IN THE
SUPREME COURT OF MISSOURI

No. 84225

ACME ROYALTY COMPANY, INC.,
and
BRICK INVESTMENT COMPANY,

APPELLANTS,

v.

DIRECTOR OF REVENUE, STATE OF MISSOURI,

RESPONDENT.

ON PETITION FOR REVIEW
FROM THE MISSOURI ADMINISTRATIVE HEARING COMMISSION
THE HONORABLE SHARON M. BUSCH, COMMISSIONER

BRIEF OF APPELLANTS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Missouri Cases

Missouri Constitution, Missouri Statutes and Other Missouri Authority

Federal Cases

Federal Constitution, Federal Statutes and Other Federal Authority

Other States' Authority

Miscellaneous Authority

JURISDICTIONAL STATEMENT

The principal issues before the Court involve the construction of sections 143.431.1; 32.200, art. IV, § 18; 143.903; and 32.053;[1] and, the application and construction of the Commerce Clause of the United States Constitution (U.S. Const. art. I, § 8), the Equal Protection Clause and the Due Process Clauses of the United States Constitution (U.S. Const. amend. XIV) and the Due Process Clause of the Missouri Constitution (Mo. Const. art. I, § 10), the Equal Protection Clause of the Missouri Constitution (Mo. Const. art. I, § 2) and the Uniformity Clause of the Missouri Constitution (Mo. Const. art. X, § 3). In particular, the questions presented are:

(1) whether under section 143.431, Appellant's trademark and trade name royalty income is Missouri source income based upon the sales of Appellant's licensee of the licensee's products in Missouri using Appellant's trademarks;

(2) whether the Commerce Clause requires a taxpayer's physical presence in Missouri before Missouri may impose its income tax on the taxpayer;

(3) whether the Equal Protection Clause, the Due Process Clause and the Uniformity Clause prohibit the Director from imposing tax on trademark and trade name royalty income of a licensor having no physical presence in Missouri paid by related corporations doing business in

[1] All statutory citations are to the Revised Statutes of Missouri of 2000, as amended, unless otherwise noted.

Missouri when the Director imposes no such liability on trademark and trade name royalty income received by a like taxpayer when it is paid by unrelated licensees under identical circumstances;

(4) whether under section 32.200, art. IV, § 17, the Commission may attribute the sales of a licensee to the licensor in computing the licensor's sales factor;

(5) whether under section 32.200, art. IV, § 18, the Commission is free to exclude the payroll or property factors in apportioning income for taxpayers having no or small payroll or property ownership; and

(6) whether the term "previous policy" as used in section 143.903 includes a position of not taxing certain transactions, and whether the phrase "change in policy or interpretation" as used in section 32.053 includes, in reaction to judicial precedent from another state, the imposition of tax on transactions that the Director earlier did not tax.

Thus, the Court's review of this case will necessarily involve the construction of sections 143.431.1; 32.200, art. IV, § 18; 143.903; and 32.053—all of which are revenue laws of the State of Missouri. This Court has exclusive jurisdiction over these issues pursuant to article V, section 3 of the Missouri Constitution.

STATEMENT OF FACTS

Introduction

Appellants Acme Royalty Company ("ARC") and Brick Investment Company ("BIC"), appeal from the Administrative Hearing Commission's ("Commission") decision upholding assessments of Missouri income tax on income received from the licensing of trademarks and trade names. The Director assessed ARC for annual tax periods from 1992-96; the Director assessed BIC for annual tax periods 1994-96 (each a "Tax Period" and, collectively, the "Tax Periods").

The facts and issues before this Court in this case are similar, but not the same, as those presented in *Gore Holdings Company v. Director of Revenue*, Case Number 84226. Specifically, this case addresses whether Missouri may subject a foreign corporation's ***trademark and trade name*** royalty income on trademarks a related corporation uses to sell the related corporation's products to customers located in Missouri. In *Gore*, the issue is whether Missouri may subject a foreign corporation's ***patent*** royalty income on patents used by a foreign manufacturer to produce products outside Missouri merely because the manufacturer is related to the patent licensor and because the licensor sells some of its products to Missouri customers. Consequently, several of the issues overlap between the two cases while others do not.

In both cases, this Court is asked to determine: (a) whether the taxpayers' royalty income is Missouri source income; (b) whether a taxpayer must have physical presence in Missouri to be subject to Missouri income tax; (c) whether the Director may subject the royalty income of a licensor of intellectual property to Missouri income tax when the intellectual property is licensed to a related corporation, while not taxing similar income when the intellectual property is licensed to an unrelated corporation; (d) whether the Director can ignore statutory factors in the three-factor apportionment

method when the numerators of some or all of the factors are small or zero; and (e) whether the Director's determination to tax the royalty income of such a licensor may be applied on a retroactive basis against Appellants.

Additionally, in this case, the Court is called upon to determine: (a) whether the sales by licensees of trademarks and trade names may be attributed to Appellants or Acme Royalty Company Limited Partnership ("ARCLP") for purposes of determining Appellants' Missouri source income; and (b) whether ARC, as a limited partner in ARCLP during Tax Periods 1994-1996, may be subjected to Missouri income tax.

Consequently, Appellants respectfully request that this case be heard in tandem with *Gore Holdings Company*, although not consolidated for argument therewith.

Acme Brick Company and Justin

Acme Brick Company was formed in 1891. Since its inception, Acme Brick Company manufactured and distributed clay bricks and other products (L.F. 37). In 1968, Acme Brick Company merged with Justin Boot Company, forming First Worth Company (L.F. 37). Two years later, the new corporation's name was changed to Justin Industries, Inc. ("Justin") (L.F. 37). In 1968, Acme Brick Company was not a separate corporation, but rather a division of Justin (L.F. 37). Justin was a publicly held Texas company headquartered in Fort Worth (Ex. 12, ¶ 1). During the Tax Periods, through its subsidiaries and operating divisions, Justin produced and sold building materials, including bricks, footwear such as Tony Lama boots, and Mexican and Americana Art (Ex. 12, ¶ 1). Further, Justin's subsidiaries, including ARC, held numerous trademarks and trade names that are at issue in this case (L.F. 38-39).

The Trademarks

The trademarks and trade names ("Trademarks") at issue are "Acme"; "Acme Brick"; "Acme Brick and Design"; "Acme Brick. The Best Thing to Have Around Your House"; "Acme Everset"; "Everlast"; "Acmeseal 85"; and "Thinwall Fences." Only the "Acme" trademark has been registered with Missouri; it has been so registered since 1964 (L.F. 42). Each of the Trademarks relates to building products that are regarded as the premier brand in the building industry, and accordingly command higher sales prices than other building products (L.F. 37; Tr. 102-109).

Reorganization and Formation of ABC and ARC

In December 1991, Justin underwent a corporate reorganization (L.F. 37). Justin separately incorporated its Acme Brick Company Division under the name Acme Brick Company ("ABC") (L.F. 37). Justin transferred all of the operating assets of the Acme Brick Company division to ABC in exchange for all of the stock in ABC (L.F. 37). During the Tax Periods, ABC manufactured, distributed and sold clay face bricks and other products like tile and bag goods in a region comprised of Texas, Louisiana, Oklahoma, Arkansas, Tennessee, and Missouri (L.F. 38).

As part of the corporate reorganization, Justin separately incorporated its boot division and management divisions in a manner similar to the creation of ABC (Tr. 31-39). Additionally, in 1991 Justin formed ARC by transferring the Trademarks to ARC in exchange for all of its stock (L.F. 38).

Justin reorganized and formed ABC and ARC in December 1991 for a number of business reasons:

(1) Many people were confused because Justin's building division did business under the name "Acme Brick Company" and thought that the division was a separate corporation;

(2) The building division was subjecting all of Justin's assets to claims against it because the division was not a separate corporation;

(3) Justin was considering selling or spinning off either its building and footwear operations in order to increase shareholder value, and this would be easier to accomplish if they were separate corporations;

(4) Justin sought to separate the corporate accounting, employee benefit, and management functions that were not performed by the subsidiaries into a newly formed separate company, Justin Management Company;

(5) Justin sought to accurately reflect the contributions the various divisions made to Justin's bottom line; and

(6) Justin separated its valuable intellectual property, including the Trademarks, from its operating divisions because different skill levels are required to manage intellectual property as opposed to the skill levels to produce and sell bricks or footwear. Justin concluded that people specializing in intellectual property would be better able to market the same to unrelated entities. (Tr. 31-42).

Justin chose to incorporate the new subsidiaries in Delaware because its laws afforded better protections from hostile takeover attempts, such as the attempt Justin had successfully defended in 1990-91 (Tr. 35-39).

The Licensing Agreement

Effective January 1, 1992, ARC entered into a licensing agreement ("Licensing Agreement") to license the Trademarks to ABC in exchange for a royalty payment determined independently by the

public accounting firm of Ernst & Young (L.F. 39; Ex. 12, ¶ 7, exhibit A). The Licensing Agreement expressly provides in section 3.1 that the license granted constitutes an "exclusive worldwide right, license and privilege" (Ex. 12, exhibit A). The Licensing Agreement stipulates in section 5.1 that it does not create any joint venture or partnership between ARC and ABC (Ex. 12, exhibit A).

ARCLP

In December 1993, Acme Royalty Company Limited Partnership ("ARCLP") was formed (L.F. 40). ARC contributed the Trademarks to ARCLP, effective January 1, 1994, in exchange for a 99% limited partnership interest in ARCLP (L.F. 40). Thus, ARC held the Trademarks only during 1992-93 (L.F. 40).

BIC was formed to be the general partner of ARCLP (L.F. 40). Effective January 1, 1994, BIC transferred to ARCLP cash in the amount of one percent of the value of the Trademarks in exchange for a one percent general partnership interest in ARCLP (L.F. 40). As general partner, BIC was responsible for the day-to-day operations of ARCLP (L.F. 40). Since 1994, ARCLP has held and holds the Trademarks, upon which it collected royalties under the Licensing Agreement (Ex. 12, ¶ 10).

Operations of ARC

ARC's offices were located in Wilmington, Delaware, during the Tax Periods (L.F. 43). All its board meetings, generally conducted twice annually, were held in Wilmington (L.F. 43). ARC filed holding company information returns with Delaware during the Tax Periods (L.F. 45). Its officers made investment decisions regarding excess cash flow or working capital, such as whether to put it in a money market account or certificates of deposit (L.F. 45).

During 1992, ARC did not have any office space or equipment (L.F. 43). ARC leased office space and equipment for payments of $1,833.33 in 1993; $2,200.00 in 1994; $2,260.00 in 1995; and $2,837.50 in 1996 (L.F. 43).

ARC did not have any employees in 1992 (L.F. 43). Three individuals were responsible for supervising the collection of royalties and ascertaining compliance with the payment of royalties to ARC

for the use of the Trademarks (L.F. 43). These individuals were not compensated (L.F. 43). From 1993-96, ARC had two part-time employees that were compensated in the amounts of $2,501.00 in 1993; $2,750.00 in 1994; $2,826.00 in 1995; and $2,900.00 in 1996 (L.F. 44).

Operations of BIC

BIC held its board meetings, generally on an annual basis, in Fort Worth, Texas (L.F. 43). BIC filed Texas franchise tax returns during the Tax Periods (L.F. 45). As general partner of ARCLP, BIC was responsible for managing, controlling and conducting the affairs of ARCLP (L.F. 45). BIC managed the cash and collection activities related to ARCLP's royalty income, monitored the licensee's use of the Trademarks, prepared financial statements and tax returns and oversaw legal filings related to the registration of the Trademarks, all from its offices in Fort Worth (L.F. 45).

BIC had no employees other than its officers, directors and agents (L.F. 45). All activities of the business were conducted under a management agreement with Justin Management Company (L.F. 45). Justin Management Company rendered administrative, management, and accounting services to BIC for an annual fee of $5,000.00 (L.F. 45).

Lack of Missouri Contacts of ARC, BIC and ARCLP

Neither ARC, BIC, nor ARCLP ever registered to do business in Missouri (L.F. 42). Neither ARC, BIC, nor ARCLP ever owned real or personal property in Missouri (L.F. 42). Neither ARC, BIC, or ARCLP ever maintained employees, had agents, had an office or mailing address, had a phone number, accounts receivable, or payroll in Missouri (L.F. 43). Neither ARC, BIC, nor ARCLP has ever, in Missouri, entered into a contract or one interpreted under Missouri law (except with regard to the prosecution of this appeal) (L.F. 43).

ABC conducted business and made sales in Missouri during the Tax Periods and filed Missouri income tax returns and paid tax based upon the Multistate Tax Compact three-factor method of apportionment (Exhibit B). But neither ARC, BIC, nor ARCLP has ever done business in Missouri or made sales in this state (L.F. 46; Tr. 45-48, 50-51; Ex. 22, p. 49-50; Ex. 26, p. 12, 16-17; Ex. B; Ex. E; Ex. F). Furthermore, neither ARC, BIC, nor ARCLP ever actively marketed anywhere, much less in Missouri, the Trademarks for licensing (Tr. 60-61).

Director's Audit

The Director audited ARC and BIC, and assessed Appellants Missouri income tax using the single factor apportionment formula set forth in section 143.451 (collectively, the "Assessment") (L.F. 46). The Director determined that all royalty payments made by ABC based upon sales made by ABC in Missouri were, either directly or through Appellants' respective partnership interests in ARCLP, income to Appellants wholly within Missouri under section 143.451 (L.F. 46-47). The Director determined that the "presence of intangible assets in Missouri" was a sufficient basis for assessing Missouri income tax against Appellants (Ex. 22, p. 23).

On or about February 2, 1999, and February 8, 1999, respectively, BIC and ARC filed Missouri income tax returns for the Tax Periods (Exs. 9-10). Appellants disagreed with the Director's use of the single-factor method of apportionment, and thus on their returns elected to allocate/apportion using the Multistate Tax Compact three-factor method of apportionment under section 32.200 (Exs. 9-

10).[2] Each return showed no tax due to Missouri because Appellants had no payroll, property or sales in Missouri

(Exs. 9-10).

Director's Policies

In October 1996, the Director published the Nexus Position of her Corporate Income Tax Manual for her Field Audit Bureau ("Nexus Position") (Ex. 15; Ex. 22, p. 27-30; Ex. 23, p. 60-67; Ex. 25, p. 25-30). Prior to the publication of the Nexus Position, the Director did not tax the royalty income of out-of-state licensors based upon a licensee's business in Missouri that contributed to the obligation to pay royalties to the licensor (Ex. 22, p. 27-30; Ex. 23, p. 60-67; Ex. 25, p. 25-30).

After the publication of the Nexus Position, the Director asserted the power to tax the royalty income of out-of-state trademark licensors based upon a licensee's business in Missouri that contributed to the obligation to pay royalties to the licensor when the licensor is related to the licensee (Ex. 22, p. 27-30; Ex. 23, p. 60-67; Ex. 25, p. 25-30). However, even after the publication of the Nexus Position, the Director has not taxed similar income when the licensor is unrelated to the licensee (Ex. 22, p. 38; Ex. 23, p. 29-32, 41-42; Ex. 25, p. 19-20, 31-34).

Commission's Decision

In its Findings of Fact and Conclusions of Law dated January 3, 2002, the Commission concluded that Appellants had sufficient nexus under both the Commerce Clause and the Due Process

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[2] The Commission's finding of fact at paragraph 57, that Appellants did not request the use of a method of apportionment other than the single factor method of section 143.451, is thus contrary to the evidence on this point.

Clause to permit Missouri taxation. Specifically, the Commission found that Appellants "purposefully availed themselves of the benefits of Missouri's economic market" by licensing the Trademarks to ABC because ABC did business in Missouri (L.F. 52).

The Commission found that Appellants had nexus with Missouri under the Commerce Clause notwithstanding the fact that Appellants had no physical presence in Missouri because the Commerce Clause's physical presence requirement, in the Commission's opinion, applies only to sales and use taxes (L.F. 54). The Commission stated:

> "Income tax is different because intangibles, such as those at issue here, may earn income in the taxing state, even though their owner has no physical presence in that state. As noted in Michael T. Fatale, *State Jurisdiction and the Mythical 'Physical Presence' Constitutional Standard*, 54 Tax Lawyer 105, 107 (Fall 2000), 'a corporation, through designated as a 'person' for purposes of various legal requirements including tax filings, is a mere legal construct that is not in fact present anywhere" (L.F. 54-55).[3]

The Commission concluded that the Assessment against Appellants did not violate the Equal Protection Clause or the Uniformity Clause (L.F. 60). Notwithstanding the statement of the Director's designee (for purposes of the Director's deposition) that the Director has not taxed similar income when the licensee is unrelated to the licensor (Ex. 23, p. 29-32, 41-42), the Commission disregarded the Director's admissions in favor of the testimony of the Director's auditor and concluded:

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[3] Michael T. Fatale is a tax attorney employed by the Massachusetts Department of Revenue.

> "[Appellants] argue that the Director attempts to tax out-of-state corporations that transfer the right to use trademarks and patents to related corporations in Missouri while not taxing out-of-state corporations that transfer the right to use trademarks and patents to unrelated corporations. However, there is no evidence that this is the Director's position. All of the auditors who testified by live testimony or deposition indicated that the Director would treat royalty income the same way regardless of whether the trademarks were transferred to a related corporation." (L.F. 60).

With respect to apportionment, the Commission apparently accepted Appellants' position that the Director is required to use the three-factor method of apportionment (L.F. 62).[4] In applying the Multistate Tax Compact, the Commission stated that both the property and payroll factors should be eliminated in apportioning Appellants' income because the property and payroll were "*de minimis* in relation to the huge amount of royalty income that [Appellants] received" (L.F. 63).

With respect to the sales factor, the Commission stated that attributing the sales of ABC in Missouri to Appellants is an "equitable method" of apportionment, and therefore included ABC's sales in the numerator of Appellants' respective sales factors (L.F. 64).

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[4] Specifically, the Commission stated that the same economic result would be reached by using the single factor method and treating Appellants' income as wholly within Missouri, as by using the Multistate Tax Compact method while eliminating the property and payroll factors, the method of apportionment the Commission discussed at length (L.F. 61).

With respect to the prospective application of its decision, the Commission held that the Assessment against Appellants in reliance on *Geoffrey v. South Carolina*, 437 S.E.2d 13 (S.C. 1993), *cert. denied*, 510 U.S. 992 (1993), was not contrary to the Director's prior policy because:

> "Before the Director began taxing royalty holding companies after *Geoffrey*, the Director did not have a policy regarding such because it was a non-issue. The decision to pursue collections under the reasoning of *Geoffrey* was not a change in the Director's policy, but simply an awareness, that was not there before, that there was a new issue possibly resulting in tax liability." (L.F. 65-66).

STATEMENT OF THE ISSUES

Section 143.431 imposes the Missouri income tax upon Missouri source income. Income is from Missouri sources only "if the Missouri effort is among the efficient causes which contribute directly to the production of income." *Wohl Shoe Co. v. Director of Revenue*, 771 S.W.2d 339, 342 (Mo. banc 1989). Neither Appellants nor ARCLP made any efforts in Missouri that generated sales of products to ABC's customers in Missouri. Does the receipt of royalty income by Appellants and ARCLP constitute Missouri source income?

The Commerce Clause authorizes Congress "to regulate Commerce with foreign Nations, and among the several States." In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), the United States Supreme Court held that a taxpayer must have physical presence within a State to be subject to sales and use taxes. The Commerce Clause does not distinguish among types of taxes affecting interstate commerce. Appellants have no physical presence in Missouri. Can Missouri subject Appellants to Missouri income tax consistent with the Commerce Clause?

The Uniformity Clause requires that all taxes "shall be uniform upon the same class or subclass of subjects within the territorial limits of the authority levying the tax." The Director imposed Missouri income tax upon Appellants based upon their transfer of the right to use the Trademarks to a related licensee. The Director's designee stated that he was unaware of any instance where the Director taxed similar income when the licensee was unrelated to the licensor. Does the imposition of Missouri income tax upon Appellants violate the Uniformity Clause?

Assuming, *arguendo*, that the Director may constitutionally subject Appellants to Missouri income tax, their income is to be apportioned using the three-factor method of apportionment. Section 32.200, art. IV, § 17 states that, in determining the sales factor under the three-factor method of

apportionment, sales other than of tangible personal property are within Missouri only if the greater proportion of the income-producing activity is performed in Missouri. Appellants' activities in securing the royalty income occurred wholly outside Missouri. Is Appellants' royalty income included as a Missouri sale for purposes of section 32.200, art. IV, § 9?

Section 32.200, art. IV, § 9 requires the use of all three statutory factors in apportioning income. The Commission excluded the property and payroll factors in apportioning Appellants' income because these factors were "*de minimis*" in comparison to Appellants' royalty income. May the Commission exclude statutory factors of the three-factor method of apportionment consistent with section 32.200, art. IV, § 9?

Section 143.903 prohibits the Director from assessing tax if a decision upholding such assessment would not have been expected by a reasonable person based on prior law or prior policy of the Director. Likewise, section 32.053 states that any final decision of the Director that is a result of a change in policy or interpretation by the Director effecting a particular class of person subject to such decision may be applied prospectively only. Prior to the publication of the Director's Nexus Position, the Director Nexus Position, the Director did not attempt to tax the royalty income of out-of-state licensors based upon the use of the trademarks by licensees in Missouri. With the publication of the Nexus Position, the Director asserted the power to tax the royalty income of out-of-state licensors based upon the use of the trademarks by licensees in Missouri. The Director purports to assess Missouri income tax upon Appellants based upon their receipt of royalty income from ABC based upon ABC's use of the Trademarks in Missouri for periods prior to her publication of the Nexus Position? Is the Director's Assessment permissible under sections 143.903 and 32.053?

STANDARD OF REVIEW

The decision of the Commission shall be upheld: (1) if it is authorized by law; (2) if it is supported by competent and substantial evidence upon the whole record; (3) if no mandatory procedural safeguards are violated; and (4) where the Commission has discretion, it exercises that discretion in a way that is not clearly contrary to the Legislature's reasonable expectations. Section 621.193, RSMo; *Concord Publishing House, Inc. v. Director of Revenue*, 916 S.W.2d 186 (Mo. banc 1996). The first two standards are at issue before this Court.

Furthermore, sections 143.431.1; 32.200, art. IV § 18; 143.903; and 32.053 are all taxing statutes. Taxing statutes are construed against the Director, and if the right to tax is not plainly conferred by statute, it will not be extended by implication. *United Air Lines, Inc. v. State Tax Comm'n*, 377 S.W.2d 444, 448 (Mo. banc 1964), *quoting Leavell v. Blades*, 141 S.W. 893, 894 (Mo. 1911) ("When the tax gatherer puts his finger on the citizen, he must also put his finger on the law permitting it.").

Finally, this Court's interpretation of Missouri's revenue laws is *de novo*. *Zip Mail Services, Inc. v. Director of Revenue*, 16 S.W.3d 588, 590 (Mo. banc 2000).

POINTS RELIED ON

I. THE ADMINISTRATIVE HEARING COMMISSION ERRED IN UPHOLDING THE NOTICES OF DEFICIENCY BECAUSE, UNDER SECTIONS 621.189 AND 621.193, THAT DECISION IS NOT AUTHORIZED BY LAW OR SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE IN THAT APPELLANTS DO NOT HAVE MISSOURI SOURCE INCOME UNDER SECTION 143.431 BECAUSE APPELLANTS DID NOTHING IN MISSOURI THAT WAS PRODUCTIVE OF THE ROYALTY INCOME.

Dow Chemical Company v. Director of Revenue, 834 S.W.2d 742 (Mo. banc 1992);

Dow Chemical Co. v. Director of Revenue, 787 S.W.2d 276 (Mo. banc 1990);

Goldberg v. State Tax Commission, 639 S.W.2d 796 (Mo. banc 1982);

Medicine Shoppe International, Inc. v. Director of Revenue, Case Number 83888 (Mo. banc 2002);

Section 143.431;

Section 32.200, arts. III and IV;

Lanham Act, 15 U.S.C. § 1051, *et seq*.;

Interstate Income Law, 15 U.S.C. § 381.

II. THE ADMINISTRATIVE HEARING COMMISSION ERRED IN UPHOLDING THE NOTICES OF DEFICIENCY BECAUSE, UNDER SECTIONS 621.189 AND 621.193, THAT DECISION IS NOT AUTHORIZED BY LAW OR SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE IN THAT APPELLANTS DO NOT HAVE A SUFFICIENT NEXUS WITH MISSOURI, CONSISTENT WITH THE COMMERCE CLAUSE AND SECTION 143.441.2(5), THAT WOULD PERMIT MISSOURI TO IMPOSE INCOME TAXES UPON APPELLANTS.

National Bellas Hess, Inc. v. Dep't of Revenue, 386 U.S. 753 (1967);

Quill Corp. v. North Dakota, 504 U.S. 298 (1992);

Cerro Copper Products, Inc. v. Alabama, Docket Number F94-444 (Ala. Dept. Rev. 1995);

J.C. Penney National Bank v. Johnson, 19 S.W.3d 831 (Tenn. Ct. App. 1999), *cert. denied*, 531 U.S. 927 (2000);

Section 143.441.2.

III. THE ADMINISTRATIVE HEARING COMMISSION ERRED IN UPHOLDING THE NOTICES OF DEFICIENCY BECAUSE, UNDER SECTIONS 621.189 AND 621.193, THAT DECISION IS NOT AUTHORIZED BY LAW OR SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE IN THAT THE EQUAL PROTECTION CLAUSE AND UNIFORMITY CLAUSE PROHIBIT THE IMPOSITION OF MISSOURI INCOME TAX ON ROYALTY INCOME RECEIVED BY A TAXPAYER HAVING NO PHYSICAL PRESENCE IN MISSOURI FROM A LICENSEE RELATED TO THE TAXPAYER WHEN NO SUCH IMPOSITION IS MADE UPON A LIKE TAXPAYER ON ROYALTY INCOME RECEIVED FROM UNRELATED LICENSEES.

Exxon Corp. v. Eagerton, 462 U.S. 176 (1983);

Schnorbus v. Director of Revenue, 790 S.W.2d 241 (Mo. banc 1990);

Mo. Const. art. X, § 3;

U.S. Const. amend. XIV, § 1.

IV. THE ADMINISTRATIVE HEARING COMMISSION ERRED IN UPHOLDING THE NOTICES OF DEFICIENCY BECAUSE, UNDER SECTIONS 621.189 AND 621.193, THAT DECISION IS NOT AUTHORIZED BY LAW OR SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE IN THAT THE SALES OF ANOTHER TAXPAYER MAY NOT BE TREATED AS APPELLANTS' SALES UNDER SECTION 32.200, ART. IV, § 17.

Section 32.200;

Section 32.200 art. IV, § 9;

Section 32.200 art. IV, § 17;

Section 143.431.

V. THE ADMINISTRATIVE HEARING COMMISSION ERRED IN UPHOLDING THE NOTICES OF DEFICIENCY BECAUSE, UNDER SECTIONS 621.189 AND 621.193, THAT DECISION IS NOT AUTHORIZED BY LAW OR SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE IN THAT UNDER SECTION 32.200, ART. IV, § 18, NEITHER THE DIRECTOR NOR THE COMMISSION IS FREE TO EXCLUDE THE PROPERTY FACTOR IN APPORTIONING THE INCOME OF TAXPAYERS HAVING NO OR SMALL AMOUNTS OF PROPERTY OWNERSHIP OR PAYROLL.

Rentco Trailer Corporation v. Director of Revenue, Case Number 97-1373RI (Mo. Admin. Hrg. Comm. 1998);

Section 32.200 art. IV, § 18;

Section 621.189;

Section 621.193.

VI. THE ADMINISTRATIVE HEARING COMMISSION ERRED IN UPHOLDING THE NOTICES OF DEFICIENCY BECAUSE, UNDER SECTIONS 621.189 AND 621.193, THAT DECISION IS NOT AUTHORIZED BY LAW OR SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE IN THAT THE IMPOSITION OF MISSOURI INCOME TAX UPON APPELLANT CONSTITUTES A CHANGE FROM "PREVIOUS POLICY" AS THAT PHRASE IS USED IN SECTION 143.903 AND CONSTITUTES A "CHANGE IN POLICY OR INTERPRETATION" WITHIN THE MEANING OF SECTION 32.053.

Laciny Brothers, Inc. v. Director of Revenue, 869 S.W.2d 761 (Mo. banc 1994);

Lloyd v. Director of Revenue, 851 S.W.2d 519 (Mo. banc 1993);

Section 32.053;

Section 143.903.

ARGUMENT

I. THE ADMINISTRATIVE HEARING COMMISSION ERRED IN UPHOLDING THE NOTICES OF DEFICIENCY BECAUSE, UNDER SECTIONS 621.189 AND 621.193, THAT DECISION IS NOT AUTHORIZED BY LAW OR SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE IN THAT APPELLANTS DO NOT HAVE MISSOURI SOURCE INCOME UNDER SECTION 143.431 BECAUSE APPELLANTS DID NOTHING IN MISSOURI THAT WAS PRODUCTIVE OF THE ROYALTY INCOME.

The Missouri income tax is imposed upon so much of a corporation's federal taxable income "as is derived from Missouri sources." Section 143.431. Here, the Director seeks to tax certain of Appellants' royalty income and thus the focus of this case is entirely upon that stream of income. Because Appellants' royalty income is not Missouri source income, it is not subject to Missouri income tax.

A. The Royalty Income Is Not Missouri Source Income

This Court has been called upon several times to determine whether income is "Missouri source income." In *J.C. Nichols Company v. Director of Revenue*, 796 S.W.2d 16, 17-18 (Mo. banc 1990), this Court stated the general proposition that "[t]he source of income 'is the place where it was produced.'" (citing *In re Kansas City Star Company*, 142 S.W.2d 1029, 1037 (Mo. banc 1940)). In *Wohl Shoe Co. v. Director of Revenue*, 771 S.W.2d 339, 342 (Mo. banc 1989), this Court determined that income was subject to Missouri tax "if the Missouri effort is among the efficient causes which contribute directly to the production of income." Recently, in *Medicine Shoppe International, Inc. v. Director of Revenue*, Case Number 83888 (Mo. banc 2002), this Court

succinctly stated the Missouri source income standard: "[t]he basic requirement is that there be some activity in [Missouri] that justifies imposing the tax."

Missouri's source of income requirement is consistent with the constitutional requirements for taxation of income. This Court explained that principle in *Dow Chemical Company, Inc. v. Director of Revenue*, 834 S.W.2d 742, 747 (Mo. banc 1992)(*Dow II*): "[the Court's decision in *Dow Chemical Co. v. Director of Revenue*, 787 S.W.2d 276 (Mo. banc 1990) (Dow I)] infuses [section] 143.431 with the grounding of principle that validates the compact apportionment formula as a device of constitutional state taxation of interstate activity."

Regardless of how Missouri source income from interstate transactions is calculated (using the single-factor apportionment formula of section 143.451 or the three-factor formula of the Multistate Tax Compact ("Compact"), section 32.200 arts. III and IV), a corporation must have some income derived from Missouri sources (i.e. activity in Missouri that is productive of its income) or it is not subject to Missouri income tax. Section 143.431.1; section 143.451.1; section 32.200 art. III, § 1 and art. IV, § 2; *Goldberg v. State Tax Commission*, 639 S.W.2d 796, 802-03 (Mo. banc 1982); *Dow II*, 834 S.W.2d at 745-46.

Under the Multistate Tax Compact, section 32.200, art. III, § 1, income tax is due "pursuant to the laws of [Missouri,]" thus incorporating section 143.431.1 and the requirement that some income be "sourced" to Missouri. Also, art. IV, § 2, provides that "[a]ny taxpayer having income from business activity which is taxable both within and without [Missouri] . . . shall allocate and apportion his net income as provided in this article." Although a unitary business is not required under Missouri's source of income requirement, that requirement is entirely consistent with the unitary business concept that is the "linchpin" of apportionability of multistate income under the Compact. *Dow II*, 834 S.W.2d at 746.

There, this Court stated that "in the context of an apportionment under [the C]ompact … *in pari materia* with [section] 143.431, ***so much of the federal taxable income as is derived from sources in Missouri*** means 'so much of the value of the business income of the unitary business activity of the multistate enterprise as can fairly be attributed to the taxpayer's activities in Missouri."[5]

The royalty income of Appellants and ARCLP derives from the Licensing Agreement between those parties and ABC. Appellants negotiated and executed the Licensing Agreement entirely outside of Missouri. Appellants sell no products at all, much less any that use the Trademarks at issue. Instead, Appellant ARC, or ARCLP, licensed Trademarks to a non-Missouri entity, ABC, pursuant to the Licensing Agreement. That Licensing Agreement is not governed by Missouri law and, in every case thereunder, payments were made outside of Missouri. Because Appellants' royalty income was produced without any effort by Appellants in Missouri, it is not Missouri source income. The fact that the licensee sells products in Missouri does not mean that Appellants are doing anything in Missouri that is productive of the royalty income at issue.

Furthermore, for tax years 1994 through 1996, ARC was a limited partner in ARCLP and, as such, was a passive investor. "[W]holly passive investments outside of the state of Missouri are not included in … Missouri source income." *Medicine Shoppe, citing Union Electric Co. v. Coale*, 146 S.W.2d 631 (Mo. banc 1940), and *Petition of Union Electric*, 161 S.W.2d 968 (Mo. banc 1942).

B. The Licensing Agreement Does Not Permit "Attributional Nexus."

[5] Emphasis added here and throughout, unless otherwise noted.

The Commission held that Appellants had nexus with Missouri because they "do business in Missouri by licensing their intangible assets for use in Missouri and earning royalty income from the use of the trademarks and trade names in Missouri" (L.F. 50). This key conclusion was presumably written in the passive voice for the simple reason that the entity using the Trademarks in Missouri was not either of the Appellants, or ARCLP for that matter, but rather ABC. Furthermore, this conclusion ignores both the undisputed evidence at trial as well as relevant trademark law and Missouri law.

In the first place, by the express terms of the Licensing Agreement, Appellants and ARCLP are precluded from ***using*** the Trademarks in Missouri because the license with ABC is exclusive. When an exclusive license is granted, the licensee is assured that there will be no other use of the license, including by the licensor itself. *See, e.g., Shoney's Inc. v. Schoenbaum*, 894 F.2d 92, 95 (4th Cir. 1990). Neither Appellants nor ARCLP market any products; they thus do not use the Trademarks. Instead, ARC in Tax Periods 1992-1993, and ARCLP in Tax Periods 1994-1996, licensed the Trademarks to a non-Missouri entity, ABC, pursuant to a contract completed outside of Missouri that is not governed by Missouri law, and under which payments are made outside of Missouri. Thus, contrary to the Commission's assertion, ABC, and not Appellants or ARCLP, used the Trademarks in Missouri.

There is no dispute that ABC used the Trademarks in Missouri. The Commission, however, attempted to attribute ABC's Missouri nexus to Appellants and ARCLP through the Licensing Agreement under federal trademark law. The federal Lanham Act, 15 U.S.C. § 1051, *et seq.*, governs trademark law in the United States and codifies basic principles of trademark protection including trademark licensing. S. Rep. No. 100-515 at 1, 4 (1988); *Inwood Laboratories, Inc. v. Ives Laboratories, Inc.*, 456 U.S. 844, 861 n.2 (1982). The Lanham Act requires that the licensor

ensure that a licensee use the marks appropriately or risk abandonment due to their deceptive use that no longer ensures the quality of goods and services. *Oberlin v. Marlin American Corp.*, 596 F.2d 1322, 1327 (7th Cir. 1979). However, to the extent such obligations are contained in the Licensing Agreement, they do not create an agency relationship:

> "The purpose of the Lanham Act, however, is to ensure the integrity of registered trademarks, ***not to create a federal law of agency***. Furthermore, the scope of the duty of supervision of a registered trademark is commensurate with this narrow purpose. The duty does not give a licensor control over the day-to-day operations of a licensee beyond that necessary to ensure uniform quality of the product or service in question. It does not automatically saddle the licensor with the responsibilities under state law of a principal for his agent." *Id.*

The Commission's error is further demonstrated by this Court's decision in *M.V. Marine Co. v. State Tax Comm'n*, 606 S.W.2d 644 (Mo. banc 1980), as clarified in *Goldberg v. State Tax Comm'n*, 639 S.W.2d 796, 798 (Mo. banc 1982), and the Commission's own decision in *John Fabick Tractor Co. v. Director of Revenue*, Case Number 95-0597RV (Mo. Admin. Hrg. Comm. 1996).

In *M.V. Marine*, the taxpayer derived income from the lease of barges, towboats and trucks. It entered into the contracts in Missouri with related companies who used the leased property both within and outside Missouri. The taxpayer argued that the lease income was generated partly within and partly without Missouri based upon the places where the property was used to generate income. This Court rejected that argument. In *Goldberg*, this Court explained that the lease income of the taxpayer

was earned where the leases were consummated; it did not matter where the lessees used the property. *Id*., 639 S.W.2d at 798. The same is true here. The Licensing Agreement was not consummated in Missouri, and there is no distinction between the lease of property and the license of the Trademarks in this context.

In *John Fabick*, a Missouri owner of tractors and other farm equipment leased such property to an Illinois customer. Under the terms of the lease, the Illinois customer was required to pick up the equipment at the Missouri company's place of business, and to return the equipment at the end of the lease term. The Missouri company argued that no Missouri sales tax was due because the leased property was to be used exclusively outside Missouri. The Commission rejected this argument, noting that the "place of use" is irrelevant in determining the application of Missouri sales tax. Instead, the Commission noted that Missouri law is clear that sales occur where possession is transferred in Missouri, the sale occurred in Missouri, and the ultimate place of use of the leased property was irrelevant for Missouri sales tax purposes.

There is no dispute that the Appellant ARC's transfer of the exclusive right to use the Trademarks, and all other of the Appellants' conduct that culminated in the execution of the license agreement or involved the management of the transactions under the license agreement, occurred outside of Missouri. Nothing the Appellants did to produce the royalty income was done in Missouri.[6]

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[6] As discussed in detail below under Point II, there is no legal basis to disregard Appellants' separate corporate existences, nor is there any partnership or agency relationship between them and ABC.

Further, as explained above, the conduct the Director focuses on is ***ABC's sales of products to Missouri customers***. Thus, the Director attempts to tax Appellants solely on the fact that ABC sells to Missouri customers products covered by Appellants' Trademarks. Yet, ***even if Appellants had directly engaged in the sale of those products to Missouri customers***, the Director would be precluded as a matter of federal law from taxing Appellants based solely on that conduct. The federal Interstate Income Law,

15 U.S.C. § 381, prohibits a state from taxing a foreign corporation solely on the basis of sales it makes to customers within that state.[7] In effect, the Director seeks to attribute the activities of ABC (sales to Missouri customers) to Appellants in an attempt to subject Appellants to Missouri income tax, ***when those particular activities if engaged in directly by Appellants*** are an insufficient basis to subject Appellants to tax.

Missouri's tax statutes are to be given reasonable constructions, *Collins v. Director of Revenue*, 691 S.W.2d 246 (Mo. banc 1985), and strictly in favor of taxpayers. *United Air Lines, Inc. v. State Tax Comm'n*, 377 S.W.2d 444, 448 (Mo. banc 1964). Under the facts of this case, section 143.431.1 has been construed in a manner never intended by the legislature, a manner that is in

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[7] Title 15, section 381 provides that "[n]o State . . . shall have power to impose . . . a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are . . . the solicitation of orders by such person . . . in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State[.]"

fact absurd! The Director attempts to apply section 143.431.1 in a way that has staggering implications for all taxpayers doing business across state lines, particularly those taxpayers who deal in intangible property. Consider the author who is paid royalties by a publisher from the sale of a book, or a software writer paid royalties for the sale of its software, or an athlete receiving royalties from his endorsement of a product, or a television producer paid royalties by a network for the use of a program. The Director would subject all of those entities to Missouri income tax, ***even though they did nothing in Missouri***, simply because they did business with persons or entities that did business in Missouri. The legislature never could have reasonably expected such a result. Indeed, as this record clearly shows and the Commission acknowledged, these types of transactions had never been subjected to Missouri income tax before, and the Missouri legislature apparently never saw fit to tax these types of transactions. The Director has certainly referenced no legislative change as a basis for this profound change in Missouri taxation. It is within the sole province of the legislature to effect such a staggering change in Missouri income tax law and not within the province of ingenious tax collectors.

Therefore, the Commission's conclusion that ABC sales of products covered by Appellants' Trademarks may somehow be attributed to Appellants or ARCLP is incorrect. In short, the receipt of royalty income by Appellants and ARCLP from the licensee, when the licensee alone sold to Missouri customers products covered by Appellants' Trademarks does not constitute Missouri source income to Appellants or ARCLP. The Appellants are not subject to Missouri income tax.

II. THE ADMINISTRATIVE HEARING COMMISSION ERRED IN UPHOLDING THE NOTICES OF DEFICIENCY BECAUSE, UNDER SECTIONS 621.189 AND 621.193, THAT DECISION IS NOT AUTHORIZED BY LAW OR SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE IN THAT APPELLANTS DO NOT HAVE A SUFFICIENT NEXUS WITH MISSOURI, CONSISTENT WITH THE COMMERCE CLAUSE AND SECTION 143.441.2(5), THAT WOULD PERMIT MISSOURI TO IMPOSE INCOME TAXES UPON APPELLANTS.

A. Introduction

Section 143.431 imposes the Missouri income tax on corporations upon so much of their federal taxable income as is derived from Missouri sources. As explained above, the royalty income at issue is not Missouri source income and is, therefore, not subject to Missouri income tax. However, even if it were Missouri source income, it would be exempt from Missouri income tax anyway. Section 143.441.2 states:

> "The tax on corporations provided in subsection 1 of section 143.431 and section 143.071 shall not apply to:
>
> * * *
>
> (5) Any other corporation that is exempt from Missouri income taxation under the laws of Missouri or the laws of the United States.

The Commerce Clause of the United States constitution prohibits Missouri from taxing Appellants' royalty income. Therefore, the income is exempt from tax by section 143.441.2(5).[8]

The Commerce Clause, Article I, Section 8 of the United States Constitution, authorizes Congress to "regulate Commerce with foreign Nations, and among the several States." Although the Commerce Clause does not expressly provide for the protection of interstate commerce in the absence of action by Congress, the United States Supreme Court has consistently stated that the "dormant" aspect of the Commerce Clause "by its own force" prohibits certain State actions that interfere with interstate commerce. *See, e.g., South Carolina State Highway Department v. Barnwell Brothers, Inc.*, 303 U.S. 177 (1938).

In *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), the United States Supreme Court evaluated a Commerce Clause challenge to a Mississippi sales tax directed upon automobiles manufactured out-of-state. The Court developed a four-part test to examine the Commerce Clause dispute that assesses:

(i) whether the tax is applied to an interstate activity with a ***substantial nexus*** with the taxing state;[9]

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[8] The Court, of course, should avoid constitutional adjudications when the case may be decided on statutory grounds. *See, e.g., State ex rel. Union Elec. v. Public Serv. Comm'n*, 687 S.W.2d 162, 165 (Mo. banc 1985). This maxim compels that section 143.431 should be construed as argued in Point I, *ante* to avoid a constitutional confrontation.

[9] Emphasis added here and throughout, unless otherwise noted.

(ii) whether the tax is fairly apportioned;

(iii) whether it discriminates against interstate commerce; and

(iv) whether it is fairly related to the services provided by the state. *Id.* at 279

This Court held that the *Brady* factors are equally applied to a determination of the taxability of the income from the interstate operations of a foreign corporation. *Amway Corp. v. Director of Revenue*, 794 S.W.2d 666, 671 (Mo. banc 1990). The issue in this case is whether Appellants have a ***substantial nexus*** with Missouri satisfying the Commerce Clause.

The United States Supreme Court's most recent discussion of the requirements of the Commerce Clause regarding the taxation of out-of-state vendors is *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). In *Quill*, the Court prohibited North Dakota from imposing a use tax collection duty on out-of-state mail order businesses. The North Dakota Supreme Court, which had permitted the imposition of use tax collection duties upon the taxpayer, based its decision on it determination that the evolution of Commerce Clause jurisprudence signaled a "retreat from the formalistic constrictions of a stringent physical presence test in favor of a more flexible substantive approach." *Id.* at 314, *citing*, 470 N.W.2d 203, 214 (N.D. 1991).

Specifically, the North Dakota Court stated that the precedents of the United States Supreme Court had signaled a retreat from *National Bellas Hess, Inc. v. Dep't of Revenue*, 386 U.S. 753 (1967). In *Bellas Hess*, the Court held that a State could not constitutionally impose a sales tax upon out-of-state vendors having no physical presence in the State, even though the vendor used the United States Postal System to deliver catalogs into the State, and used the Postal System or a common carrier to deliver their products.

In *Quill*, the Supreme Court flatly rejected the reasoning set forth by the North Dakota Supreme Court. The United States Supreme Court stated that it had never intimated a desire to reject "bright-line" tests in all instances, and reinforced the bright-line rule of *Bellas Hess*:

> "Like other bright-line tests, the *Bellas Hess* rule appears artificial at its edges: Whether or not a State may compel a vendor to collect a sales or use tax may turn on the presence in the taxing State of a small sales force, plant or office. ***This artificiality, however, is more than offset by the benefits of a clear rule***. Such a rule firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes. This benefit is important, for as we have so frequently noted, our law in this area is something of a 'quagmire' and the 'application of constitutional principles to specific state statutes leaves much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation.'" *Id*. at 315-16 (citations omitted).

The Court continued:

> "In sum, although in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar bright-line, physical presence requirement, our reasoning in those cases does not compel that we now reject the rule that *Bellas Hess* established in the area of sales and use taxes. To the contrary, the continuing value of a bright-line rule in this area and the doctrine

> and principles of stare decisis indicate that the *Bellas Hess* rule remains good law.
>
> "This aspect of our decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve. No matter how we evaluate the burdens that use taxes impose on interstate commerce, Congress remains free to disagree with our conclusions." *Id*. at 317-18.

In short, the Court, while noting Congress has the power to modify the standard, stated in *Quill* that ***in the absence of a physical presence of a taxpayer in the State, the taxpayer does not have substantial nexus***, for purposes of the Commerce Clause. Significantly, Congress has not modified this standard in the decade since the Court's decision in *Quill*.

B. The Commission's Attempts to Avoid the Commerce Clause are Unavailing.

There is no dispute that Appellants had no physical presence in Missouri. The Director's Final Decision states that the substantial nexus standard is satisfied by "[t]he use of the trademarks and patents in Missouri" (Ex. 1, p. 2).[10] That should be the end of the matter, with the conclusion that the Director may not constitutionally tax Appellants. But the Commission held, notwithstanding the lack of physical presence, that the Director could impose taxes upon Appellants. Because none of the reasons

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[10] This conclusion is not consistent with *Quill*. There, the Supreme Court noted that the existence of floppy diskettes owned by Quill in North Dakota did not constitute physical presence. Appellants do not have even those minimal amounts of property in Missouri.

advanced by the Commission in support of that conclusion pass constitutional muster, each should be rejected by this Court.

1. The Commerce Clause Requires Physical Presence for the Imposition of Income Tax.

The Commission concluded that, while the Commerce Clause requires physical presence for the imposition of sales and use taxes, no physical presence was required for the imposition of income taxes. This position cannot be reconciled with the language of the Commerce Clause or the Supreme Court's interpretation of the Commerce Clause in *Quill*.

In *Quill*, the Court stated:

> "First, as the state court itself noted, 470 N.W.2d at 214, all of these cases involved taxpayers who had a physical presence in the taxing State and therefore do not directly conflict with the rule of *Bellas Hess* or compel that it be overruled. Second, and more importantly, although our Commerce Clause jurisprudence now favors more flexible balancing analyses, we have never intimated a desire to reject all 'bright-line' tests. Although we have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes, that silence does not imply repudiation of the *Bellas Hess* rule." *Id*. at 314.

The Director's primary authority (and the one that precipitated her change in policy) is *Geoffrey v. South Carolina*, 437 S.E.2d 13 (S.C. 1993), *cert. denied*, 510 U.S. 992 (1993). There, the South Carolina Supreme Court held that physical presence is not required to establish nexus in an income tax case. In upholding the assessment on Geoffrey's trademark and trade name royalty income, the court erroneously paraphrased the language of *Quill*, above, as stating that "the physical presence requirement has not been extended to other types of taxes." *Id*. at 23, n.4. The Court also

emphasized the presence of accounts receivable in South Carolina and characterized Geoffrey as a franchiser. Thus, *Geoffrey* is not only inconsistent with *Quill*, and therefore wrong, but it is distinguishable on its facts.

In contrast to Geoffrey, neither Appellants nor ARCLP have accounts receivable in Missouri. Further, neither Appellants nor ARCLP are franchisers, but merely act as licensors of the Trademarks during the respective Tax Periods. Thus, the basis upon which *Geoffrey* asserted physical presence is not present in this case.

The other authorities cited by the Commission likewise provide no support for its decision. First, its citation of *Borden Chemicals and Plastics, L.P. v. Zehnder*, 726 N.E.2d 73 (Ill. App. 2000), for the proposition that physical presence is not required for income tax cases is inappropriate since the Illinois Court of Appeals' statement was mere *dictum* in that the Illinois court concluded that the plaintiff was physically present in Illinois.

Second, the Commission cited the slip opinion of the New Mexico Court of Appeals in *Kmart Properties, Inc. v. Taxation and Revenue Dep't*, Number 21,140 (November 27, 2001). In *Kmart*, the intermediate appellate court concluded that an out-of-state corporation owning trademarks and trade names that were licensed to another corporation for use in New Mexico was subject to New Mexico income tax. This decision is of no avail to the Director since the New Mexico Supreme Court, pursuant to New Mexico Rule of Appellate Procedure 12-502, granted a petition for writ of certiorari by Kmart, and specifically ordered the Court of Appeals to refrain from taking any action to publish its decision. Hence, the *Kmart* opinion is currently in legal limbo and is not authority for anything. A copy of the Writ of Certiorari is attached as Appendix A.

As evidenced by the dearth of authority in *Geoffrey*, *Borden*, and *Kmart*, the Commerce Clause itself does not articulate differing standards for different types of taxes. Instead, it states that Congress has the power to "regulate Commerce with foreign Nations, and among the several States." There is no basis in the language of the Commerce Clause nor any logical reason to extrapolate from the Commerce Clause a distinction between different types of taxes on interstate commerce.

The Commission, in attempting to distinguish sales/use taxes from income taxes stated:

> "Income tax is different because intangibles, such as those at issue here, may earn income in the taxing state even though the owner has

> no physical presence in that state. As noted in Michael T. Fatale,[11] *State Tax Jurisdiction and the Mythical 'Physical Presence' Constitutional Standard*, 54 Tax Lawyer 105, 107 (Fall 2000), 'a corporation, though designated as a 'person' for purposes of various legal requirements including tax filings, is a mere legal construct that is not in fact present anywhere.' We do not countenance the use of a mere legal construct to shelter income from taxation in the state from whose revenue stream the income was derived, as the Supreme Court has plainly ruled that physical presence is not required." (L.F. 54-55).

Neither the Commission nor Fatale, the Massachusetts revenue attorney the Commission cited for authority, attempted to explain any policy rationale for distinguishing income taxes from sales and use taxes for purposes of the Commerce Clause. Contrary to their insinuations, the United States Supreme Court has stated that direct taxes impose greater burdens on interstate commerce than sales and use taxes. *National Geographic Society v. California Board of Equalization*, 430 U.S. 551, 560 (1977). Therefore, to the extent the two types of taxes are properly distinguishable, the Commerce

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[11] The Commission's citation of the arguments of Massachusetts Revenue Department attorney Fatale is indeed ironic in light of its exclusion at the hearing of the testimony (Ex. 20) of Appellants' witness on this issue, Professor Richard Pomp of the University of Connecticut. Unlike the biased opinions of the Director's lawyer's counterpart in Massachusetts, Professor Pomp's opinions are that of an academician and tax scholar.

Clause should impose ***greater*** barriers for the imposition of direct income taxes than for the imposition of sales and use taxes.

The Commission also failed to square Fatale's statement that a corporation may not be present anywhere with the numerous decisions of the United States Supreme Court determining the presence of corporate entities for purposes of personal jurisdiction and Commerce Clause litigation.

The Commission did not consider or discuss decisions of various state tribunals that have rejected the Commission's rationale. For example, in *J.C. Penney National Bank v. Johnson*, 19 S.W.3d 831 (Tenn. Ct. App. 1999), *cert. denied*, 531 U.S. 927 (2000), a Tennessee appeals court rejected the revenue authority's attempt to apply its net income tax upon a corporation managing thousands of credit card accounts and deriving fees from Tennessee residents. The Tennessee revenue authority maintained that the Commerce Clause required no physical presence for imposing franchise and excise taxes and, alternatively, that the presence of the corporation's credit cards and affiliated companies in Tennessee constituted the corporation's physical presence there. The Tennessee court disagreed. First, it concluded that a physical presence was required. *Id*., 19 S.W.3d at 839. Second, it concluded that the presence of the credit cards, which represented the corporation's intangible credit accounts, did not constitute physical presence. *Id*., 19 S.W.3d at 840. Last, it concluded that the presence of retail J.C. Penney stores of a related company was insufficient to establish the taxpayer's physical presence. *Id*., 19 S.W.3d at 842-43. Therefore, consistent with *Quill*, the imposition of Tennessee income tax was unconstitutional.

The Tennessee court's decision is not unique in its rejection of the Director's argument for the dismissal of a physical presence requirement under the Commerce Clause. *See, e.g., Syl, Inc. v. Comptroller*, Case Number C-96-0154-01 at 6 (Md. Tax Ct. 1999) ("*Geoffrey* focused on the

use of the marks by the in-state affiliate of the unitary group in order to determine the nexus of the foreign corporation. We disagree that that activity constitutes substantial nexus."); *Cerro Copper Products, Inc. v. Alabama*, Docket Number F94-444 (Ala. Dept. Rev. 1995) ("I disagree with *Geoffrey's* Commerce Clause analysis concerning intangibles. Specifically, I disagree that receivables generated by a non-resident taxpayer's activities in a state are necessarily 'located' in that state. I also disagree that the 'use' or 'presence' of intangibles in a state is, by itself and without some physical presence, sufficient to establish 'substantial nexus' for Commerce Clause purposes.").

The Commission also ignored the conclusions of the hearing officer in the unpublished *Kmart* decision:

> "I concur with KPI's arguments that I can find ***no principled basis to distinguish between sales and use taxes, and income taxes under the Commerce Clause***…. On this basis, I disagree with the portion of the South Carolina Supreme Court's decision in *Geoffrey*, which upheld the imposition of an income tax, under facts nearly identical to this case … on the basis that the Commerce Clause physical presence requirement announced in *Quill*, was limited to sales and use taxes (citations omitted). Number 01-287446-00-6 at 23, n. 10 (N.M. Tax Dept. 2000).

In summary, there is no principled distinction between income taxes and sales/use taxes for purposes of the Commerce Clause. Therefore, the Commission's attempt to create such a distinction to avoid the physical presence requirement of the Commerce Clause must be rejected by this Court.

2. The Nexus of Appellants' Licensee May Not Be Attributed to Appellants.

The Director argued below that the nexus of ABC could be attributed to Appellants. Although the Commission declined to reach this issue based upon its determination that the Commerce Clause's physical presence requirement does not apply to income taxes, the Commission made several findings of fact regarding the control of ABC, ARC, BIC, ARCLP, and Justin, and stated, "[b]ecause the Justin enterprises were a unitary business and were functionally integrated, we could easily rule that the Justin business activity conducted in Missouri may be attributed to [Appellants] and that physical presence is established." (L.F. 60). As demonstrated below, this line of argument is clearly inconsistent with Missouri law.

Under Missouri law, even when the stock of one corporation is owned partly or wholly by another, the two separate corporations are to be regarded as distinct legal entities. *Central Cooling & Supply Co. v. Director of Revenue*, 648 S.W.2d 546, 547-48 (Mo. 1982). Corporations are not responsible for the acts of related entities. *See, e.g., Grease Monkey Int'l, Inc. v. Godat*, 916 S.W.2d 257, 262 (Mo. App. E.D. 1995); *Mitchell v. K.C. Stadium Concessions, Inc.*, 865 S.W.2d 779, 784 (Mo. App. W.D. 1993).

Although the Director's arguments before the Commission were somewhat opaque, she apparently argued that the above-cited general rule did not apply to Appellants for three reasons: (1) ABC was engaged in a partnership with ARC, BIC, and ARCLP; (2) ABC was the alter ego of ARC, BIC, and ARCLP; and/or (3) the Licensing Agreement created some sort of joint venture. None of these theories is consistent with the facts of this case.

(a) ABC Was Not Engaged in a Partnership with ARC, BIC or ARCLP.

The existence of a partnership is never presumed, and the burden is on the party asserting a partnership to prove by clear, cogent, and convincing evidence that a partnership exists. *Morrison v. Labor and Industrial Relations Commission*, 23 S.W.3d 902 (Mo. App. W.D. 2000). A partnership consists of partners placing their money, efforts, labor, and skill in lawful commerce and dividing the resulting profits and losses. *Id*. In this case, the record is clear that ABC shared neither profits nor losses. Thus, while ARC and BIC were partners in ARCLP, ABC was not the partner of any of those entities.

(b) ABC Was Not the Alter Ego of ARC, BIC, or ARCLP.

The Commission emphasized that Justin and its subsidiaries had a commonality of officers and directors and constituted a functionally integrated unitary business in stating that it could "easily rule that the Justin business activity in Missouri may be attributed to [Appellants] and that physical presence is established" (L.F. 60). The Commission did not cite any authority showing that any of these facts authorized it to disregard the separate statuses of Appellants from ABC and Justin. Missouri law is clear that a corporation is an entity separate and apart from its stockholders. Mere ownership of all the stock of one corporation by another, and the common identity of officers with another, are not alone sufficient to create an identity of corporate interests between two companies. Rather, there must be such dominion and control that the controlled corporation has, so to speak, no separate mind, will, or existence of its own. *Blackwell Printing Co. v. Blackwell-Wielandy Company*, 440 S.W.2d 433, 437 (Mo. 1969); *Mid-Missouri Telephone Co. v. Alma Telephone Co.*, 18 S.W.3d 578, 582 (Mo. App. W.D. 2000). The evidence demonstrates that Appellants were not the alter ego of Justin or ABC.

In *Collet v. American National Stores, Inc.*, 708 S.W.2d 273, 284 (Mo. App. E.D. 1986), the court noted that among the factors used to determine whether a subsidiary is the alter ego of its parent is whether the parent uses the subsidiary's property as its own and whether the directors of the subsidiary act independently in the interest of the subsidiary or take their orders from the parent corporation in the latter's interest. Appellants licensed the Trademarks to ABC. ARC, BIC, and ARCLP were formed for the specific purpose of separating the Trademarks from the operating divisions of Justin because different skill levels are required to manage intellectual property than to produce and sell footwear, and because Justin concluded that people specializing in intellectual property would be better able to market the same to unrelated entities (Tr. 31-42).

In an interesting twist, in *Central Cooling & Supply Co. v. Director of Revenue,* 648 S.W.2d 546 (Mo. 1982), the Director successfully argued for the separate corporate existence of two related corporations that were exchanging tangible personal property. This Court refused to disregard the separate corporate existence in upholding the assessment of sales and use tax on transactions between two related corporations. *Id.* at 547. This Court relied on *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436, 438-39 (1943), which held:

> "The doctrine of corporate entity fills a useful purpose in business life. Whether the purpose be to gain an advantage under the law of the state of incorporation or to avoid or to comply with the demands of creditors or to serve the creator's personal and undisclosed convenience, so long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity."

The Director's arguments that the commonality of interests between Justin, ABC, ARCLP, and Appellants permits this Court to disregard their respective separate statuses are inconsistent with Missouri law.

III. THE ADMINISTRATIVE HEARING COMMISSION ERRED IN UPHOLDING THE NOTICES OF DEFICIENCY BECAUSE, UNDER SECTIONS 621.189 AND 621.193, THAT DECISION IS NOT AUTHORIZED BY LAW OR SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE IN THAT THE EQUAL PROTECTION CLAUSE AND UNIFORMITY CLAUSE PROHIBIT THE IMPOSITION OF MISSOURI INCOME TAX ON ROYALTY INCOME RECEIVED BY A TAXPAYER HAVING NO PHYSICAL PRESENCE IN MISSOURI FROM A LICENSEE RELATED TO THE TAXPAYER WHEN NO SUCH IMPOSITION IS MADE UPON A LIKE TAXPAYER ON ROYALTY INCOME RECEIVED FROM UNRELATED LICENSEES.

The Uniformity Clause of the Missouri Constitution requires that all taxes "shall be uniform upon the same class or subclass of subjects within the territorial limits of the authority levying the tax." Mo. Const. art X, § 3. While the power of the State to classify for purposes of taxation is broad, taxpayers must be classified on a reasonable basis. *Schnorbus v. Director of Revenue*, 790 S.W.2d 241, 242 (Mo. banc 1990). The validity of a state tax statute under the Equal Protection Clause (U.S. Const. amend. XIV, § 1) is determined under the rational basis standard. *Exxon Corp. v. Eagerton*, 462 U.S. 176, 195-96 (1983).

The taxation of out-of-state trademark and trade name licensors based upon the use of trademarks and trade names by a related licensee to sell products to Missouri customers violates the Uniformity and Equal Protection Clauses when the Director does tax the same transactions if they involve unrelated licensees. There is utterly no rational basis for such discrimination under the law. The

Commission did not dispute this legal conclusion. Instead, it said that "there is no evidence that this is the Director's position" (L.F. 60), a statement that is patently incorrect.

The Commission's factual finding is unsupported by competent and substantial evidence in the record. The Director, through her designee pursuant to Missouri Rule of Civil Procedure 57.03(b)(4), testified that, although there were numerous situations in which out-of-state licensors derive royalty income from the use of trademarks by unrelated licensees in Missouri, she was unaware of any instance in which an assessment was made in that situation (Ex. 23, pp. 29-32, 41-42). This conclusion was amplified by the deposition of one of the Director's auditors, another designee of the Director, and who sits on the Director's Tax Policy Committee. He likewise stated that he was unaware of any situation in which the Director taxed income similar to Appellants' when the licensee was unrelated to the licensor (Ex. 25, p. 19-20, 31-34).

Accordingly, the Commission's statement that "All of the auditors who testified by live testimony or deposition indicated that the Director would treat royalty income the same way regardless of whether the trademarks were transferred to a related corporation" (L.F. 60), is contradicted by the Director's failure to assess similarly situated taxpayers. The Director's assessment against Appellants is invalid because it is contrary to the Uniformity Clause and denies Appellants equal protection.

IV. THE ADMINISTRATIVE HEARING COMMISSION ERRED IN UPHOLDING THE NOTICES OF DEFICIENCY BECAUSE, UNDER SECTIONS 621.189 AND 621.193, THAT DECISION IS NOT AUTHORIZED BY LAW OR SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE IN THAT THE SALES OF ANOTHER TAXPAYER MAY NOT BE TREATED AS APPELLANTS' SALES UNDER SECTION 32.200, ART. IV, § 17.

The Missouri income tax is imposed upon so much of a corporation's federal taxable income "as is derived from Missouri sources." Section 143.431. Because Appellants do not have any Missouri source income, the Director's assessment against Appellants is invalid.

Missouri adopted the Compact as codified by section 32.200. Article IV, section 9 of section 32.200 provides that "all business income shall be apportioned to this state multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three." Because Appellants' respective property, payroll and sales factors are zero, Appellants have no Missouri source income.

In computing Appellants' Missouri taxable income, the Commission included

ABC's sales of products in Missouri within the sales factor of ***Appellants***.[12] This is inconsistent with section 32.200, art. IV, § 17, which provides that sales other than sales of tangible personal property are included in the numerator of the sales factor only if the majority of the income producing activity takes place in Missouri. The Director's Regulation 12 CSR 10-2.075(56) states that income-producing activities include the sale, licensing or other use of intangible personal property. As stated above, Appellants have no products for which the Trademarks are used to market. Instead, Appellants licensed the Trademarks to a non-Missouri entity, ABC, pursuant to a contract completed outside Missouri that is not governed by Missouri law, and under which, in every case, payments were made outside Missouri.[13] Because all of Appellants' income producing activities took place outside of Missouri, the Commission's aggregation of ABC's sales into Appellants' respective sales factors was inappropriate.

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[12] The Commission's attribution of ABC's sales of products in Missouri to ARC for Tax Periods 1994-1996 is particularly erroneous since during those Tax Periods, ARC was merely the limited partner of ARCLP, and was therefore engaged in a passive investment activity.

[13] But for the fact that ABC was related to Appellants and ARCLP, Appellants and ARCLP, Appellants and ARCLP would not likely even have access to the locations of ABC's sales to ABC's customers and, therefore, would not even know where to file income tax returns, or how much to pay, under the Director's theory of taxation.

V. THE ADMINISTRATIVE HEARING COMMISSION ERRED IN UPHOLDING THE NOTICES OF DEFICIENCY BECAUSE, UNDER SECTIONS 621.189 AND 621.193, THAT DECISION IS NOT AUTHORIZED BY LAW OR SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE IN THAT UNDER SECTION 32.200, ART. IV, § 18, NEITHER THE DIRECTOR NOR THE COMMISSION IS FREE TO EXCLUDE THE PROPERTY FACTOR IN APPORTIONING THE INCOME OF TAXPAYERS HAVING NO OR SMALL AMOUNTS OF PROPERTY OWNERSHIP OR PAYROLL.

The Commission apportioned Appellants' income by using the sales factor with a denominator of one. Thus, assuming *arguendo* that Appellants are subject to Missouri income tax, the Commission's decision incorrectly apportioned Appellants income under the Compact. The Commission stated that it excluded the property and payroll factors because ARC's payroll and property were *de minimis* in relation to its royalty income and because BIC did not have employees, and the record did not demonstrate that it had property (L.F. 63). The Commission justified this departure from the statutorily required three-factor method under the authority of section 32.200, art. IV, § 18, which provides that the Director may exclude one or more factors "[i]f the allocation and apportionment provisions of this article do not fairly represent the extent of the taxpayer's business activities in this state." The Commission's determination that the three-factor method does not fairly represent Appellants' business is erroneous and is contrary to its own decision in *Rentco Trailer Corporation v. Director of Revenue*, Case Number 97-1373RI (Mo. Admin. Hrg. Comm. 1998).

As here, in *Rentco*, the Commission addressed a situation in which the Director attempted to apportion a taxpayer's income using fewer than all of the three factors. Specifically, the Director excluded the payroll factor because the taxpayer did not have payroll in any state. In *Rentco*, the Commission held that the Director's calculation was impermissible because the statute requires the use of all three factors. While the Commission recognized that section 32.200, art. IV, § 18 permits a deviation from the statutory formula, such a deviation requires a determination that the three-factor method does not fairly represent the extent of the taxpayer's business. Because the Commission determined that the taxpayer's lack of payroll was due to its organization rather than the nature of its business, the Commission determined that the use of an alternative method of apportionment was inappropriate.

Assuming *arguendo* that Appellants are subject to Missouri income tax, under *Rentco*, the Commission's exclusion of the payroll and property factors was improper and must be rejected. Appellant small (or nonexistent) amounts of property and payroll were based upon the nature of Appellants' respective organizations. A simple example demonstrates the fallacy of the Commission's reasoning, particularly for income generated from intellectual property. Suppose Stephen King, Inc., writes books that it copyrights and licenses. Stephen King, Inc. pays its one employee, Stephen King, $20,000 per year in salary. Stephen King, Inc. has only a small office and a word processor that its one employee uses, and the value of that property is $2,000. Yet, Stephen King, Inc. generates millions of dollars each year in copyright royalties. The Commission would disregard the payroll and property factors because they were minimal in relation to the royalties, yet no one could reasonably deny that the one employee and the small amount of property were primarily responsible for the production of that royalty income.

Indeed, the Commission's willingness to disregard factors that, in the Commission's opinion, are "minimal" will make it practically impossible for corporations that actually are subject to Missouri income tax to predict with any kind of certainty their Missouri income tax liability. Depending upon the Commission's whim, Missouri may be a one, two, or three factor apportionment state for a particular taxpayer. One can only wonder whether the Director would agree with the Commission if Appellants' "minimal" property or payroll were in Missouri.

In short, because Appellants' property, payroll and sales factors are zero, Appellants have no Missouri source income. Because section 143.431 permits the Director to assess Missouri income tax upon Missouri source income, the Director's assessment against Appellants is invalid.

VI. THE ADMINISTRATIVE HEARING COMMISSION ERRED IN UPHOLDING THE NOTICES OF DEFICIENCY BECAUSE, UNDER SECTIONS 621.189 AND 621.193, THAT DECISION IS NOT AUTHORIZED BY LAW OR SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE IN THAT THE IMPOSITION OF MISSOURI INCOME TAX UPON APPELLANTS CONSTITUTES A CHANGE FROM "PREVIOUS POLICY" AS THAT PHRASE IS USED IN SECTION 143.903 AND CONSTITUTES A "CHANGE IN POLICY OR INTERPRETATION" AS THAT PHRASE IS USED WITHIN THE MEANING OF SECTION 32.053.

Section 143.903 provides that an "unexpected" decision is applied only after the most recently ended tax period for purposes of additional assessment. A decision is unexpected if "a reasonable person would not have expected the decision or order based on prior law, policy or regulation of the Director." *Id. See also Lloyd v. Director of Revenue*, 851 S.W.2d 519, 522-23 (Mo. banc 1993); *Laciny Brothers, Inc. v. Director of Revenue*, 869 S.W.2d 761 (Mo. banc 1994).

The Director's designee stated that her Audit Manual sets forth the policy and guidelines for what the Director holds taxable (Ex. 23, p. 63-64). Prior to the publication of the Nexus Position in the Audit Manual in October 1996, the Director did not assert the power to tax the royalty income of out-of-state licensors based upon the use of patents by a licensee to manufacture products outside of Missouri that are eventually sold to Missouri customers. After the publication of the Nexus Position, the Director did assert this power and began making retroactive assessments, including the assessments against Appellants.

Nonetheless, the Commission determined that the Director's change of position did not constitute a change of policy because prior to the Nexus Position, "the Director did not have a policy" (L.F. 65). The Commission stated, "The Director's decision to pursue collections under the reasoning of *Geoffrey* was not a change in the Director's policy, but simply an awareness, that did not exist before, that there was a new issue possibly resulting in tax liability" (L.F. 65-66).

It should go without saying that the Director's constitutional duty, as provided by article IV, section 22 of the Missouri Constitution is to "collect all taxes and fees payable to the state as provided by law." Thus, the Director's overriding policy is to collect all taxes imposed by statute. The Commission's statement that the Director was "unaware" of whether a certain type of income is subject to Missouri tax suggests a dereliction of the Director's constitutional duty. Instead, the Director's decision to pursue collections under the reasoning of *Geoffrey* was a change in the Director's interpretation of the law, and therefore a change in policy that should be applied on a prospective only basis under section 143.903.

Likewise, section 32.053 provides that any final decision of the Director, which is the result of a change in policy or interpretation by the Director, may be applied on a prospective basis only. Even assuming *arguendo* that the Director did not have a "policy" with respect to the taxation of the trademark and trade name royalty income of out-of-state licensors based upon the use of trademarks by a licensee to sell products to Missouri customers, it is clear that the Director's assertion of the power to tax such income was based upon a new interpretation of the law as a result of *Geoffrey*. As a consequence, this determination must be applied on a prospective basis. Because the Assessment against Appellants was made on a retroactive basis, the Assessment is invalid.

CONCLUSION

For the foregoing reasons, Appellants respectfully requests that the Court reverse the decision of the Commission and determine that the Assessments against Appellants are invalid because: (a) Appellants have no income derived from Missouri sources; (b) Appellants have no nexus with Missouri; and (c) even if the royalty income were Missouri source income, it would not be subject to tax retroactively. Furthermore, even if the royalty income were subject to Missouri tax, the Commission incorrectly calculated the Missouri income tax by disregarding two of three apportionment factors.

Respectfully Submitted,

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CERTIFICATE OF SERVICE

I hereby certify that two true and accurate copies of the foregoing, as well as a labeled disk containing the same, were mailed first class, postage prepaid or hand-delivered this 6th day of May, 2002, to State Solicitor Jim Layton, P.O. Box 899, Jefferson City, Missouri 65102.

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CERTIFICATE REQUIRED BY SPECIAL RULE 1(C)

I hereby certify that the foregoing brief includes the information required by Supreme Court Rule 55.03 and complies with the limitations contained in Supreme Court Special Rule 1(b). The foregoing brief contains 13,635 words.

The undersigned further certifies that the disk simultaneously filed with the briefs filed with this Court under Supreme Court Rule 84.05(a) has been scanned for viruses and is virus-free.

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