

No. SC86096

IN THE MISSOURI SUPREME COURT

**MURPHY COMPANY
MECHANICAL CONTRACTORS & ENGINEERS,**

Respondent,

v.

DIRECTOR OF REVENUE,

Appellant.

BRIEF OF APPELLANT DIRECTOR OF REVENUE

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The Administrative Hearing Commission erred in concluding that the taxpayer is an “engineering firm” exempt from sales and use taxation on its purchase of computers and computer software under § 144.030.2(28), RSMo, because the taxpayer is primarily a contractor or a design–build contractor in that a) its design–build activities, including construction of projects it designs, produce only 21.5% of total revenue, and design services produce 2.36% of that 21.5% of revenue, b) its remaining total revenue is produced by its service and maintenance contracts and construction activities, c) 50% of its construction activities is designed by other firms, d) 800 of its 1000 employees are union craftspeople, and e) up to 34 of its employees are engineers.

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JURISDICTIONAL STATEMENT

This is an appeal by the Director of Revenue from a decision of the Administrative Hearing Commission finding the taxpayer to be exempt from sales and use taxation on the purchase of computers and computer equipment. *See* § 621.189, RSMo Supp. 2003. This appeal involves the construction of the revenue laws of this state, namely, § 144.030.2(28), RSMo, exempting from sales and use taxation the purchase of computers and computer software for use by engineering firms headquartered in this state. *See* Mo. Const. art. V, § 3 (as amended 1982). Therefore, the Missouri Supreme Court has jurisdiction.

STATEMENT OF FACTS

Procedural background

The Director of Revenue conducted a sales and use tax audit of the purchase of computers and computer software by Murphy Company Mechanical Contractors & Engineers for the sales tax period of July 1997 through December 2001 and the use tax period of January 1999 through December 2001. (Tr. 94–95; A8.) The Director issued final decisions assessing sales tax in the amount of \$8,233.44 and use tax in the amount of \$53,617.85, plus interest. (Tr. 94–95; A17–18.) Murphy appealed to the Administrative Hearing Commission (AHC). (R. 1.)

After hearing, the AHC decided that Murphy is exempt from sales and use taxation on its purchase of computers and computer software because it is an engineering firm headquartered in the state. (A29.) But the AHC also decided that Murphy is liable for sales tax of \$984.49 and use tax of \$13,854.12 on certain purchases because it had not established that they were for computers or computer software. (A29.) Murphy moved to amend or modify the decision, and the AHC denied the motion. (R. 104–105.) The Director petitioned this court to review the AHC’s decision that Murphy is an engineering firm and, thus, entitled to the sales and use tax exemption.

Murphy's business

Murphy performs construction and engineering work in the industrial, commercial, municipal, and institutional construction markets. (R. 1, 63; A2.)

Murphy installs heating, cooling, and plumbing systems and some refrigeration systems, but its work with refrigeration systems is mostly service and maintenance of deep cycle refrigeration facilities, such as grocery stores. (Tr. 74–76; A3.)

Murphy has its headquarters in St. Louis and another office in Denver, Colorado, which shares a computer network with the St. Louis headquarters. (Tr. 24, 40–42; A2, A8.)

Most of Murphy's design work is done at the St. Louis headquarters or in one of its adjacent buildings, and some is done in Denver and on site. (Tr. 33–34, 63–64, 72, 81; A2, A4.) Murphy has 12 mobile offices located at customer sites, and it has on-site office space provided by some of its customers, including 6 out-of-state sites. (Tr. 34–39; A7–8.) At these sites, Murphy provides its own employees, equipment, and phone lines, and is responsible for its own offices. (Tr. 34–39; A8.) The St. Louis headquarters provides administrative support for these sites. (Tr. 39–40; A8.)

Murphy's business strategy

Murphy's business and marketing strategic plan is to marry a mechanical contracting firm to an engineering firm by providing design-build services. (Tr. 13-14, 15; A2, A3.) The design-build method combines the design and construction of a project so that both are covered under one agreement for a lump sum and can proceed at the same time, saving the customer time and money. (Tr. 14-15; A3.) Design-build contrasts with the traditional design-bid-build method by which the customer hires an engineering firm to design a project and then a contracting firm to construct the project. (Tr. 14-15; A3.) Design-build is a "one-stop shop" for the customer, with the design-build firm retaining control over the entire project. (Tr. 14, 45; A3.) Murphy competes against other design-build firms and against joint ventures between engineering and contracting firms. (Tr. 88; A5.) Murphy has had since 1983 a corporate certificate of authority to offer engineering services in Missouri that is current and has always been in good standing. (Tr. 16-17; A3.)

Murphy's strategic plan does not include providing solely engineering services, though it does provide solely engineering services on "very rare occasions" to customers with whom it has done a lot of business. (Tr. 14, 49; A3, A4.) Nor does Murphy's strategic plan include providing solely construction

services. But Murphy does provide solely construction services when the customer requests it, and it has no part in designing 50% of its construction work. (Tr. 51, 76; A5). Occasionally at the request of contractors, Murphy provides free value engineering, which is analysis of another firm's design to make it more cost effective, particularly in energy efficiency. (Tr. 52, 54–55; A4.)

Murphy's employees

Murphy employs over 1,000 persons. (Tr. 62; A5.) Eight hundred of these are union craftspeople in the pipe fitter, boiler maker, plumber, sheet metal, ironworker, millwright, operating engineer, and laborer trades. (Tr. 62; A5). Two hundred fifty to three hundred are full-time salaried employees. (Tr. 62; A5.) In its design-build department, Murphy employs 45 to 50 people in St. Louis, and it also has a design-build department in Denver. (Tr. 25; A4.) Murphy employs at no more than 16 registered professional engineers. (Tr. 17–18, 62; A3.) A registered professional engineer is necessary to stamp and approve a blueprint, but an engineer need not be registered to perform engineering work. (Tr. 87; A3.) Murphy employs 28 persons with a bachelor of science in mechanical engineering, 5 with a bachelor of science in civil engineering, and 1 with a bachelor of science in building construction. (Tr. 18–19; A3.) Project manager engineers and senior officers are not involved in design-build; they verify and validate. (Tr. 43–44; A4.)

Verification is done after design is completed and authorizes construction to begin, and validation is done after construction is completed and affirms that construction has been properly completed. (Tr. 24–26. 27; A5.)

Murphy's revenue

For the three fiscal years ending in March 2002, 21.5% of Murphy's total revenue was from design–build projects, including their construction. (Tr. 25–26, 27, 56–57; A4, A30.) Design services only — billable hours of engineers working at Computer Assisted Design machines¹ and engineers overseeing their effort — produced only 2.36% of that 21.5% of total revenue. (Tr. 21, 47 ; A4, A30.) The

¹Computer Assisted Design machines (CADs) are the automated equivalent of the engineer or draftsman sitting at the drafting table and drawing a blue print. (Tr. 22.) The machines have elaborate keyboards with magnetic pencils and large display screens, and their software permits the engineer or draftsman to point and click the line and scale wanted. (Tr. 23–24.) Electronic blueprints can be printed on “custom plotters,” but the preferable method of transferring them is electronically as an attachment to an e-mail. (Tr. 26–27.) Murphy also uses its CADs for administrative functions, such as payroll and accounting, and at the site to receive electronic blueprints when doing construction only. (Tr. 62, 78–80.)

remaining 78.5% of total revenue was from service and maintenance contracts and construction. (Tr. 61; A6.) Murphy's goal is to have service and maintenance contracts comprise 50% of its revenue, but for the audit periods at issue, service and maintenance contracts provided 30% of revenue. (Tr. 61; A6.) Other engineering services, such as project management and verification and validation, are included in construction revenues. (Tr. 48, 58–59.) Revenue from solely engineering services is “few and far between” and “very minimal” and not included in the above calculations. (Tr. 50.)

Murphy's reputation

Murphy was named “Mechanical Contractor of the Year” in 1996 by *Contractor: the News Magazine of Mechanical Contracting*, is ranked the 14th largest mechanical specialty contracting firm in the 2001 ENR/Engineering News–Record, and is ranked the 28th largest mechanical contracting firm by the 2002 Contractor Annual Report on the Nation's Largest Mechanical Contracting Firms in the United States. (Tr. 77; A6.) If the engineering section stood alone, Murphy would be one the largest engineering firms in St. Louis. (Tr. 55; A4.) Murphy advertises in the yellow pages under “Mechanical Contractors,” not “Engineers.” (Tr. 74; A6.)

POINT RELIED ON

The Administrative Hearing Commission erred in concluding that the taxpayer is an “engineering firm” exempt from sales and use taxation on its purchase of computers and computer software under § 144.030.2(28), RSMo, because the taxpayer is primarily a contractor or a design–build contractor in that a) its design–build activities, including construction of projects it designs, produce 21.5% of total revenue, and design services produce 2.36% of that 21.5% of revenue, b) its remaining total revenue is produced by its service and maintenance contracts and construction activities, c) 50% of its construction activities is designed by other firms, d) 800 of its 1000 employees are union craftspeople, and e) no more than 34 of its employees are engineers.

§ 144.030, RSMo Supp. 2003

§ 327.465, RSMo Supp. 2003

Branson Properties USA, L.P. v. Director of Revenue,

110 S.W.3d 824 (Mo. banc 2003)

Southwestern Bell Yellow Pages, Inc. v. Director of Revenue,

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ARGUMENT

The Administrative Hearing Commission erred in concluding that the taxpayer is an “engineering firm” exempt from sales and use taxation on its purchase of computers and computer software under § 144.030.2(28), RSMo, because the taxpayer is primarily a contractor or a design–build contractor in that a) its design–build activities, including construction of projects it designs, produce 21.5% of total revenue, and design services produce 2.36% of that 21.5 % of revenue, b) its remaining total revenue is produced by its service and maintenance contracts and construction activities, c) 50% of its construction activities is designed by other firms, d) 800 of its 1000 employees are union craftspeople, and e) up to 34 of its employees are engineers.

A. Standard of review

The Administrative Hearing Commission’s (AHC’s) interpretation of revenue laws is reviewed de novo and upheld when authorized by law and supported by competent and substantial evidence. *See* § 621.193, RSMo Supp. 2003; *Branson Properties USA, L.P. v. Director of Revenue*, 110 S.W.3d 824, 825 (Mo. banc 2003). Tax exemptions are strictly construed against the taxpayer and allowed only

upon clear and unequivocal proof by the taxpayer. *See id.*; *Lincoln Industrial, Inc. v. Director of Revenue*, 51 S.W.3d 462, 465 (Mo. banc 2001). Exemptions are interpreted to give effect to the General Assembly’s intent, using the plain and ordinary meaning of its words, with statutory ambiguity and doubts resolved against the taxpayer. *See id.*; *Southwestern Bell Yellow Pages, Inc. v. Director of Revenue*, 94 S.W.3d 388, 390 (Mo. banc 2003).

B. Murphy is primarily a contractor or a design–build contractor

The AHC decided this case in Murphy’s favor because it held a certificate of authority to offer engineering services in Missouri. About the certificate, the AHC said: “This fact is critical in this case.” (A23.)

Murphy is more than a contracting firm. . . . Murphy holds a corporate certificate of authority to offer engineering services in Missouri, and it provides engineering services. Therefore, it qualifies as an engineering firm under § 144.030.2(28).

(A23.) But this fact is only one of many facts that should be considered in determining whether Murphy is an engineering firm. And this fact is not determinative because Murphy does not subcontract its engineering work. Even if Murphy did minor amounts of engineering on projects it was building, it would be

required to hold an engineering certificate unless it subcontracted with an engineering firm with a certificate. *See* § 327.465.2, RSMo Supp. 2003; A38.

By the plain language of the statute, the sales and use tax exemption applies only to “architectural and engineering firms,” not to contractors or design–build contractors. § 144.030.2(28), RSMo Supp. 2003; A35. And if the plain language of the exemption were not enough, when the legislature subsequently permitted design–build contractors not to have certificates of authority to offer architectural, engineering, and land survey services if they subcontract with persons or corporations who do have such certificates, the legislature did not amend the sales and use exemption to include design–build contractors.² *See* § 327.465.2; A38.

Another mistake the AHC made was to think that the Director believed that Murphy had to engage in engineering services “exclusively.” (A23.) The exemption does not require that. An engineering firm is a firm that primarily employs engineers and primarily provides engineering services.³ Though Murphy

²The legislature enacted the tax exemption in 1995 and the design–build statute in 2002. *See* 1995 Mo. Laws 433; 2002 Mo. Laws 771.

³Because the AHC misunderstood the Director, certain of her letter rulings, L9754, May 16, 1997 (A40), and LR2671, December 21, 2000 (A41), are not inconsistent with her position that the primary nature of a firm determines whether it

may be more than a contracting firm, it is not primarily an engineering firm. The evidence adduced at the administrative hearing demonstrates that Murphy is primarily a contractor or design–build contractor.

An examination of Murphy’s business strategy, employees, revenue, and reputation all indicate that it is a contractor or a design–build contractor, rather than an engineering firm. Murphy’s business and marketing strategic plan is to marry a mechanical contracting firm to an engineering firm by providing design–build services. It competes against other design–build firms and against joint ventures between engineering and contracting firms. Its strategic plan does not include providing solely engineering services or solely construction services.

Murphy primarily employs construction workers. Murphy employs over 1,000 persons, 800 of which work construction. They are union craftspeople in the pipe fitter, boiler maker, plumber, sheet metal, ironworker, millwright, operating engineer, and laborer trades. Only 45 to 50 people work design–build. Only 14 to 16 people are registered, professional engineers. Murphy employs no more than 34 engineers — less than 1% of its work force.

qualifies for the exemption. A firm can offer more than one type of service and still qualify so long as it is primarily an architectural or engineering firm.

The sources of Murphy's revenue reinforce the conclusion that it primarily provides construction services. For the three fiscal years ending in March 2002, only 21.5% of Murphy's total revenue was from design-build projects, and that percentage includes the construction of design-build projects. Design services only, those services of engineers designing projects and of engineers overseeing those designs, produce only 2.36% of that 21.5% of total revenue. The remaining 78.5% of Murphy's total revenue comes from its service and maintenance contracts and construction. And Murphy has no part in designing 50% of its construction work.

Finally, Murphy holds itself out in the yellow pages as a mechanical contractor. And others perceive Murphy as a mechanical contractor. It has received the mechanical contractor of the year award and is the 14th largest mechanical specialty contracting firm and the 28th largest mechanical contracting firm in the country.

Because Murphy is primarily a contractor or a design-build contractor, not primarily an engineering firm, it is not entitled to the exemption for sales and use tax on its purchase of computers and computer software.

CONCLUSION

For the reasons stated above, the decision of the Administrative Hearing Commission finding the taxpayer exempt from sales and use taxes on the purchase of computers and computer software should be reversed. In all other respects, the decision should be affirmed.

Respectfully submitted,

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CERTIFICATES OF SERVICE AND COMPLIANCE

I hereby certify that 1 copy and 1 computer diskette of the foregoing and 1 copy of the Separate Appendix of Appellant Director of Revenue were served by first-class mail, postage prepaid, this day of ____ day of October, 2004, upon:

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I hereby certify that this brief contains the information required by Rule 55.03, complies with the limitations contained in Rule 84.06(b), and contains 2,724 words and that the diskettes provided this Court and counsel have been scanned for viruses and are virus-free.

Assistant Attorney General