SC93900

IN THE SUPREME COURT OF MISSOURI

SOUTHWESTERN BELL TELEPHONE COMPANY AS SUCCESSOR IN INTEREST TO SOUTHWESTERN BELL TEXAS HOLDINGS, INC.,

Respondent,

v.

DIRECTOR OF REVENUE,

Appellant.

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

BRIEF OF APPELLANT

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JURISDICTIONAL STATEMENT

This case arose from an assessment of franchise tax against Southwestern Bell Telephone Company, as successor in interest to Southwestern Bell Texas Holdings, Inc. Holdings appealed that assessment to the Administrative Hearing Commission, which ruled for Holdings. The question presented in this appeal is whether the franchise tax law, § 147.010—a revenue law—ceased to apply to Holdings when Holdings or Southwestern Bell created a structured in which the Missouri operations of the Southwestern Bell were controlled by a limited partnership in which Holdings was both the limited and (through a wholly owned "LLC") the general partner. Because answering that question requires the construction of a revenue law, the petition for review was appropriately filed by the Director of Revenue in this Court. Mo. Const. Art. V, § 3; § 621.189[1], RSMo.

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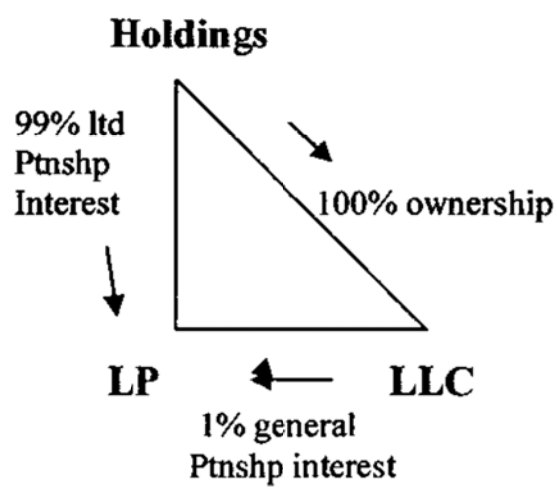
[1] All statutory references are to RSMo Supp. 2013 unless noted otherwise.

STATEMENT OF FACTS

This case addresses the franchise tax liability of Southwestern Bell Texas Holdings, Inc. ("Holdings").

Holdings is "a Delaware corporation, with its commercial domicile located outside of Missouri"—with a business address in Dallas, Texas. LF 203; App. 2. Prior to the tax years at issue, Holdings "form[ed] and own[ed] 100% of a single-member limited liability company (LLC)." LF 204; App. 3. Holdings also created a Texas limited partnership, Southwestern Bell Texas, with the LLC as the general partner with a 1% interest, and Holdings owning the other 99% interest as a limited partner. LF 204-05; App. 3-4. The Administrative Hearing Commission (AHC) illustrated the relationships:



LF 206; App. 5. In other words, Holdings and Southwestern Bell created a partnership in which Holdings was, in effect, both the limited and (through the wholly-owned and controlled LLC) the general partner.

Pursuant to the limited partnership agreement entered into by Holdings (essentially with itself), "title to the real and personal property or interest therein now and hereafter acquired by the Partnership, shall be owned, held or operated by the Partnership, and no Partner, individually, shall have any ownership of such property." LF 206-07; App. 5-6.

Though Holdings' income was included in Missouri income tax returns filed by its parent for 2003, 2004, and 2005, neither Holdings nor the partnership filed Missouri franchise tax returns for 2003, 2004, or 2005. LF 207; App. 6.

Based on notices of deficiency issued in August 2007, the Director of Revenue "determined that [Holdings] was engaged in business in Missouri in 2003, 2004 and 2005, through its interest in" the limited partnership. LF207; App. 6. "Holdings was subject to the Missouri franchise tax for th[ose] tax periods because it held the entire interest in LLC and LP." LF207; App. 6.

Holdings timely sought review at the AHC. LF202; App. 1. The AHC took up the matter on stipulated facts. LF203; App. 2. The AHC held that because the General Assembly "did not explicitly" "impose the franchise tax on foreign corporations employing their assets to do business in Missouri … through its interest in a limited partnership," Holdings was not subject to the franchise tax. LF 218-19; App. 17-18.

POINT RELIED ON

The Administrative Hearing Commission erred in holding that the taxpayer is exempt from the Missouri franchise tax because taxpayer is required to pay the Missouri franchise tax in that it is a foreign corporation operating in the State of Missouri, albeit through a limited partnership in which it is both the limited and, through a wholly-owned LLC, the general partner.

Bates Co. Nat. Bank v. Wilson,

767 S.W.2d 101, 103 (Mo. App. W.D. 1989)

Unifund CCR Partners v. Kinnamon,

384 S.W.3d 703, 705-06 (Mo. App. W.D. 2012)

Wills v. Wills, 750 S.W.2d 567, 572 (Mo. App. E.D. 1988)

§ 147.010

ARGUMENT

Standard of Review

"A decision of the [Administrative Hearing Commission] will be affirmed if: (1) it is authorized by law; (2) it is supported by competent and substantial evidence based on the whole record; (3) mandatory procedural safeguards are not violated; and (4) it is not clearly contrary to the reasonable expectations of the legislature." *Union Elec. Co. v. Dir. of Revenue*, --- S.W.3d ----, 2014 WL 946849 at *2 (Mo. 2014), citing § 621.193, and *Brinker Missouri, Inc. v. Dir. of Revenue*, 319 S.W.3d 433, 435 (Mo. banc 2010). But here, the question that divides the taxpayer and the Director is purely one of law. "The Court reviews the AHC's interpretation of revenue statutes de novo." 2014 WL 946849 at *2, citing *Brinker*, 319 S.W.3d at 435.

"With respect to any issue relevant to ascertaining the tax liability of a taxpayer all laws of the state imposing a tax shall be strictly construed against the taxing authority in favor of the taxpayer." § 136.300.1. Thus "[w]hen a tax statute is ambiguous because of duplicity, indistinctness, or uncertainty in the meaning of language in the statute, the statute must be strictly construed in favor of the taxpayer and against the taxing authority." *Street v. Dir. of Revenue*, 361 S.W.3d 355, 362 (Mo. 2012).

Introduction

This is the rare case that arises from Missouri's "franchise tax" law—a tax that is imposed on corporations doing business in Missouri. The franchise tax is imposed by § 147.010—a provision made especially complex because of changes in the law that have required transition clauses and exemptions for some companies that generally do not apply here. We excerpt the portion of the provision that applies here as:

> 1. For … each taxable year beginning on or after January 1, 1980, but before January 1, 2000, every corporation … shall, in addition to all other fees and taxes now required or paid, pay an annual franchise tax to the state of Missouri equal to one-twentieth of one percent of the par value of its outstanding shares and surplus if its outstanding shares and surplus exceed two hundred thousand dollars, or if the outstanding shares of such corporation or any part thereof consist of shares without par value, then, in that event, for the purpose contained in this section, such shares shall be considered as having a value of five dollars per share unless the actual value of such shares exceeds five dollars per share, in which case

> the tax shall be levied and collected on the actual value and the surplus if the actual value and the surplus exceed two hundred thousand dollars. If such corporation employs a part of its outstanding shares in business in another state or country, then such corporation shall pay an annual franchise tax equal to one-twentieth of one percent of its outstanding shares and surplus employed in this state …, and for the purposes of sections 147.010 to 147.120, such corporation shall be deemed to have employed in this state that proportion of its entire outstanding shares and surplus that its property and assets employed in this state bears to all its property and assets wherever located. A foreign corporation engaged in business in this state … shall be subject to this section. … For all taxable years beginning on or after January 1, 2000, but ending before December 31, 2009, the annual franchise tax shall be equal to one-thirtieth of one percent of the corporation's outstanding shares and surplus ….

We can further simplify the language by rearranging. So done, the tax law says three things pertinent to the issues raised in this case:

1. "A foreign corporation engaged in business in this state … shall be subject to" the tax.
2. "If such corporation employs a part of its outstanding shares in business in another state or country, then such corporation shall pay an annual franchise tax equal to one-[thirtieth] of one percent of its outstanding shares and surplus employed in this state."
3. "[S]uch corporation shall be deemed to have employed in this state that proportion of its entire outstanding shares and surplus that its property and assets employed in this state bears to all its property and assets wherever located."

§ 147.010.1.

Here, there is no dispute that "property and assets" are being employed (3) by a foreign corporation (1) to operate in Missouri. But Holdings is no longer holding nor using physical assets in Missouri directly; it has created a wholly owned limited partnership to operate in our state. The question is whether by doing so, Holdings and its parent have entirely avoided the franchise tax.

As explained below, the AHC is wrong. Having chosen to use a partnership rather than a corporate form for its subsidiary, Holdings has not created a barrier between it and the assets it uses in Missouri that is sufficient to avoid the franchise tax.

I. The franchise tax applies to out-of-state corporations whose "property and assets [are] employed in this state."

Before turning to the question posed in this case, we take up two simpler hypotheticals. In the first—the simplest—a foreign corporation operates in Missouri without the intervening use of any sort of partnership. We take up each of the three points of the statute listed above.

As to (1), we have a foreign corporation engaged in business in the state. So it is subject to the franchise tax. "A finding of what constitutes 'doing business' in the state is to be determined on the facts in each individual case." *State v. Murray's*, 767 S.W.2d 127, 129 (Mo. App. E.D. 1989). Certainly having offices and employees and using equipment within Missouri constitutes "doing business" so as to make a corporation like Holdings (or Southwestern Bell) subject to the franchise tax (again, for purpose of this section, without an intermediary).

As to (2), in this first hypothetical a portion of the corporation's "outstanding shares and surplus [are] employed in this state." § 147.010.1. Though that sentence refers to use of "shares and surplus," (3) tells us that we determine whether and to what extent "shares and surplus" are used in Missouri by looking at use of "property and assets." *Id.* And here, for simplicity, we assume that the corporation uses half of its property and assets in Missouri.

In this hypothetical there is no question that the corporation owes franchise tax in Missouri, and that the tax is "one-[thirtieth] of one percent of" one-half of "its outstanding shares and surplus."

This is not, of course, entirely hypothetical. Rather, it is a description of the situation before the restructuring that led to this case. Holdings or its predecessor "filed Missouri corporation franchise tax returns from at least 1975 through 2001." AHC at 4. Its "2000 Missouri corporation franchise tax liability was $713,726 and its 2001 Missouri corporation franchise tax liability was $701,251." AHC p. 4. Had Holdings or its corporate predecessor continued to operate in Missouri without the use of subsidiary partnerships, it would have continued paying substantial Missouri franchise taxes. Indeed, even careful observers might have expected that to continue even after the restructuring: when Southwestern Bell sought Missouri Public Service Commission (PSC) approval for the restructuring, it told the PSC that the change would "have no effect on the tax revenues of the State of Missouri." AHC p. 3.

II. Because "property and assets" of a partnership are "property and assets" of the partners, a corporation that is a partner in a general partnership whose "property and assets [are] employed in this state" is subject to the franchise tax.

In our second hypothetical, a foreign corporation does business in Missouri not directly, but through a general partnership.

As the AHC observed, "Missouri adheres to the common law "aggregate theory of partnership." AHC p. 15, quoting *Unifund CCR Partners v. Kinnamon*, 384 S.W.3d 703, 705-06 (Mo. App. W.D. 2012). Thus, for example, a "partner, as an agent of the partnership, may bind the partnership to a contract if he has either actual or apparent authority to do so." *Bates Co. Nat. Bank v. Wilson*, 767 S.W.2d 101, 103 (Mo. App. W.D. 1989). And each "partner is a co-owner with his partners of specific partnership property holding as a tenant in partnership and his interest is his share of the profits and surplus." *Wills v. Wills*, 750 S.W.2d 567, 572 (Mo. App. E.D. 1988).

It seems apparent, then, that if a foreign corporation does business in Missouri through a general partnership—regardless of whether it owns or controls all of the partners—the use of that partnership does not shield the corporation from the franchise tax. The "property and assets" of the partnership are deemed to be "property and assets" of the partners—*i.e*, of the foreign corporation.

III. That a foreign corporation creates and entirely owns and controls a limited partnership to operate in Missouri does not excuse that corporation from Missouri's franchise tax.

Finally, we turn to what is before the Court. Here we have a foreign corporation doing business in Missouri—but not through a general partnership. Instead, the foreign corporation has created a limited partnership. And the corporation has transferred its Missouri operations to that limited partnership. In other words, the very same business that the corporation was operating in Missouri directly is still being operated by the corporation, but through a limited partnership that the corporation created unilaterally (and presumably can abolish unilaterally—and may do so once the Missouri franchise tax has expired, *see* § 147.010.1(5). RSMo.).

The question here, then, is whether the insertion of a limited, as opposed to general, partnership changes the result from our two hypotheticals. Or to post the question slightly differently: Is the nature of the limited partnerships enough to make them, for purposes of franchise tax liability, more like subsidiary corporations that would be taxed (if at all) on the basis of their own assets, than like general partnerships? The answer is, "no." The fact remains that the foreign corporation is using its "property and assets" in Missouri, even though the "property and assets" have been transferred, on paper, to limited partnerships.

A. The franchise tax is imposed for the privilege of doing business in Missouri—which Holdings does through its limited partnership.

To reach that conclusion, we begin, of course, with the franchise tax law itself. That law ties operations and corporations—and in doing so, in effect says that if one corporation operating in Missouri creates a new subsidiary corporation and transfers its Missouri operations to the corporation, the parent corporation is no longer liable for the franchise tax—instead, the subsidiary pays. *See* 12 C.S.R. 10-9.200(2)(c)(C). But there is nothing in the franchise tax law that suggests that operating in Missouri using a partnership of any kind has the same effect on the parent corporation of limited partnerships. And there is a logic to that omission.

"The Missouri franchise tax is a tax on the privilege of doing business in Missouri …." *TSI Holding Co. v. Dir. of Revenue*, 118 S.W.3d 597, 601 (Mo. 2003). As a court in Holdings' (and Southwestern Bell's) home state recently explained, "The granting of the privilege to transact business in this state confers economic benefits, including the opportunity to realize gross income and the right to invoke the protection of local law. The Texas franchise tax is a tax on the value of this privilege." *Bullock v. Nat'l Bancshares Corp.*, 584

S.W.2d 268, 270 (Tex. 1979) (citations omitted), quoted with approval, *In re Nestle USA, Inc.*, 387 S.W.3d 610, 622 (Tex. 2012). Here, there is no question that Southwestern Bell and Holdings are obtaining “economic benefits” from “transacting business” in the State of Missouri. That they have created wholly owned partnership through which to do so does not change that fact at all.

So we then reach the question of whether the Missouri General Assembly, in imposing that tax on Holdings’ privilege of doing business in Missouri, gave Holdings—and thus Southwestern Bell—a pass because they unilaterally created wholly-owned limited partnerships through which—again, on paper—to do that business. And that means asking whether Holdings’ “property and assets [are] employed in this state.” They are, when looked at in either of two possible ways.

B. The “assets and property” of the partnerships—even “limited partnerships”—are aggregated to Holdings.

First, the assets of the partnership are, under the aggregate theory discussed in II, attributed to the parent corporation. The AHC agreed that would be true if the partnerships were general ones, but concluded that by structuring its business through limited partnerships, Southwestern Bell and Holdings removed the Missouri business from the franchise tax. But nothing in Missouri statutes or caselaw can be read to exempt limited partnerships from the aggregation rule.

This Court has not addressed the aggregation rule in the context of limited partnerships. The closest it has come was in *Acme Royalty Co. v. Dir. of Revenue*, 96 S.W.3d 72 (Mo. 2002), where the Court's language implies that the "limited" label is unimportant, though the issue was not raised. The case involved royalty income received by two Delaware taxpayers for the years 1992 through 1996. In the midst of those years, Acme, much like Southwestern Bell and Holdings, unilaterally created a wholly owned limited partnership, and redirected income through that limited partnership. *Id.* at 74. But this Court did not suggest that mattered in terms of income tax liability. Instead, the Court answered the question (adverse to the Director) with words that treated the limited partnerships—and both the limited and general partners—as part of the corporate whole. *See id.* at 75.

In fact, as to aggregation, the use of limited rather than general partnerships should not matter, neither for corporation income tax, at issue in *Acme Royalty*, nor for franchise tax, at issue here. The AHC pointed to nothing in the language of the franchise law to suggest that it should. Instead, the AHC looked at partnership law, and focused on the ability of a limited partnership to sue and be sued in its own name. AHC at 16. The AHC is right that "a limited partnership is a separate and independent legal entity in some ways that a general partnership is not." AHC at 16. But the AHC does not provide any basis, much less a logically persuasive one, nor one tied to the language of the franchise law statute, for leaping to the conclusion that all limited partnerships are exempt from the aggregation approach. And the only line between aggregation and non-aggregation that can be derived from the AHC decision is between general partnerships and limited partnerships; limited partnerships apparently are exempt from aggregation regardless of their nature, ownership, or control.

Ultimately, there is no way to read the franchise tax statute to suggest that the General Assembly intended to give corporations what the AHC thinks corporations have: the unfettered ability to unilaterally exempt themselves from the franchise tax by moving their assets into wholly-owned and controlled partnerships.

C. The partnerships themselves are "assets" of Holdings, which Holdings is using to do business in Missouri.

The statute speaks of "assets and property" being used in Missouri, but it does not define either "asset" or "property." And it is common and entirely appropriate for both partnerships and partnership interests to be called "assets." Because Holdings is using an "asset"—the partnership—to continue the Southwestern Bell operations in Missouri, Holdings is liable for the franchise tax.

Principal among the examples of areas in which courts call partnerships "assets" are bankruptcy cases. *E.g. Matter of Jack Dillon Const. Co., Inc.,* 54 B.R. 136, 138 (Bankr. D.N.J. 1984) ("The Magnum Partnership is an asset subject to the enforcement procedure of marshalling by subrogating or substituting Midlantic, then Dee, to the rights of Heritage to collect payments from the Magnum Partnership."); *In re Katz*, 341 B.R. 123, 128 (Bankr. D. Mass. 2006) ("A debtor's interest in a partnership is an asset of the debtor's estate under 11 U.S.C § 541; the assets of the partnership are not."), quoted with approval, *In re Silver Beach, LLC*, BAP.NV-09-1049, 2009 WL 7809002 (B.A.P. 9th Cir. Nov. 3, 2009); *In re Olszewski*, 124 B.R. 743, 746 (Bankr. S.D. Ohio 1991) ("Although the debtors, here, have an interest in the partnership and that interest is property of their bankruptcy estate, any property owned by the partnership itself is not considered estate property …."); *In re Kanan*, 09 B 33071, 2010 WL 4823848 (Bankr. N.D. Ill. Nov. 22, 2010) ("…the Court thereby finds: … 7. The Defendant's fifty percent (50%) ownership interest in the Shell Gas Station, whether it is a corporation or a partnership, is an asset of the bankruptcy estate.").

But partnerships are also called "assets" for purposes of calculating eligibility for benefits and child support. *E.g.*, *Hollinrake v. Iowa Dep't of*

Human Servs., 444 N.W.2d 95, 97 (Iowa Ct. App. 1989) ("We agree with the petitioner he does not own the partnership bank accounts. The partnership owns the partnership bank accounts. But the inquiry as to assets available to petitioner does not end here because petitioner's interest in the partnership is an asset owned by him."); *Matthews v. Northrup*, 01-09-00063-CV, 2010 WL 2133910 (Tex. App. May 27, 2010) ("Matthews's limited partner interest in the Partnership is an asset.").

And they have been called "assets" in connection with forfeiture decisions. *See In re 650 Fifth Ave. & Related Properties*, 777 F. Supp. 2d 529, 568-69 (S.D. N.Y. 2011) ("The Partnership is an asset owned by two corporations, Assa Corp. and the Foundation, but that does not mean that forfeiture of the Partnership is a forfeiture of the corporations that own it.")

Here, Holdings is using a partnership to continue the decades-old Southwestern Bell business in the State of Missouri. Because the partnership is Holdings' asset, Holdings is utilizing its "assets or property" in the State, thus making it subject to the franchise tax even if partnership aggregation principles did not apply because Holdings and Southwestern Bell chose to use a limited rather than a general partnerships.

CONCLUSION

Thus the Administrative Hearing Commission's decision should be reversed and the Director's decision affirmed.

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CERTIFICATE OF SERVICE AND COMPLIANCE

I hereby certify that a true and correct copy of the foregoing was served electronically via Missouri CaseNet e-filing sysetm on May 20, 2014, 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 4,086 words.

/s/ *James R. Layton*
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