSR 10-111.010(2) (Appendix A1 – A8). The agency has the authority to promulgate regulations within the legislative authority conferred upon the state agency, and the regulations “cannot be interpreted in such a manner as to create an exemption from taxation that the General Assembly did not authorize.” *Hearst Corp. v. Dir. of Revenue*, 779 S.W.2d 557, 559 (Mo. banc 1989). Here, the definitions in the regulation are similar to the dictionary definitions and do not mention restaurants. Indeed, the regulations include some helpful examples specifically discussing “assembly lines.” 12 CSR 10-111.010(4).

**Mining** – the process or business of making or of working  
mines

**Fabricating (fabricate)** – **1a:** to form by art and labor:  
manufacture, produce **b:** to form into a whole by  
uniting parts: construct, build **2a:** to make, shape, or  
prepare (parts) according to standardized  
specifications so as to be interchangeable **b:** to cause  
(raw material or stock) to be manufactured: shape **3a:**  
invent, formulate

**Producing (produce)** – **8a:** to give being, form, or shape to:  
make often from raw materials: manufacture **b:** to  
make economically valuable: make or create so as to  
be available for satisfaction of human wants

**Plants** – **3a:** the land, buildings, machinery, apparatus, and  
fixtures employed in carrying on a trade or a  
mechanical or other industrial business **b:** a factory  
or workshop for the manufacture of a particular  
product

Webster's Third New International Dictionary 811, 1378, 1438, 1731, 1810  
(1993). The dictionary definitions provide some guidance concerning these

general and broad terms. “Dictionary definitions are not, however, the final source of guidance in statutory interpretation.” *State v. Payne*, 250 S.W.3d 815, 820 (Mo. App. W.D. 2008). This is particularly true when the definitions provide only moderate guidance given the broad terms and numerous meanings that could be applied. *Id.*

It is possible, of course, in the most generic and broadly construed definitions of the terms, to stretch the terms in this case to meet the potential interpretation submitted by Chili’s. Indeed, the fact that Chili’s has decided to limit its argument to the term “producing” is simply an opportunistic approach. If preparing a hamburger or a glass of soda in a neighborhood restaurant constitutes “producing” a product in a “plant” then it certainly could also be characterized as “manufacturing” or “fabricating” in a “plant.” Yet, this kind of watering down of the statutory terms fails to account for the most basic rule for exemptions – the exemption is subject to strict construction against the taxpayer. *Armco, Inc.*, 787 S.W.2d at 724.

Because § 144.030.2(4)-(5) constitutes an exemption from the sales and use tax, Chili’s bears the burden of showing that it is entitled to an exemption under the statute. Exemptions from taxation are to be construed strictly against the taxpayer, and any doubt is resolved in favor of application of the tax. *Great S. Bank v. Dir. of Revenue*, 269 S.W.3d 22, 24 (Mo. banc

2008); *Branson Properties, USA, L.P. v. Dir. of Revenue*, 110 S.W.3d 824, 825 (Mo. banc 2003). Thus, if there is any doubt as to whether the rolling of a burrito is manufacturing, fabricating, or producing, or whether a neighborhood restaurant is a food and drink producing plant, then the terms should not be interpreted that broadly. Doubt as to the expansive construction of these terms is more than obvious in this case.

A strict construction of the statutory language at issue would limit the definitions of manufacturing, mining, fabricating, producing, and plants to a more natural reading – instances in which activities defined by traditional notions of manufacturing, mining, fabricating, or producing have occurred in actual plants that are normally recognized as such. In most, if not all circumstances, a strict or narrow construction of the terms at issue in this case would mean that the resulting food and drink products are not immediately eaten and drunk by customers, but are sold to other entities that utilize the products for ultimate consumption. § 144.030.2(4).

In *Wilson & Co., Inc. v. Dept. of Revenue*, 531 S.W.2d 752 (Mo. 1976) the issue before this Court was whether a “hog slaughtering and packing plant” that ran a “mass-production line” slaughtering and processing “several thousand hogs per day” constituted manufacturing for purposes of the statute. *Id.* at 753-54. This Court found that it satisfied the statute because

it involved a “process which took something practically unsuitable for any common use and changed it so as to adapt it to . . . common uses.” *Id.* at 755; *see also* 12 CSR 10-111.010(2)(E)(ii). It is this kind of mass-production and assembly line that is the natural and strict reading of the plain language of the statute; not a reading that changes the making of a hamburger at a neighborhood restaurant into the “manufacturing” or “producing” of a food product at a plant.

**B. The Surrounding Statutory Context Supports the Commission’s Interpretation.**

Not only does the plain language of the statutory terms at issue support the conclusion that Chili’s is not “manufacturing, mining, fabricating or producing” food products or that they are “manufacturing, mining or fabricating plants,” but the statutory structure and context also supports that same common sense conclusion. *See State ex rel. Burns*, 219 S.W.3d at 225. An important rule of statutory construction is that the provisions of a statute are “not read in isolation but construed together, and if reasonably possible, the provisions will be harmonized with each other.” *Bachtel v. Miller County Nursing Home Dist.*, 110 S.W.3d 799, 801 (Mo. banc 2003).

Chapter 144 actually uses the term “restaurant” in other sections in a way that is both drastically different than the broad meaning suggested by

Chili's, and consistent with the plain and ordinary meaning. *See* § 144.014.2. Had the legislature intended to include restaurants or equipment in restaurants within the exemptions set forth in § 144.030.2, then it could have easily used the term restaurant just as it did in § 144.014. Indeed, the legislature provided exemptions for numerous items or processes in § 144.030.2, ranging from “feed for livestock or poultry” and “grain to be converted into foodstuffs which are to be sold ultimately in processed form at retail” in § 144.030.2(1) to “materials, replacement parts, and equipment [for] aircraft, aircraft power plants, and aircraft accessories.” § 144.030.2(40). Yet, nowhere in § 144.030.2 is the term “restaurant” used.

Moreover, when the legislature did use the term “restaurant” in § 144.014, it was not used as the tortured and watered-down version suggested by Chili's in an attempt to turn a restaurant into a manufacturing or food producing plant. Instead, the legislature used the common and ordinary meaning for what a restaurant does – “food prepared by such establishment.” § 144.014.2; *see also* § 144.020.1(6) (noting that in a restaurant meals and drinks are “furnished” or “served” to the public not produced or manufactured). Thus, in the same chapter, and only a few sections before the one at issue, the proper usage of a restaurant is used

repeatedly by the legislature – restaurants make “prepared food” and do not manufacture, mine, fabricate or produce food and drinks in a plant.

There are still further clues as to the legislature’s meaning of the relevant terms in this same section dealing with restaurants. In describing restaurants in § 144.014.2, the legislature provides that the food prepared at a restaurant is “for immediate consumption on or off the premises.” *Id.* (emphasis added). This is perfectly logical and consistent with the plain and ordinary meaning of a restaurant. In contrast, the exemptions at issue in § 144.030.2(4)-(5) contemplate a step back in the process whereby the product is “intended to be sold ultimately for final use or consumption” and not immediately for consumption. § 144.030.2(4)-(5) (emphasis added).

This concept of “ultimate” use which suggests a non-retail setting is found repeatedly in § 144.030.2. *See, e.g.*, § 144.030.2(1) (“to be sold ultimately at retail”; “to be sold ultimately in processed form at retail”; “to be sold ultimately in processed form at retail”; “to be sold ultimately in processed form at retail”); *id.* (2) (“intended to be sold ultimately for final use or consumption”; “ultimately consumed in the manufacturing process”; “intended to be sold ultimately for final use or consumption”). Equally present is the concept of intermediate processing and not final retail preparation. *See, e.g.*, § 144.030.2(7) (“[a]nimals or poultry used for breeding

or feeding purposes”); (“[p]umping machinery and equipment used to propel products delivered by pipelines engaged as common carriers”).

Thus, considered in the context of the entire statute, the exemptions set forth in § 144.030.2 do not contemplate the interpretation or meaning suggested by Chili’s. Instead, they are to be strictly construed and intended to cover only those circumstances in which actual manufacturing, mining, fabricating or producing is done in plants for ultimate consumption or use, and not the preparation of food for immediate consumption in a neighborhood restaurant.

**C. An Interpretation that Produces an Absurd and Illogical Result Should be Rejected.**

Even if the strictly-construed meaning of the terms in this case could be interpreted to include food and soft drinks prepared at neighborhood restaurants, the interpretation should be rejected because of the absurd and illogical results it would produce. Courts reject an interpretation, notwithstanding its possibility as an interpretation, if it produces an absurd or illogical result. *See Akins*, 2010 WL 623653, \*1. This is just such a case.

The petitioners in this case, Chili’s and the other restaurants, are but a very few restaurants spread throughout the State. Their proposed tax exemption would reduce the tax revenue of the State by approximately

\$45,000. Yet, there are literally thousands of restaurants throughout the State that would follow suit seeking exemption from millions and millions of dollars in taxes. And that is not all. There are still thousands of convenience stores preparing food items and making fountain drinks available to their customers. Everything from Slushies to hotdogs at the local gas station would be fair game.

Indeed, this is not an empty or imagined parade of horrors. At this very moment a parallel case, *Aquila Foreign Qualifications Corp. v. Dir. of Revenue*, Case No. 09-0376 RS, is pending before the Commission. (Appdx. A9). The issue presented in *Aquila* is whether each convenience store operated by Aquila under the name of Casey's General Stores is manufacturing, processing, or producing a product pursuant to § 144.054.2. Aquila alleges that each convenience store manufactures coffee, pizzas, sandwiches, soft drinks, etc., which each store then sells to the public for immediate consumption. A finding in this case that restaurants are manufacturers when they prepare food products or drinks would not be limited to restaurants and would result in a devastating impact on the tax revenue of Missouri.

Retail convenience stores like Casey's and similar types of businesses, including snack bars and fast food businesses, which prepare food products

for sale at retail, would immediately clamor to become supposed manufacturers. Not only would such a finding allow restaurants to claim the § 144.030 manufacturing exemptions for machinery and equipment, but it could also open the door for them to claim the § 144.054.2 exemption for electrical energy, natural or propane gas, water, coal, energy sources, chemicals, and materials used or consumed in manufacturing, processing, or producing any product. Without limitation, retail food businesses including the unexpected, such as movie theaters that operate concession sales of soft drinks and popcorn, would qualify as manufacturers that would pay no taxes on their purchases of machinery, equipment, utilities, and materials.

A holding that mere preparation of food is enough to constitute “manufacturing, mining, fabricating or producing” could have an impact on all sorts of other items that businesses purchase for their own use in preparing items for retail sale when such preparation does not rise to the level of creating a new item with a commercial value out of something that lacked general commercial value. Furthermore, such a broad interpretation of § 144.030.2(4)-(5) would impact the taxes paid by other industries in Missouri. The national discount chain-store Wal-Mart, for example, claims that it is entitled to purchase paint-mixing equipment tax-free because it manufactures paint in its stores when it dyes white paint to the color its

customers demand. *See Fluid Management, Inc. v. Dir. of Revenue*, Case No. 09-1172 RS (dismissed on other ground) (Appdx. A44).

This is not the result the legislature intended, and such a broad and unjustified interpretation, even if possible under the dictionary definitions of the relevant terms, should be rejected by this Court as absurd and illogical.

**D. The Commission and Courts Throughout the Country Have Uniformly Rejected Similar Efforts to Broadly Construe a Manufacturing Exemption.**

Although the Missouri Supreme Court has not issued a decision specifically addressing whether restaurants are considered manufacturers for purposes of § 144.030.2(4)-(5), the Commission and courts throughout the country have routinely rejected such a broad construction of the statute.

**1. The prior Commission decision rejecting restaurants as manufacturing or food and drink producing plants.**

In *Wendy's of Mid-Missouri, Inc. v. Dir. of Revenue*, Case No. RS-79-0222 (Mo. Admin. Hearing Comm'n, July 22, 1982) (Appdx. A64), the taxpayer prepared meals and drinks in a manner much like Chili's does in its restaurants. Individual hamburger patties were formed from ground beef in twenty-pound bulk bags. The patties were stacked, wrapped in plastic, and returned to refrigerated storage until needed that day. Lettuce, tomatoes, and onions were similarly cleaned, sliced and prepared for use on the hamburgers.

Wendy's also made chili by combining twelve pounds of cooked ground beef, two cans of red beans, a can of tomato mixture, five cans of tomato juice, and a spice packet. The chili was cooked from four to six hours and then simmered on the stove so it was always ready to serve. Similar processes were followed for preparation of all sandwiches, French fries, soft drinks, and dairy desserts. None of these activities were found by the Commission to be manufacturing subject to a tax exemption. And at no point since this decision by the Commission in 1982 has the Missouri legislature seen fit to change the definition for exemptions in § 144.030.2 to specifically include restaurants.

**2. Numerous states have issued decisions similar to the  
Commission's decision concerning restaurants.**

In addition to the Commission's longstanding decision, courts throughout the country have rejected similar theories by restaurants. In *McDonald's Corp. v. Okla. Tax Comm'n*, 563 P.2d 635 (Okla. 1977), the Oklahoma Supreme Court found that a fast-food restaurant's preparation of food for immediate retail sale was not manufacturing or processing. The manufacturing equipment exemption was similar to Missouri's § 144.030.2(4)-(5), in that Oklahoma's exemption required the existence of a manufacturing plant,<sup>2/</sup> defined as being an establishment "primarily engaged in manufacturing or processing operations, and generally recognized as such." *Id.* at 636.

The Oklahoma court found that McDonald's was primarily in the business of selling at retail its products which consisted of, among other things, hamburgers, fish fillet sandwiches, French fried potatoes, shakes and

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<sup>2/</sup> Section 144.030.2(4) uses the term plant in defining a "material recovery processing plant" as meaning "a facility that has as its primary purpose the recovery of materials into a useable product or a different form which is used in producing a new product."

carbonated soft drinks. The preparation or cooking of food is not generally recognized as manufacturing or processing. *Id.* at 638.

In ruling that McDonalds was not manufacturing, the Oklahoma Supreme Court referred to a Missouri case, *Kansas City v. Manor Baking Co*, 377 S.W.2d 545 (Mo. App. W.D. 1964). In *Manor Baking*, the essence of the taxpayer's business was selling or merchandising of freshly baked breads and not manufacturing. *Id.* at 547-548. Although Manor Baking Company baked its own products, it only baked for its own sales for immediate consumption and did not prepare the bread to be sold to a retailer for resale to the public. Manor Baking Company was therefore not a manufacturer for municipal licensing purposes.

Like the Oklahoma Supreme Court, the New York Court of Appeals in *In re Burger King, Inc. v. State Tax Comm'n*, 416 N.E.2d 1024 (N.Y. App. 1980), found that restaurant food was a category distinct from tangible personal property. Similar to Missouri law, where sales tax is imposed on the sale of tangible personal property in § 144.020.1(1), and on the sale of meals and drinks at a restaurant in § 144.020.1(6), the New York sales tax was imposed on tangible personal property in one section of the statute and imposed on restaurant food in another section. The New York court harmonized New York's two statutory provisions by saying that the sale of

restaurant food included a taxable service in combination with the sale of the food. Because the service was connected with the sale of the restaurant food, the restaurant was not manufacturing.

New York similarly held, in *Marriott Family Restaurants, Inc. v Tax Appeals Tribunal of New York*, 570 N.Y.S.2d 741 (N.Y. App. Div., 1991) that the sale of food and service in a restaurant was a hybrid transaction, rather than the sale of tangible personal property. The machinery used to prepare the food was not used in manufacturing.

Massachusetts also does not consider the production of food in a restaurant “manufacturing” for sales tax exemption purposes. *See York Steak House Sys., Inc. v. Comm’r of Revenue*, 472 N.E.2d 230 (Mass. Supreme Judicial Court, 1984). The court held that the thawing and cooking of a steak in a restaurant did not produce a sufficient change in the steak to qualify as manufacturing. *Id.* In *Az. Dept. of Revenue v. Blue Line Distrib., Inc.*, 43 P.3d 214 (Az. Ct. App. 2002), the Arizona Court of Appeals ruled that an industrial dough mixer was not exempt as manufacturing or processing equipment when purchased by a pizzeria. The court held that a restaurant that uses machinery or equipment to make pizza dough from scratch is not commonly understood to be either a manufacturing operation or a processing operation. *Id.* at 215.

Likewise, the Ohio Supreme Court found that a restaurateur was not a manufacturer and that personal property used in preparation of food for sale to the general public was not manufacturing equipment. *See, Roberts v. Bowers*, 162 N.E.2d 858 (Ohio 1959). The Court held:

It is quite apparent from this record that the cooking is only a part of the service involved in the operation of the retail business of a restaurant. . . . Sale of materials already manufactured in order to take a profit already earned differs greatly from sale at retail of foods cooked primarily at the time and for the purpose of sale in a retail food-service business.

*Id.* at 861.

In *Golden Skillet Corp. v. Va.*, 199 S.E.2d 511 (Va. 1973), the Virginia Supreme Court held that equipment used in preparation and cooking of chicken for sale at retail was not exempt from sales and use taxes under statutory exemptions for machinery or tools used directly in processing, manufacturing, or conversion of products for sale or resale. In *Golden Skillet*, the statutory exemption language did specifically limit the exemption to “industrial materials,” allowing the court to find that “Common sense tells us that the process of preparing and frying chicken for sale at retail,

notwithstanding the novelty of the patented method and cookers used by the franchisees, is not an industrial operation.” *Id.* at 514.

North Carolina follows the same view that a restaurant is not a manufacturer within the meaning of typical machinery tax statutes. *HED, Inc. v. Powers*, 352 S.E.2d 265 (N.C. App. 1987). Thus, the overwhelming authority throughout the country is that a restaurant is not a manufacturing or processing plant for purposes of tax exemption statutes.

**3. The cases cited by Chili’s do not support their broad interpretation of the statute.**

In an attempt to undermine both imminent reason and overwhelming authority, Chili’s cites a number of unpersuasive cases. For example, they refer to *Concord Publ’g House, Inc. v. Dir. of Revenue*, 916 S.W.2d 186 (Mo. banc 1996), for the supposed purpose that the exemptions in § 144.030.2(4)-(5) are not limited to companies engaged in particular businesses. Specifically, Chili’s refers to the language on page 196 of that case that states the exemption language “does not refer to the identity of the user, but only to a use for the designated purpose.” App. Br. at 19-20. Reliance on this phrase is misplaced.

The identity of the user is indeed irrelevant; but in order for the manufacturing exemption to be applicable the user must be engaging the

machinery or equipment in manufacturing, fabricating or producing a product “intended to be sold ultimately for final use or consumption.” § 144.030.2(4). The *Wendy’s* decision issued by the Commission and all of the other state court decisions referred to above hold the correct view that restaurants are engaged in the retail or mercantile business of preparing meals and drinks to be served to customers at the retail location. Restaurants do not manufacture, fabricate, or produce a product as required by § 144.030.2(4)-(5).

A great many more of the cases cited by Chili’s simply do not involve restaurants. In fact, in *Concord Publ’g*, 916 S.W.2d 186, the taxpayer was a newspaper publisher. In *DST Sys., Inc. v. Dir. of Revenue*, 43 S.W.3d 799 (Mo. banc 2001), the taxpayer sold data processing reports to mutual funds. In *Jackson Excavating Co. v. Admin. Hearing Comm’n*, 646 S.W.2d 48 (Mo. 1983), the taxpayer purchased equipment to purify water. In *Southwestern Bell Tel. Co. v. Dir. of Revenue*, 182 S.W.3d 226 (Mo. banc 2005), the taxpayer was found to manufacture telephone signals.

In *Hudson Foods, Inc. v. Dir. of Revenue*, 924 S.W.2d 277 (Mo. banc 1996), the taxpayer chilled freshly dressed chickens and also froze chickens. That case, however, was not brought under § 144.030.2(4)-(5). Instead, the issue was whether the taxpayer was eligible for the exemption in

§ 114.030.2(12), which is not an issue in this case but involves an exemption of sales tax on electricity used in the taxpayer's chilling/freezing process. This Court found the taxpayer's operation to be "processing." Yet, the taxpayer was not a retail restaurant selling prepared meals to the public. The taxpayer was processing a food product that was then sold to a retailer for resale to the public.

Finally, Chili's relies on two additional cases that do not support their position. In *Al-Tom Invest. v. Dir. of Revenue*, 774 S.W.2d 131 (Mo. banc 1989), the case involved the purchase of cooking oil by Kentucky Fried Chicken ("KFC"). The issue in *Al-Tom* was not whether KFC was manufacturing, fabricating, or producing a product to be sold for ultimate use and consumption under § 144.030.2(4)-(5). Instead, the issue as identified by this Court was whether the cooking oil became a component part or ingredient of the chicken sold by KFC in its fast-food restaurant.

This Court found in *Al-Tom* that a portion of the cooking oil was incorporated into the chicken during the cooking process and therefore KFC's purchase of all of the cooking oil was exempt from sales and use tax pursuant to § 144.030.2(2). The true issue was whether the cooking oil was purchased for resale, and not purchased at retail, by KFC. The parties apparently did not raise nor did the court make any reference to the manufacturing

exemptions in § 144.030.2(4)-(5). Having found that the cooking oil was exempted from the tax because a portion of the cooking oil was resold as part of the chicken, this Court did not go any further to consider or make any finding that the restaurant was actually engaged in manufacturing, mining, fabricating or producing.

Chili's also cites *Souffle, Inc. v. Dir. of Revenue*, Case No. 92-001068 RV (Mo. Admin. Hearing Comm'n, June 7, 1993) (Appdx. A57), to support the contention that restaurants are manufacturers. This case was a non-appealed decision issued by the Commission. The taxpayer in *Souffle* was a restaurant that cooked its own meat by a cooking method called "smoking." The parties agreed that smoking was processing and the Commission concluded that the ingredient and component part exemption in § 144.030.2(2) was applicable to the purchase of wood to create smoke that flavored the meat. As in *Al-Tom*, the manufacturing exemptions in § 144.030.2(4)-(5) were not raised or discussed. The Commission did not consider the issue whether a restaurant providing meal and drink service is a manufacturer under the statute.

This Court should affirm the Commission's interpretation of § 144.030.2(4)-(5) in this case because it is consistent with the required strict interpretation of the plain meaning of the statutory terms at issue, it is

consistent with the statutory structure and overwhelming authority, and because to adopt Chili's broad interpretation would produce an absurd and illogical result that would be disastrous for the State of Missouri and the collection of taxes.

**II. The Commission Correctly Held that the Use of Furniture and Reusable Items in a Restaurant are Subject to Use Tax and Not Excluded as a Supposed Resale of Those Items to the Customer – Responding to Appellant's Point II.**

In addition to seeking a refund for equipment used to prepare food and soft drinks, Chili's requests a refund of use taxes they paid on the purchase price of tables, chairs, dishes, silverware, and other items used by customers while eating meals at the restaurant. Chili's claims that these items are not just being used (*i.e.* subject to use tax), but are actually being resold to the customers and are thereby excluded from use taxes. This interpretation defies the statutory language, logic, and caselaw.

**A. Reusable Items in a Restaurant are Subject to Use Tax and Not Excluded Under the Exclusion for Sales or Resales to Customers.**

In § 144.610.1, the legislature specifically imposed a tax on taxpayers such as Chili's for the "privilege of storing, using, or consuming . . . tangible personal property." *Id.* There is no question that the purchase of tables, chairs, dishes and silverware by Chili's in this case is just such tangible personal property that would ordinarily be subject to use tax under § 144.610.1. Chili's, however, seeks to invoke an exemption or exclusion for resale in order to avoid paying use tax.

As stated above, an exemption from taxes must be strictly construed against the taxpayer. *Armco, Inc.*, 787 S.W.2d at 724. Exclusions should also be strictly construed against the taxpayer.<sup>3/</sup> The supposed exclusion that Chili's pursues is the exclusion in § 144.615(6) for tangible personal property held "solely for resale in the regular course of business." § 144.615(6). Once again, Chili's attempts to stretch a statutory exclusion past any reasonable interpretation. Common sense, and a strict construction of the terms "solely

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<sup>3/</sup> The Court has used the terms exemption and exclusion interchangeably with the same result in finding against the taxpayer. *See ICC Management, Inc. v. Dir. of Revenue*, 290 S.W.3d 699 (Mo. banc 2009).

for resale,” would lead to the conclusion that the furniture and plates are not being repeatedly sold or resold to customers. No customer that walks into a Chili’s could rationally assume that when they purchase their meal and drinks they can take the chair with them. The suggestion is ridiculous. Likewise, no customer would assume that they can take the plates and silverware with them. Chili’s does not allow the customer to take the leftover food from the meal home with such items, but rather, Chili’s provides “to-go” containers to the customer for the customer to use to transport the food home.

Thus, in *Chase Hotel, Inc. v. Dir. of Revenue*, No. RS-80-0042 (Mo. Admin. Hearing Comm’n, July 28, 1982) (Appdx. A10), the Commission found that a hotel was the ultimate consumer of the guest room furnishings purchased by the hotel. The Commission quoted *Ky. Bd. of Tax Appeals v. Brown Hotel Co.*, 528 S.W.2d 715 (Ky. 1975):

Although the guest may be an incidental beneficiary, the prime recipient of any benefits arising from its use is the hotel. The fact that a guest is at the best a . . . sole possessor will not convert the transaction into a “resale” of tangible personal property to the guest ...

The Commission reached the same conclusion in *Drury Supply Co. v. Dir. of Revenue*, No. 95-000870 RV (Mo. Admin. Hearing Comm'n, October 8, 1996) (Appdx. A19), when it found that guest room supplies, such as towels and ashtrays, were not resold to the hotel guests. The hotel normally used and consumed the guest supply items in the course of its business and replaced these items due to wear and tear. The guests' right to use the property was merely short-term: overnight or for a limited number of days. The guest supply items were reusable by the hotel and were not resold to the hotel guests. The Commission also ruled that items of a nonreusable nature consumed by the guests were resold to the guests, such as shampoo and soap.

The *Chase Hotel* and *Drury Supply Co.* decisions are now found in § 144.011.1(11), which excludes from the definition of "retail sale":

The purchase by persons operating hotels, motels or other transient accommodation establishments, of items of a nonreusable nature which are furnished to the guests in the guests' room of such establishments and such items are included in the charge made for such accommodations. Such items shall include, but not be limited to, soap, shampoo, tissue and other

toiletries and food or confectionery items offered to the guests without charge.

Section 144.011.1(11) excludes only “nonreusable” items furnished to the hotel guests. Reusable items such as furnishings (beds, chairs, tables, etc.) and guest supplies (towels, sheets, etc.) are subject to tax at the time of the hotel’s purchase.

A similar statutory exclusion applies to purchases made by restaurants. Section 144.011.1(10), excludes from the definition of “retail sale”:

The purchase by persons operating eating or food service establishments, of items of a nonreusable nature which are furnished to the customers of such establishments with or in conjunction with the retail sales of their food or beverage. Such items shall include, but not be limited to, wrapping or packaging materials and nonreusable paper, wood, plastic and aluminum articles such as containers, trays, napkins, dishes, silverware, cups, bags, boxes, straws, sticks and toothpicks.

Once again, only the purchases of “nonreusable” items are excluded from the term “retail sale.” Restaurants remain subject to sales or use tax on their purchases of reusable items.

In contrast to this very natural and reasonable interpretation of the statute, Chili’s launches into an expansive reading of an exclusion that should be strictly construed. They take the terms “solely for resale” in § 144.615(6) and turn them into a very expansive concept in which customers supposedly purchase and repurchase the right to temporarily use chairs, dishes and other reusable items. To accomplish these gymnastics of statutory interpretation they first turn to other portions of the statute.

Section 144.010.1(10) defines “sale at retail,” in relevant part, as “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 . . . .” Section 144.605(7), defines “sale” as “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.” Yet, neither of these definitions – particularly strictly construed as required by law – can support Chili’s interpretation of the exclusion.

**B. Caselaw Supports the Conclusion that Reusable Items in a Restaurant are Not Being Sold or Resold to Customers.**

The three elements of § 144.605(7) defining the term sale must be met for a transaction to constitute a sale or 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 or to be paid. *See Aladdin's Castle, Inc. v. Dir. of Revenue*, 916 S.W.2d 196 (Mo. banc 1996). As Missouri courts have considered these elements, two approaches have developed.

The first approach considers the situation where the transfer of tangible personal property is determined to be a resale because the property is included with the sale of another item or service that is subject to sales tax and the purchaser keeps the tangible personal property. The cases utilizing this approach have focused on the first and second elements in determining that tangible personal property transferred with the retail sale of an item was a sale or resale. In these cases, the third element – “consideration paid or to be paid” – was satisfied because there was a transfer of tangible personal property that was included with a taxable sale of an item or service.

The second approach considers the situation where the use of the tangible personal property is determined to be a resale because the customer

is purchasing an item and paying a higher price that is subject to sales tax to obtain the item and the use of the tangible personal property. For both of these approaches, the tangible personal property is commonly referred to as being “factored into” the sale of another item or service that is subject to sales tax. However, referring to tangible personal property being factored into the sale of another item or service misconstrues the analysis of a resale transaction because in all purchases, all costs incurred by a business are factored into all sales by that business.

- 1. One line of cases establishes that a resale occurs when the customer takes possession of the item.**

In *King v. Nat'l Super Markets*, 653 S.W.2d 220 (Mo. banc 1983), the grocery store purchased paper bags and provided them to its customers. There was no charge to the customer for the paper bags as the store included the price of the paper bags into the price of its groceries purchased by the customers. This Court concluded that the customers paid consideration for the paper bags because their cost had been factored into the price of the groceries. The paper bags were not subject to sales tax because the bags were for resale to its customers. The customers took permanent, not temporary, physical possession of the bags and ownership of the paper bags transferred to the customers.

Similarly, in *Sipco, Inc. v. Dir. of Revenue*, 875 S.W.2d 539 (Mo. banc 1994), the corporation was in the business of butchering hogs and delivering meat products to its customers. In order to preserve the meat during delivery, the business would package the meat in dry ice. After receipt of the meat product, the customer could use or discard the remaining dry ice. This Court again concluded that the business factored the cost of the dry ice into the price paid for the meat product. And the customer actually received ownership of the dry ice. Therefore, the dry ice was purchased for resale.

In *Aladdin's Castle*, 916 S.W.2d 196 (Mo. banc 1996), the customers purchased tokens for use in games. Some of the games would dispense tickets, which were redeemable by the customers for prizes purchased by the taxpayer, Aladdin's Castle. This Court concluded that the purchases of the prizes qualified as sales for resale to its customers. In doing so, this Court affirmed its holding "that where a business does not charge separately for goods transferred to customers, but rather factors the cost of the goods into the price of all the items sold to the customers, such goods are exempt from use tax." *Id.* at 197. Yet, once again the customer took possession of the additional item.

In *Brambles Indus. v. Dir. of Revenue*, 981 S.W.2d 568 (Mo. banc 1998), the company leased pallets to Proctor and Gamble ("P & G"), which used the

pallets to ship soap from its plant to its customers. This Court concluded “the first two prongs of the *Sipco* test were met, in that the undisputed evidence was that P & G had the right to use Chep’s pallets, and P & G physically transferred those pallets to its customers.” *Id.* at 571. “P & G does not receive either rented or leased pallets back from its customers.” *Id.* at 569.

Finally, in *Kansas City Royals Baseball Corp. v. Dir. of Revenue*, 32 S.W.3d 560 (Mo. banc 2000), promotional items such as baseball caps, gloves, and t-shirts were given to fans who paid to attend particular baseball games. This Court focused on whether the goods were purchased for resale, not on whether they were purchased by a corporation in the business of selling such tangible goods. This Court held that the Royals were entitled to a refund of use tax paid on the promotional items because when the Royals later gave the promotional items to fans that paid to attend particular baseball games, the items were considered to be “resold” to the fans. Although all paying fans did not get the items, and although no fan paid anything above the usual ticket price to obtain the items, the cost of each item was factored into overall ticket prices. *Id.* at 561-62.

In each of these cases, the customers kept the items that were purchased for resale: grocery bags, dry ice, prizes, pallets, and promotional items. Consideration for the items was the taxable sale of tangible personal

property or service because the items were transferred to the customers with the taxable property or service. As with this first approach and corresponding cases, Chili's customers are charged the same price for meals and drinks, whether or not the customers use the benches, chairs, tables, menus, dishes or other items. However, unlike the facts of these cases, the customers do not get to keep any of these items. The items are retained by Chili's for reuse in the providing of meals and drinks to other customers. There is no sale for resale of the reusable items to the customers.

**2. A second line of cases establishes a resale when the customer pays more for the use of the item.**

The second type of approach and corresponding lines of authority focus on the third element of the statute: whether there was consideration paid or to be paid for the temporary transfer of the use of the tangible personal property. In these cases, courts have found that there was additional consideration for the use of tangible personal property and that this additional consideration was subject to sales tax. Therefore, the tangible personal property used by a customer was a sale for resale.

In *Weather Guard, Inc. v. Dir. of Revenue*, 746 S.W. 2d 657 (Mo. App. E.D. 1988), the wholesaler sold insulation to its retailers who then sold the insulation to their customers. The price of the insulation varied depending

on whether customers purchased insulation only or purchased insulation that included the use of insulation blowers at an increased price:

The [blowers] were not held for resale in the ordinary sense of the word, because they were not permanently transferred to retailers and ultimately to customers as were the paper sacks in *King v. National Super Markets, Inc.*, 653 S.W.2d 220 (Mo. banc 1983). However, it is obvious from § 144.605(5) that a rental qualifies as a sale. Thus the question remains whether the machines were rented to customers or loaned at no charge.”

*Id.* at 657.

The appellate court concluded that the blowers were purchased for resale and the cost of the blowers were included in the cost of the higher-priced insulation purchased by the consumer. “Because the customers paid sales tax on the increased cost of the insulation, there was no loss of tax revenue to the State.” *Id.* at 658. Therefore, because the customer paid a higher price for the insulation and use of the blower and the higher price was subject to sales tax, the blower machines were purchased for resale and not subject to use tax.

In *Ronnoco Coffee Co., Inc. v. Dir. of Revenue*, 185 S.W.3d 676 (Mo. banc 2006), the company purchased coffee equipment from out-of-state vendors and subsequently provided the equipment to its retail grocery store customers as part of the coffee bean purchases. The retail grocery stores then allowed their customers to use the coffee equipment to grind coffee beans and/or brew coffee. The coffee equipment was considered to be a loan to the retail grocery stores as long as they purchased the coffee beans. If the retail grocery stores stopped purchasing coffee beans from Ronnoco, they were required to return the coffee equipment. This Court concluded that “the elements required for a resale were met in Ronnoco’s ‘loan agreement’ transactions in that the equipment was transferred to the customer, who had the right to use that equipment, for the consideration of (1) continued purchase of [Ronnoco’s] products and (2) payment of an increased cost of those products based on the cost of the equipment used.” *Id.* at 680.

In *Weather Guard* and *Ronnoco*, the customers were charged higher prices for insulation and coffee, respectively, if their purchases included the use of equipment. The equipment used by the customer was included in the higher price paid by the customer purchasing insulation or coffee and this higher price was the additional consideration that was subject to sales tax. Chili’s unquestionably charged the same price for meals and drinks

regardless of whether customers used the benches, chairs, tables, menus, dishes, or other reusable items and whether or not meals and drinks were consumed in the restaurant or taken home for consumption. (L.F. 127). There is no additional consideration paid by a customer to obtain the use of these reusable items nor is there a reduced price for the meals if taken out.

The first type of analysis and corresponding lines of authority under § 144.605(7) have the common thread of the customers keeping the items that were for resale. This common thread does not apply to the reusable items provided by Chili's to its customers for temporary use while dining. The customers do not keep the tables, chairs, benches, menus, dishes or other reusable items with their purchases.

The common thread of the second type of analysis and corresponding lines of authority is that when the customer paid a higher purchase price of an item to obtain the use of certain equipment with that item, the equipment was purchased for resale because the item sold for a higher price was subject to sales tax. The higher price was the additional consideration for the use of the equipment. There is no additional consideration paid by Chili's customers to obtain the use of a table, chair, menu, bench, dish or other reusable item. The customers are charged the same price for meals and drinks, whether or not the customers use one or more of the reusable items or

take the meals and drinks home for consumption. Therefore, Chili's fails under either approach to satisfy the elements for an exclusion under § 144.605(7).

### CONCLUSION

For the foregoing reasons, the Administrative Hearing Commission's decision should be affirmed.

Respectfully submitted,

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### **Certification of Service and of Compliance with Rule 84.06(b)-(c)**

The undersigned hereby certifies that on this 24<sup>th</sup> day of March 2010, one true and correct copy of the foregoing brief, and one disk containing the foregoing brief, were mailed, postage prepaid, to:

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The undersigned further certifies that the foregoing brief complies with the limitations contained in Rule No. 84.06(b) and that the brief contains 8,979 words.

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

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