SC91010

IN THE SUPREME COURT OF MISSOURI

E & B GRANITE, INC.,

Respondent (Petitioner below),

vs.

DIRECTOR OF REVENUE,

Appellant (Respondent below).

From the Administrative Hearing Commission of Missouri,
The Honorable Karen A. Winn, Commissioner

APPELLANT'S REPLY BRIEF

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E & B is compelled to acknowledge the simple truth that controls this case: "upon the affixation to real estate that certain aspects of these products are changed from tangible personal property to real property." Respondent's Brief, p. 18. It is unclear what E & B thinks those "certain aspects" are; but regardless, the law is clear that an item such as a granite countertop becomes real property when attached as an improvement to real estate. *See State ex rel. Thompson v. Osage Outdoor Adver., Inc.*, 674 S.W.2d 81, 83 (Mo. App. W.D. 1984) ("[A]dditions affixed to real estate acquire the status of real property . . . ."). And there can be no dispute that real property is not a "product" for purposes of § 144.054, particularly when strictly construed as required by Missouri law. *See Dir. of Revenue v. Armco, Inc.,* 787 S.W.2d 722, 724 (Mo. banc 1990) ("Canons of construction direct that exemption statutes be strictly construed against the taxpayer").

Yet, E & B wants the Court to ignore this simple truth and the associated legal principles, and instead look back to an intermediate step in the process of making a real property improvement. According to E & B, whether they are entitled to a tax exemption on the purchase of raw granite slabs should be decided based on what the resulting granite countertop might

have been "prior to affixation." Respondent's Brief, p. 11. This cannot, and should not be permitted.

Moreover, a narrow construction of § 144.054, as required by Missouri law, also supports the conclusion that the "materials" listed in the statute are items which are not the raw granite slabs but instead are items being used to process or manufacture the raw granite slabs. Indeed, if the Commission's interpretation is adopted, virtually every construction contractor could obtain a tax exemption if they do anything to process, manufacture, or produce the raw product that is eventually attached to real property. This is not supported by the plain language of § 144.054, and would be a dramatic departure from longstanding case law. *See, e.g., Bratton Corp. v. Dir. of Revenue*, 783 S.W.2d 891, 892 (Mo. banc 1990).

I. The Term "Product" in § 144.054.2, Strictly Construed, Does Not Include Real Property or Items "Affixed to Real Estate" – Which is What E & B Admits Its Granite Countertops Become Before Title is Transferred.

There is no dispute that the tax exemption sought in this case should be strictly construed against E & B. Respondent's Br., p. 9. Indeed, in order for E & B to obtain the tax exemption, there must be "clear and unequivocal proof," and all "doubts are resolved against the party claiming it." *Branson*

Properties USA, L.P. v. Dir. of Revenue, 110 S.W.3d 824, 825 (Mo. banc 2003); *see Armco, Inc.,* 787 S.W.2d at 724 (holding that exemption statutes are "strictly construed" against the taxpayer).

Despite conceding that a strict construction must apply to § 144.054.2, E & B proceeds to broadly interpret the statute and the key terms in it – including "product." *See* Respondent's Brief, p. 24 (stating that the statute "exempts virtually anything"). According to E & B, as well as the Commission, the term "product" should be expanded to include items that are "affixed to real estate" and have therefore become real property. Respondent's Brief, p. 11. This proposed expansion of the tax exemption under § 144.054.2 must fail for at least two fundamental reasons: first, real property, or an item "affixed to real estate," is not a "product," and; second, whether an item is a "product" for purposes of sales and use tax (or for a sales or use tax exemption) is determined at the time title is passed – in this case after the granite countertop has become affixed to real estate.

A. Real Property, or an Item "Affixed to Real Estate," is Not a "Product" Under § 144.054.2.

While the exemption statute at issue does not define "product," dictionaries do provide several definitions of "product." *See State ex rel. Burns v. Whittington*, 219 S.W.3d 224, 225 (Mo. banc 2007) (holding that in

the absence of a statutory definition, the "plain and ordinary meaning of a term may be derived from a dictionary"). None of the dictionary definitions, however, include real property or an item affixed to real estate as a "product." *See, e.g.,* Webster's Third New International Dictionary 1810 (1993) (defining product as "something produced by physical labor or intellectual effort" or "the output of an industry or firm"); Black's Law Dictionary 840 (abridged 6th ed. 1991) (defining product as "[g]oods produced or manufactured" or "[s]omething produced by physical labor or intellectual effort").

In contrast, the dictionary definitions of real property and real estate include items such as granite countertops affixed to real estate. *See, e.g.,* Black's Law Dictionary 847 (abridged 6th ed. 1991) (defining real property as "[l]and, and generally whatever is erected or growing upon or affixed to land"); *id.* 873 (defining real estate as "anything permanently affixed to the land, such as buildings, fences, and those things attached to the buildings, such as light fixtures, plumbing and heating fixtures, *or other such items which would be personal property if not attached*") (emphasis added); Webster's Third New International Dictionary 1890 (1993) (defining real estate as "lands, tenements, or hereditaments" as well as "land and its permanently affixed buildings or other structures together with its improvements").

The case law is in accord with the dictionary definitions and legal principles distinguishing between an item that is separate from real estate and the same item permanently affixed to real estate. This basic principle – that "additions affixed to real estate acquire the status of real property" – is well recognized and uniformly applied. *State ex rel. Thompson*, 674 S.W.2d at 83; *see, e.g., Blaske v. Smith & Entzeroth, Inc.*, 821 S.W.2d 822, 836 (Mo. banc 1991) (noting that when a unit that is "affixed to the building or the real property is an improvement to real property"); *Leawood Nat. Bank of Kansas City v. City Nat. Bank & Trust Co. of Kansas City*, 474 S.W.2d 641, 644 (Mo. App. W.D. 1971) ("A fixture is an article of the nature of personal property which has been so annexed to the realty that it is regarded as a part of the land and partakes of legal incidents of the freehold and belongs to the person owning the land."). Thus, once an item such as a granite countertop is permanently affixed to real estate, it losses its prior status and acquires the status of real property.

Yet, E & B ignores these most basic principles of property law and asks, "before the countertop is installed and affixed to a customer's real property, *what is it* if its [sic] not tangible personal property?" Respondent's

Brief, p. 11 (emphasis in original).[1/] The answer is simple; before a countertop is installed and affixed to real property it is indeed an item of tangible personal property. But this does not make it tangible personal property forever, much less a "product" for purposes of § 144.054.2. That determination, which must be strictly construed against application of the tax exemption, must be made not at any point in the process but instead at the time title is transferred.

B. Sales and Use Taxes (or an Exemption) are Determined at the Time Title is Transferred.

E & B's argument assumes that if an item could be construed at any time as a "product" or tangible personal property then it ought to be subject to the tax exemption under § 144.054.2. Respondent's Brief, p. 11 ("That the countertop is eventually affixed to real estate does not change the fact that what was originally manufactured was tangible personal property."). Not only is this inconsistent with a strict construction of tax exemptions, but it is

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[1/] According to E & B, "The Director claims that the granite countertops and other granite products that E & B manufactures using granite slabs are not 'products.'" Respondent's Brief, p. 10. This is not true. Some are. But items that are attached to real property when title is transferred are not "products."

equally inconsistent with controlling law on the timing of which tax exemptions are analyzed.

In *Blevins Asphalt Const. Co. v. Dir. of Revenue*, 938 S.W.2d 899 (Mo. banc 1997), this Court held that "[i]n sales and use tax, the taxable event is the passage of title or ownership." *Id.* at 901 (citing *Kurtz Concrete, Inc. v. Spradling*, 560 S.W.2d 858, 860 (Mo. banc 1978)). And "[p]assage of title or ownership depends on the intent of the parties." *Id.* (citing *Brinson Appliance, Inc. v. Dir. of Revenue*, 843 S.W.2d 350, 352 (Mo. banc 1992)). Here, the parties agreed that title passed *after* the granite countertops were permanently affixed to real estate. Thus, at the time sales and use taxes (and any exemptions) are analyzed, the countertops at issue had already changed status to become real property.

Attempts to look back at what the countertops might have been "prior to affixation" is simply improper and contrary to fundamental principles of Missouri law.[2/] There is no support in the statute to suggest that these

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[2/] E & B even gives an example that illustrates this point. E & B argues that granite countertops should be no different than ceiling fans or shower heads. Respondent's Brief, p. 17. But in their own words they isolate the critical distinction – the hypothetical ceiling fans or shower heads "are affixed to real estate *after they are purchased by consumers*." Respondent's Brief, p.

fundamental principles of property and tax law should be changed. The legislature could have, but did not, provide the tax exemption for an item of tangible personal property that *could have been* a product or which at *any time* was tangible personal property. Nor should this Court change the very nature of what constitutes a "product" by including real estate as a "product." *See International Business Machines Corp. v. Dir. of Revenue*, 958 S.W.2d 554, 557 (Mo. banc 1997) (holding that a "product" can be "either tangible personal property or a service"); *see also Southwestern Bell Tel. Co. v. Dir. of Revenue*, 78 S.W.3d 763, 766-67 (Mo. banc 2002) (reviewing the development of "product").

By concluding that "an installed countertop is a product," Decision, p. 9, the Commission erroneously (and dramatically) expanded the definition of a "product" to include real property. This conclusion is contrary to both the statute and basic principles of law. Accordingly, the Commission should be reversed.

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11. Thus, title passes before being affixed to real estate. As such, the ceiling fans and shower heads described by E & B would be "products" when sales and use taxes were assessed.

II. "Materials Used or Consumed in the Manufacturing," Strictly Construed, Should Not Include the Raw Product Being Manufactured.

In our second point on appeal, an alternative analysis was presented suggesting a more narrow definition of the term "materials." According to E & B, the term "materials" is "clear and unambiguous," and there is no reason it "should be interpreted differently in *Blevins* and Section 144.030, on the one hand, and in Section 144.054 on the other." Respondent's Brief, pp. 21 & 23. This conclusion, however, does not reflect either the different uses of the term "materials" in § 144.030 and § 144.054, or the strict construction that must be applied to its use.

The term "material" or "materials" is used no less than 28 times in § 144.030 and 5 times in § 144.054, and many of the usages demonstrate a different meaning even within the same section. For example, in § 144.030.2(2), "[m]aterials" is used to describe something that becomes "a component part or ingredient of the new personal property resulting from such manufacturing." In § 144.030.2(4), a still different kind of "materials" is described as "materials and supplies solely required for the installation or construction of such replacement machinery, equipment, and parts." Section

144.030.2(12) even uses the term "raw materials." Yet, none of these usages of "materials" is the same as the usage at issue in § 144.054.2.

Because the term "materials" is so generic, *see* Webster's Third New International Dictionary 1392 (1993), its specific meaning in § 144.054 is dependant on the context of the statute. In § 144.054.2, for example, the term "materials" follows a more specific list of terms that could also be characterized as "materials used or consumed in the manufacturing." In that way, the terms are "of the same kind." *Standard Operations, Inc. v. Montague*, 758 S.W.2d 442, 444 (Mo. banc 1988) (applying the maxim "*ejusdem generis* ('of the same kind')"). Thus, the terms are linked to each other in the list.

And while it is certainly possible to interpret the term "materials" to include virtually everything, including the very raw product being manufactured, such an interpretation would not be consistent with the other "materials" in the list and would be an impermissible and expansive interpretation. Similarly, the definitions of "used or consumed" in § 144.054.2 support this same more narrow interpretation of "materials."

Considered in the context of the surrounding list and terms, the plain meaning of the term "materials" – especially given the strict or narrow construction required of a tax exemption – does not apply to the raw product

ultimately installed in real property. Instead, the statute was intended to extend only to those materials that facilitate the manufacturing of the raw product.

III. Section 144.054 Does Not Support Tax Free Purchases for Construction Contractors and Their Customers.

Finally, the trial court's erroneous conclusion would result in two identical countertops being treated differently – with one subject to sales and use tax while the other is not. *See* Respondent's Brief, p. 26 (noting that "its retail sales of granite are subject to state and local sales tax"). And the only difference is that the tax free version is installed and becomes real property before title is transferred. E & B acknowledges this result, but argues that this is not so absurd, because after all the company is still subject to "income tax" and its employees are subject to "payroll and withholding taxes." Respondent's Brief, pp. 8 & 26. This entirely misses the point.

There is nothing in the statute to suggest that a construction contractor such as E & B is permitted tax free purchases if they install the granite countertops they make instead of simply selling them after they are made. And while E & B argues that there is no case law "stating that items cannot move throughout the stream of commerce without being taxed," Respondent's Brief, p. 26, one does not even need to go to case law to support

the proposition that the legislature intended that items of tangible personal property are to be taxed at some point in the stream of commerce.

In § 144.021, it states that "[t]he purpose and intent of sections 144.010 to 144.510 is to impose a tax upon the privilege of engaging in the business, in this state, of selling tangible personal property." And this Court relied on this very purpose in *International Business Machines Corp. v. Dir. of Revenue*, 958 S.W.2d 554 (Mo. banc 1997) to support the conclusion that the point of a manufacturing exemption was to develop "enterprises that produce products that are within the scope of the sales tax law." *Id.* at 558 (citing *West Lake Quarry & Material Co. v. Schaffner*, 451 S.W.2d 140, 142 (Mo. 1970)). The purpose is therefore met with an exemption if "'sales taxes would be paid on *all* of their finished products when sold.'" *Id.* (quoting *Heidelberg Central, Inc. v. Dir. of Revenue*, 476 S.W.2d 502, 506 (Mo. 1972)) (emphasis in original).

Thus, if the purpose of the statute is to ensure a tax on the sale of tangible personal property, and such purpose would be entirely defeated by the Commission's interpretation, then it should be rejected. The natural consequences of the Commission's interpretation is for construction contractors to install items so as to avoid sales or use tax. A carpenter could certainly cut the wood for the floor, walls, or cabinets, install the "product,"

and then claim the exemption in § 144.054. This is not at all a result supported by the statutory language. As such, E & B cannot show that it fits the statutory exemption exactly, and its claims should therefore be rejected. *Cook Tractor Co., Inc. v. Dir. of Revenue*, 187 S.W.3d 870, 872 (Mo. banc 2006).

CONCLUSION

For the foregoing reasons, as well as those set forth in the Director of Revenue's opening brief, the Administrative Hearing Commission's decision should be reversed and judgment entered in favor of the Director of Revenue.

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 29th day of November 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 3,038 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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