SC94999

IN THE SUPREME COURT OF MISSOURI

IBM CORPORATION,

Respondent/Cross-Appellant,

vs.

DIRECTOR OF REVENUE,

Appellant/Cross-Respondent.

Appeal from the Administrative Hearing Commission
The Honorable Sreenivasa Rao Dandamudi, Commissioner

BRIEF OF APPELLANT DIRECTOR OF REVENUE

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JURISDICTIONAL STATEMENT

The issues before the Court in this matter involve the construction of § 144.054.2, RSMo (2013 Cum. Supp.),[1/] a revenue law of the State of Missouri. Therefore, this Court has exclusive jurisdiction over this matter pursuant to Article V, § 3 of the Missouri Constitution.

[1/] All references to the Missouri Revised Statutes are to the 2013 Cumulative Supplement unless otherwise specified.

STATEMENT OF FACTS

In 2008, in the space of only 29 days, IBM Corporation ("IBM"), sold a significant amount of computer-related hardware and software to MasterCard International, LLC ("MasterCard"). (LF 16-19). The use taxes paid on the purchases alone was more than $200,000. (LF 8-9; Tr. 30). IBM now seeks a refund of all use taxes paid on these purchases under § 144.054.2, arguing in part that MasterCard is using the hardware and software to manufacture millions upon millions of products each day – in the form of credit card transactions. (LF 5-6, 15; Ex. 8, ¶ 13; Ex. 11, 14:4-12).

A. MasterCard Communicates Financial Transactions and Information.

MasterCard is a financial services company that facilitates "literally tens of millions of transactions on a given day" between its customers (banks) and merchants. (Tr. 9). It has three distinct financial functions as its core business, and all involve electronic communications: "authorization," "clearing," and "settlement." (LF 19; Ex. 11, 7:23-24).

For the "authorization" function in any credit card transaction, a cardholder presents a credit card to a merchant, at which point the merchant communicates the information to its bank. (LF 19-20; Ex. 3). The authorization message is an electronic message and it generally happens in 140 milliseconds. (Ex. 8; Tr. 9, 50). The merchant's bank, in turn,

communicates the information to MasterCard. (LF 19-20; Ex. 3). MasterCard then communicates the information to the bank that issued the credit card, which decides whether to accept or decline the transaction. (LF 20; Tr. 54). The decision to accept or decline the transaction is then communicated back to the merchant through MasterCard. (LF 20). MasterCard's part in the transaction is merely to communicate information electronically between different parties, and thereby facilitate a smooth path for the message to flow from the merchant to the cardholder bank and back again. (Ex. 11, 24:13).

The next step in a credit card transaction is "clearing." (LF 20; Ex. 3). Clearing occurs electronically and automatically. (Ex. 11, 28:17-18). It is the exchange of data in order to determine the merchant bank and cardholder bank's settlement position for transactions. (Ex. 5, MC-1620). As the Commission found, banks "communicate the data to MasterCard," (LF 20), which then reconciles each bank's account for that particular cycle, including the incorporation of charges each bank incurs from MasterCard. (LF 20; Ex. 3). When clearing ends, each bank knows whether or not it will receive payment or pay to settle its account. (LF 20; Tr. 59). Again, MasterCard's part is to communicate information.

The final step in a credit card transaction is "settlement." (LF 20; Ex. 3). During settlement, MasterCard acts as a sort of middleman between the merchant and cardholder banks to facilitate the transfer of money owed on

the transactions for that cycle. (Ex. 11, 34:5-35:7). MasterCard "communicates the settlement positions" to the merchant banks and the cardholder banks. (LF 20). A settlement bank then facilitates the transfer of funds to MasterCard and the other banks. (Ex. 3). Once the cardholder bank receives its net settlement position, the cardholder bank transfers the amount of funds to the settlement bank. (Ex. 3). And the settlement bank then transfers the amounts owed to the merchant banks, so the merchant banks can provide the amounts owed to its merchants using its banking services. (Ex. 3). Once again, MasterCard's part is to communicate information and facilitate transactions.

B. Additional Services and Programs.

MasterCard also provides additional services and programs to banks, including Fraud Scoring, Stand-In, InControl and Warehouse Data Services. For Fraud Scoring, MasterCard compares incoming transactions with other transactions. (LF 21). MasterCard uses models developed by other companies to predict whether a particular transaction may be fraudulent. (LF 21). The models use prior transactions to recognize whether or not a particular transaction may be fraudulent. (LF 21). The models then assign a fraud score to each transaction. (LF 21).

Even though MasterCard requires banks to participate in Fraud Scoring, and charges a fee to participate, the authorization message already

contains information to assist cardholder banks in determining potential fraud. (Ex. 11, 40:21-42:9). Cardholder banks have their own sophisticated methodology and fraud prevention procedures in order to determine whether the transaction is fraudulent. (Ex. 11, 22:22-24).

Cardholder banks also have no choice but to participate in Stand-In. (Ex. 11, 46:10-13). Stand-In allows MasterCard to approve or deny a merchant bank transaction should the cardholder bank be unable to receive the message and make the decision itself. (LF 20). Once MasterCard makes the decision, it transmits the decision back to the merchant bank in order to complete the transaction and retains the decision until the cardholder bank is once again able to receive incoming authorization messages. (Ex. 11, 49:5-21).

Unlike Fraud Scoring and Stand-In, InControl is optional to banks. (Ex. 11, 46:16-17.). InControl allows each cardholder to set specific requirements regarding charges to their credit card. (Ex. 11, 43:17-22). The cardholder gives the specific requirements to the cardholder bank, which in turn provides them to MasterCard. (Ex. 44:9-45:15). MasterCard performs no function other than to follow the bank's instructions.

Finally, MasterCard warehouses all of the transaction data it receives from banks. (Tr. 82). From this data, MasterCard cannot characterize specific sales from gross receipts. MasterCard can only total transactions without categorizing the totals. (Tr. 90). For example, MasterCard cannot discern

between the various categories of sales made at Wal-Mart or Target because the information is from gross receipts. (Tr. 89-90). MasterCard simply adds up the total sales charged for certain business types. (Tr. 90).

C. The Administrative Hearing Commission's Decision.

In 2012, IBM filed a Use Tax Return on behalf of MasterCard for purchases of computer hardware and software from September 1, 2008 through September 29, 2008 (LF 16; Ex. B).

In its decision granting the refund, the Administrative Hearing Commission ("Commission") departed from recent decisions of this Court, including *Brinker Mo., Inc. v. Dir. of Revenue*, 319 S.W.3d 433 (Mo. 2010), and cases specifically interpreting the provision at issue in this case – § 144.054.2; namely, *Aquila Foreign Qualifications Corp. v. Dir. of Revenue*, 362 S.W.3d 1 (Mo. 2012); *AAA Laundry & Linen Supply Co. v. Dir. of Revenue*, 425 S.W.3d 126 (Mo. 2014); *Union Elec. Co. v. Dir. of Revenue*, 425 S.W.3d 118 (Mo. 2014); *Ben Hur Steel Worx, LLC v. Dir. of Revenue*, 452 S.W.3d 624 (Mo. 2015); and *Fred Weber, Inc. v. Dir. of Revenue*, 452 S.W.3d 628 (Mo. 2015). (LF 36). The Commission acknowledged that if these cases are followed then the refund should be denied because "none of [MasterCard's] activities have anything like an industrial connotation." (LF 34).

Instead, the Commission followed an older line of cases under § 144.030; namely *Bridge Data Co. v. Dir. of Revenue,* 794 S.W.2d 204 (Mo. 1990); *Concord Publ'g House Inc. Co. v. Dir. of Revenue*, 916 S.W.2d 186 (Mo. 1996); *Int'l Bus. Machs. v. Dir. of Revenue*, 958 S.W.2d 554 (Mo. 1997); *DST Sys., Inc. v. Dir. of Revenue*, 43 S.W.3d 799 (Mo. 2001); *Southwestern Bell Tel. Co. v. Dir. of Revenue*, 78 S.W.3d 763 (Mo. 2002); and *Southwestern Bell Tel. Co. v. Dir. of Revenue*, 182 S.W.3d 226 (Mo. 2005). (LF 36).

POINTS RELIED ON

I. The Commission Erred in Refunding Use Taxes Collected on the Sale of Computer Hardware to MasterCard, Because a Credit Card Company and Its Activities Do Not "Fit[] the Statutory Language Exactly," as Required by Strict Construction of Tax Exemptions, In That Communicating Financial Transactions and Information is Not the Manufacturing of a Product Under § 144.054.2.

Akins v. Dir. of Revenue, 303 S.W.3d 563 (Mo. 2010)

Aquila Foreign Qualifications Corp. v. Dir. of Revenue, 362 S.W.3d 1 (Mo. 2012)

Ben Hur Steel Worx, LLC v. Dir. of Revenue, 452 S.W.3d 624 (Mo. 2015)

Brinker Mo., Inc. v. Dir. of Revenue, 319 S.W.3d 433 (Mo. 2010)

§§ 144.010.1(14), 144.030.2(9), 144.054, 144.087.3, 144.100, and 148.030

II. The Commission Erred in Refunding Use Taxes Collected on the Sale of Computer Hardware to MasterCard, Because § 144.054.2 is Applicable to Manufacturing or Industrial-Type Activities Not Credit Card Companies, In That the Statute Merely Expanded the Items Subject to Exemption, Not the Type of Activities.

Aquila Foreign Qualifications Corp. v. Dir. of Revenue, 362 S.W.3d 1 (Mo. 2012)

Cook Tractor Co., Inc. v. Dir. of Revenue, 187 S.W.3d 870 (Mo. 2006)

Int'l Bus. Machs. Corp. v. Dir. of Revenue, 958 S.W.2d 554 (Mo. 1997)

§ 144.054.2

SUMMARY OF THE ARGUMENT

A financial services company such as MasterCard, that communicates transactions from merchants like Wal-Mart to banks like JP Morgan Chase, is not "manufacturing" products under § 144.054.2 by doing so. Unless, of course, they are talking about the manufacture of actual plastic credit cards – which they are not. Instead, the issue in this case is whether MasterCard's communication of financial transactions or information is the manufacturing of tens of millions of products each day. If it is, then there really is no limit to what constitutes the manufacturing of a product. Any company that communicates information, from UMB to Facebook, would be manufacturing products. The General Assembly, however, did not intend such a result in § 144.054.2. And the voters and taxpayers would be greatly surprised at such a departure from common sense.

Because tax exemptions are to be strictly construed against the taxpayer, the language of an exemption is as important for what it includes as for what it does not include. *See Aquila Foreign Qualifications Corp. v. Dir. of Revenue*, 362 S.W.3d 1, 4 (Mo. 2012) (noting the omission of terms related to retail food preparation). Here, the General Assembly exempted manufacturing activities in § 144.054.2 by using terms such as "manufacturing," "processing," "compounding," "mining," and "producing," as well as "solid waste stream." Notably absent is any reference to terms such as

"financial institutions," "credit cards," "communications," "transactions," "transfer," "financial," or "information."

The omission of financial or communication terms from the manufacturing exemption in § 144.054.2 is significant, and cannot be swallowed up by expansive definitions of the manufacturing terms. This is so, not only because such an approach runs contrary to the long-established principles for strictly interpreting tax exemptions, but because the General Assembly has demonstrated that it can, and does, exempt communication entities, activities, and equipment as well as financial institutions. *See, e.g.,* § 144.054.3 (exempting "television or radio broadcasting"); § 144.030.2(9) (exempting "computers" and "equipment" "used in producing newspapers published for dissemination of news to the general public"); Chapter 148 ("Taxation [and Exemptions] of Financial Institutions").

Had the General Assembly intended to include financial institutions or communication activities in § 144.054.2, it certainly knew how to do that. Or vice versa, had the General Assembly believed that manufacturing included the communication of financial information, it certainly would have used terms such as manufacturing, processing, producing, mining, or compounding to describe the taxation of financial institutions. But it did not, and the communication of financial transactions or information does not exempt

MasterCard from taxes under § 144.054.2 for the purchase of computer hardware.

The consequences of finding a manufacturing exemption in this case would be significant and extend well beyond MasterCard and well beyond computer hardware to all "electrical energy and gas . . . water, coal, and energy sources, chemicals, machinery, equipment, and materials." § 144.054.2. Even now, refund claims totaling millions of dollars are awaiting resolution of this case. *See, e.g., Dell Marketing, LP v. Dir. of Revenue*, 12-0029 RS (located at http://ahc.mo.gov/); *Sun Microsystems, Inc. & Oracle America, Inc. v. Dir. of Revenue*, 12-0040 RS (same); *UMB Bank, NA v. Dir. of Revenue*, 14-0198 RS (same). And that is just the tip of the iceberg.

This case once again points to a fundamental misunderstanding of § 144.054.2 by certain enterprising taxpayers. While this provision is unquestionably "in addition" to other exemptions, it is not so because it expands the manufacturing activities subject to exemption, but instead because it expands the types of items (*e.g.*, water, coal, etc.) that are subject to the manufacturing exemptions. Section 144.054.2 should be interpreted accordingly; not as a broad expansion of what it means to be a manufacturer of a product, but as the expansion of items exempt if used in the manufacturing of a product.

For these reasons, the Director of Revenue requests that this Court reverse the Administrative Hearing Commission as to the payment of use tax by MasterCard for computer hardware.

ARGUMENT

Standard of Review

The only issues in this case are legal issues, and they involve the interpretation of a revenue law – § 144.054.2. This Court reviews the Commission's interpretation of revenue laws *de novo*. *Brinker Mo., Inc. v. Dir. of Revenue*, 319 S.W.3d 433, 436 (Mo. 2010) ("Statutory interpretation is an issue of law that this Court reviews *de novo*."); *Finnegan v. Old Republic Title Co. of St. Louis, Inc.*, 246 S.W.3d 928, 930 (Mo. 2008).

Section 144.054 is not just any revenue law; instead, it provides for sales and use tax exemptions. *See* § 144.054 ("Additional sales tax exemptions for various industries and political subdivisions."). This distinction is especially important because tax exemptions are "strictly construed against the taxpayer." *Branson Properties USA, L.P. v. Dir. of Revenue*, 110 S.W.3d 824, 825 (Mo. 2003); *Dir. of Revenue v. Armco, Inc.*, 787 S.W.2d 722, 724 (Mo. 1990) (noting that "strict construction is mandated for statutes establishing conditions for claiming an exemption") (citing *Mo. Pub. Serv. Comm'n v. Dir. of Revenue*, 733 S.W.2d 448, 449 (Mo. 1987)).

An exemption "'is allowed only upon clear and unequivocal proof, and doubts are resolved against the party claiming it.'" *AAA Laundry & Linen Supply Co. v. Dir. of Revenue*, 425 S.W.3d 126, 128 (Mo. 2014) (quoting *Branson Properties USA, L.P.*, 110 S.W.3d at 826). As such, the burden is on

the taxpayer claiming the exemption "to show that it fits the statutory language exactly." *Cook Tractor Co., Inc. v. Dir. of Revenue*, 187 S.W.3d 870, 872 (Mo. 2006).

In this case, IBM cannot satisfy the burden to show that the ultimate taxpayer – MasterCard – fits the statutory exemption at all, much less exactly. Accordingly, the Commission's decision to refund use taxes for the purchase of computer hardware under the exemption in § 144.054.2 should be reversed and judgment entered in favor of the Director of Revenue.

I. The Commission Erred in Refunding Use Taxes Collected on the Sale of Computer Hardware to MasterCard, Because a Credit Card Company and Its Activities Do Not "Fit[] the Statutory Language Exactly," as Required by Strict Construction of Tax Exemptions, In That Communicating Financial Transactions and Information is Not the Manufacturing of a Product Under § 144.054.2.

As with any statutory provision, "the primary rule of statutory interpretation is to give effect to legislative intent as reflected in the plain language of the statute." *Akins v. Dir. of Revenue*, 303 S.W.3d 563, 565 (Mo. 2010) (citing *State ex rel. White Family P'ship v. Roldan*, 271 S.W.3d 569, 572 (Mo. 2008)). Statutory language is given its "plain and ordinary meaning."

United Pharm. Co. of Mo., Inc. v. Mo. Bd. of Pharm., 208 S.W.3d 907, 910 (Mo. 2006).

Furthermore, "[n]o portion of a statute is read in isolation, but rather is read in context to the entire statute, harmonizing all provisions." *Utility Serv. Co., Inc. v. Dep't of Labor & Indus. Relations*, 331 S.W.3d 654, 658 (Mo. 2011). "Ascertaining and implementing the policy of the General Assembly requires the court to harmonize all provisions of the statute." *20th & Main Redevelopment P'ship v. Kelley,* 774 S.W.2d 139, 141 (Mo. banc 1989). It is likewise essential that the "[c]onstruction of statutes should avoid unreasonable or absurd results." *Reichert v. Bd. of Educ. of City of St. Louis,* 217 S.W.3d 301, 305 (Mo. 2007).

The Director interpreted § 144.054.2 consistent with its plain and ordinary meaning, the statutory context of the sales and use tax exemption, and in a way that avoids truly unreasonable and absurd results. The Commission, however, did not. And its decision violates each of these principles of statutory construction, not to mention the narrow or strict construction that must be applied to sales and use tax exemptions.

A. The Plain Language of § 144.054.2 Makes No Reference to Financial Institutions or Their Communications.

As with any statutory provision, "the primary rule of statutory interpretation is to give effect to legislative intent as reflected in the plain language of the statute." *Akins v. Dir. of Revenue*, 303 S.W.3d 563, 565 (Mo. 2010) (citing *State ex rel. White Family P'ship v. Roldan*, 271 S.W.3d 569, 572 (Mo. 2008)). The plain language of § 144.054.2 is reflective of the legislature's intent not only for the words and terms it uses – manufacturing words and terms – but it is especially notable for the words and terms it does not use – financial and communication words and terms.

The absence of words or terms in a statute is compelling as to the intent of the legislature, especially when the language is to be strictly construed. *See Brinker Mo., Inc. v. Dir. of Revenue*, 319 S.W.3d 433, 438 (Mo. banc 2010). Indeed, "[e]ssential to *Brinker*'s holding was the lack of the terms 'restaurant,' 'preparation,' 'furnishing,' or 'serving' in section 144.030.2." *Aquila*, 362 S.W.3d at 4, citing *Brinker Mo., Inc.*, 319 S.W.3d at 438. "Had the legislature intended to exempt those activities from taxation, it would have included those terms in the statute." *Id.*

This Court recently reached the same conclusion in *Ben Hur Steel Worx, LLC v. Dir. of Revenue*, 452 S.W.3d 624, 627 (Mo. 2015), noting that

the word "'construction' does not appear in § 144.054, nor do any words that would be associated with construction activities. The General Assembly knows how to delineate between construction activities and the large-scale industrial activities it intended to exempt in § 144.054.2." *See also Fred Weber, Inc. v. Dir. of Revenue*, 452 S.W.3d 628, 631 (Mo. 2015) (noting that the "General Assembly intended the plain and ordinary language of § 144.054.2 to apply only to industrial-type activities," not construction).

It is the same in this case with respect to financial institutions and the communication of financial transactions and information. Section 144.054 provides in relevant part:

> 2. In addition to all other exemptions granted under this chapter, there is hereby specifically exempted . . . electrical energy and gas, whether natural, artificial, or propane, water, coal, and energy sources, chemicals, machinery, equipment, and materials used or consumed in the manufacturing, processing, compounding, mining, or producing of any product[.]

§ 144.054.2.

Notably absent from this provision, and from § 144.054 in its entirety, is any reference to words or terms such as "financial institutions," "credit

cards," "communications," "transactions," and "transfers," or even just basic terms such as "financial" or "information." These are significant omissions, particularly considering the strict construction that must be applied to the exemptions in § 144.054. Even if the absence of such words or terms merely raises a doubt as to the applicability of § 144.054.2, the exemption should be denied.

Instead of referencing financial institutions or the communication of financial transactions or information, § 144.054.2 uses terms classically associated with industrial-type manufacturing; a type that most Missouri citizens and taxpayers would not associate with MasterCard. For example, when was the last time MasterCard had a "solid waste stream." § 144.054.1(2) (used in defining "recovered materials" in § 144.054.2). Or, alternatively, when was the last time MasterCard used "coal" to fire one of its call centers. § 144.054.2.

Of course, these are not the only words or terms used in § 144.054.2, but they are some of those surrounding the terms "manufacturing, processing, compounding, mining, or producing of any product." And a word or term is known – under "the principle of statutory construction known as *noscitur a sociis*" – by "the company it keeps." *Union Elec. Co. v. Dir. of Revenue*, 425 S.W.3d 118, 122 (Mo. 2014).

These words or terms certainly give meaning to "manufacturing" in § 144.054, which by very definition carries an industrial connotation:

- 1: to make (as raw material) into a product suitable for use ... 2a: to make from raw materials by hand or by machinery ... 2b: to produce according to an organized plan and with division of labor. *Webster's Third New International Dictionary* 1378 (1993).
- 1. a. To make or process (a raw material) into a finished product, esp. by means of a large-scale industrial operation. b. To make or process (a product), esp. with the use of industrial machines. 2. To create, produce, or turn out in a mechanical manner. *The American Heritage Dictionary*, 2nd College Edition 764 (1991).

Quoted in Southwestern Bell Tel. Co. v. Dir. of Revenue, 182 S.W.3d 226, 238 (Mo. 2005) (Stith, J., dissenting).

The plain language of § 144.054.2 points to large-scale industrial "manufacturing," which the Commission concedes is not the case here. (LF 34). MasterCard's communication of financial transactions or information, therefore, does not "fit[] the statutory language exactly," and the

Commission's decision to refund use taxes should be reversed. *Cook Tractor Co., Inc.*, 187 S.W.3d at 872.

B. The Surrounding Statutory Provisions Confirm That § 144.054.2 Does Not Include Financial Institutions or Their Communications.

The absence of words or terms such as "financial institutions," "credit cards," "communications," "transactions," "transfer," "financial," or "information" in § 144.054 is not only significant on its own, but the General Assembly's intent is confirmed by the surrounding statutory provisions that repeatedly refer to these words or activities in other provisions and sections. For example, in the very next subsection of § 144.054, the General Assembly exempted "utilities, machinery, and equipment used or consumed in television or radio broadcasting." § 144.054.3.

Television and radio broadcasting, by their very nature, involve the gathering of information and communication to others. No doubt, television and radio broadcasters think of their communications as "product" – in the most generic sense. *See, e.g.,* http://arbradio.com/ (referring to the "production" of video and television for The Academy of Radio and Television Broadcasting). But if communications or the transfer of information were already considered the manufacturing of a product under § 144.054.2, then

why would the General Assembly include television and radio broadcasting in the very next subsection?

Furthermore, note the absence of items such as "propane," "coal," and "chemicals," from the list of exempt items for television or radio broadcasting in § 144.054.3. These items – "propane," "coal," and "chemicals" – are used in a classic industrial setting and are therefore listed in § 144.054.2. But they would not be used by television or radio broadcasting, just as they would not be used by a credit card company communicating financial transactions or information. Instead, the term "utilities" is used in § 144.054.3 for television or radio broadcasting, which is exactly what a television or radio broadcasting station would use (as well as an office communicating credit card transactions and information).

What is more, there are several other sections that give significant insight into the General Assembly's intent:

- § 144.010.1(14) defines telecommunication services as "the *transmission of information* by wire, radio, optical cable, coaxial cable, electronic impulses, or other similar means";
- § 144.030.2(9) specifically exempts "computers" and "equipment" "used in producing newspapers

published for *dissemination of news* to the general public";

- § 144.087.3 refers to "financial institution";
- § 144.100 refers to "transactions" and "credit card[s]"; and
- Chapter 148, which is dedicated entirely to "Taxation of Financial Institutions," includes sales and use tax exemptions.

(Emphasis added). The General Assembly knows how to use, and distinguish between, financial and communication terms and activities on the one hand and large-scale industrial-type activities on the other.

Furthermore, § 148.030 – which falls under the chapter for "Taxation of Financial Institutions" – is particularly instructive. In this subsection, the General Assembly specifically provides tax credits for "[e]very banking institution," and includes "state and local sales and use taxes paid to seller's, vendors, or the state of Missouri with respect to the taxpayer's purchases of tangible personal property and the services enumerated in chapter 144." § 148.030.3. As such, banking institutions receive credits for the purchase of tangible personal property like computer hardware. Credit card companies do not. Had the General Assembly intended to exempt credit card companies

from sales and use tax on the purchase of tangible personal property and services, it certainly knows how to do so.

Sections 144.010.1(14), 144.030.2(9), 144.087.3, 144.100, 148.030, and Chapter 148 all demonstrate that the General Assembly routinely uses words or terms such "financial institutions," "credit cards," "communications," "transactions," "transfer," "financial," or "information." More importantly, these provisions demonstrate that the General Assembly uses such words or terms in relation to financial institutions and exempt purchases of tangible personal property and services. No such words or terms, however, appear in § 144.054.2. And their absence is dispositive, *see Aquila*, 362 S.W.3d at 5, particularly given that "[e]xemptions from taxation are to be strictly construed against the taxpayer, and any doubt is resolved in favor of application of the tax," *Southwestern Bell Tel. Co. v. Dir. of Revenue*, 182 S.W.3d 226, 228 (Mo. 2005).

C. The Commission's Broad Interpretation Produces Absurd and Illogical Results.

In addition to the plain language, context, and statutory structure applicable to § 144.054.2, courts also look at the potential consequences of the proposed interpretation. Thus, for example, if the proposed interpretation produces an absurd or illogical result the court will not adopt that interpretation or meaning. *See Akins*, 303 S.W.3d at 565 ("A court will look

beyond the plain meaning of the statute only when the language is ambiguous or would lead to an absurd or illogical result.") (citing *Spradlin v. City of Fulton*, 982 S.W.2d 255, 258 (Mo. 1998)).

If MasterCard's activities – the communication of financial transactions or information – constituted the manufacturing of tens of millions of products each day then there would be virtually no limitation on the tax exemption for manufacturing in § 144.054.2. Take, for example, a lawyer or law firm. Lawyers or law firms regularly gather information and communicate that information to clients both by phone and electronically through computer hardware. There is a ready market for legal work and lawyers produce written "work *product*" for clients, and lots of it. Thus, under the Commission's interpretation of § 144.054.2, lawyers and law firms could be viewed as manufacturing a product and thereby all of their computers and related items used for communicating and transferring information could be purchased tax free.[2/]

[2/] As an interesting aside, adopting the Commission's interpretation would mean that nearly every business could purchase computers and related items (and much more) tax free at any time regardless of whether their business or activities were contemplated or referenced in the sales and use tax exemptions. At the same time, however, students – who *are* specifically

But that is not all. Not only would lawyers and law firms be free of taxes for computers and related equipment, they would be equally free from taxes on all "electrical energy and gas, whether natural, artificial, or propane, water, coal, and energy sources, chemicals, machinery, equipment, and materials." § 144.054.2. The potential impact is staggering considering the thousands of businesses that could claim an exemption under such an interpretation. Indeed, at this very moment there are millions of dollars in tax refund claims awaiting the resolution of this case. *See, e.g., Dell Marketing, LP v. Dir. of Revenue*, 12-0029 RS (located at http://ahc.mo.gov/); *Sun Microsystems, Inc. & Oracle America, Inc. v. Dir. of Revenue*, 12-0040 RS (same); *UMB Bank, NA v. Dir. of Revenue*, 14-0198 RS (same). These cases include banks such as UMB and financial institutions such as Edward Jones. If the communication of financial transactions and information is covered under § 144.054.2, then all banks and financial institutions could have much of their purchases tax free. This cannot be.

Attempts by IBM and the Commission to water down the statutory terms in § 144.054.2 fails to account for the most basic rule for tax exemptions – that tax exemptions are subject to strict construction against

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covered by a tax exemption – could still only purchase computers and related items during a short three-day window each year. § 144.049.2.

the taxpayer. *Armco, Inc.*, 787 S.W.2d at 724. Thus, if there is any doubt as to whether communicating financial transactions or information is the manufacturing of tens of millions of products, then the terms should not be interpreted that broadly. Doubt as to the expansive construction of these terms is more than obvious in this case.

D. This Court's Recent Decisions Interpreting § 144.054.2 Should be Followed.

A source of anxiety for the Commission appears to be the perceived tension between two lines of cases. The first line, interpreting § 144.030, begins in 1990 with the decision in *Bridge Data Co. v. Dir. of Revenue,* 794 S.W.2d 204 (Mo. 1990) and ends in 2005 with *Southwestern Bell Tel. Co. v. Dir. of Revenue*, 182 S.W.3d 226 (Mo. 2005). The more recent line of cases begins with *Brinker Missouri, Inc. v. Dir. of Revenue*, 319 S.W.3d 433 (Mo. 2010) and ends with several cases actually interpreting the very provision at issue in this case – § 144.054.2. The most recent cases, in fact, were decided just this year. *See Ben Hur Steel Worx, LLC v. Dir. of Revenue*, 452 S.W.3d 624 (Mo. 2015), and *Fred Weber, Inc. v. Dir. of Revenue*, 452 S.W.3d 628 (Mo. 2015). And it is worth reviewing both lines of cases.

The Commission, for its part, begins by asking the "threshold question" of "whether the facts in this case are substantially similar to those in ***Bridge Data***," among other cases. (LF 32 (emphasis in original)). Actually, the

decision in *Bridge Data* was abrogated by this Court in *Int'l Bus. Machs. Corp. v. Dir. of Revenue*, 958 S.W.2d 554, 559 (Mo. 1997), which concluded that the opinion in *Bridge Data* had "little analysis of the statutory language, and no analysis of the critical phrase." *Id.* Thus, it seems a rather odd authority for the Commission to begin its dispositive analysis.

And this Court's criticism of *Bridge Data* was not finished with the recognition of "little analysis" in the opinion. "In fact, *Bridge Data* is founded on the premise that this Court's function is to update the sales tax laws." *Id.* at 559 (quoting *Bridge Data* as stating that the "recognition of the manufacturing exemption represents a reasonable adoption of the statutes to processes which were not known or hardly known, at the time they were enacted"). This premise was expressly rejected, with this Court holding that "[t]o the contrary, sales tax is purely a matter of statute and within the power of the legislature, subject to constitutional limits. This Court has no authority to amend the sales tax laws in order to update them." *Id.* at 559 (internal citation omitted).

The next case the Commission relies on is *Concord Publ'g*, and it is also of no help. In *Concord Publ'g*, the Court considered the use of computers in the manufacturing of newspapers. The Court held that "computers are as

essential to the printing of the paper as the printing presses themselves."[3/] *Concord Publ'g House, Inc. v. Dir. of Revenue*, 916 S.W.2d 186, 192 (Mo. 1996). What the Court really recognized in *Concord Publ'g* was that collecting information on a computer and transmitting that information was part of a larger process of manufacturing a newspaper. *Id.* at 191 ("We hold that the computers in the present case were used in 'manufacturing' a newspaper."). Yet, this was the first case in which the Court stated "[w]e have already established that organizing information through computer technology is 'manufacturing.'" *Id.* Ironically, as the only support for this proposition the Court in *Concord Publ'g* cites *Bridge Data*, which would be criticized and abrogated the very next year.

[3/] The exemption at issue in *Concord Publ'g* originally only covered "Newsprint used in newspapers published for dissemination of news to the general public." § 144.030.1(8), RSMo (1996). Following *Concord Publ'g*, and presumably in an effort to codify the Court's decision, the exemption was expanded in 1998 to cover "Newsprint, ink, computers, photosensitive paper and film, toner, printing plates and other machinery, equipment, replacement parts and supplies used in producing newspapers published for dissemination of news to the general public." § 144.030.1(8), RSMo (2000).

In *DST Sys., Inc. v. Dir. of Revenue*, 43 S.W.3d 799 (Mo. 2001), the Court repeated the statement from *Concord Publ'g* regarding organizing information through computer technology. But like the company in *Concord Publ'g*, DST was not merely organizing information through computer technology. Instead, the company was using mainframe computers and other materials to print a variety of materials on a large scale (indeed, on an industrial scale) – literally tens of millions of packages each year. That constituted the manufacturing of a product. *Id.* at 801.

Then came the two *Southwestern Bell* cases, both analyzed under § 144.030. Unmoored from the concept of industrial manufacturing, the Court held that the reproduction of the human voice through telephone wires constituted the manufacturing of a product. *See Southwestern Bell Tel. Co. v. Dir. of Revenue*, 78 S.W.3d 763 (Mo. 2002); and *Southwestern Bell Tel. Co. v. Dir. of Revenue*, 182 S.W.3d 226 (Mo. 2005). Pushed to the brink of unrecognizability as a manufacturing exemption, Judge Stith dissented in the second of the *Southwestern Bell* cases, and noted that the Court had "unintentionally [given] the word a meaning beyond its dictionary meaning and inconsistent with the intent of the legislature as expressed in the taxing statutes themselves." *Southwestern Bell*, 182 S.W.3d at 238 (Stith, J., dissenting).

Judge Stith rightfully returned to the dictionary definition of manufacturing, stating:

> To "manufacture" is variously described as, "1: to make (as raw material) into a product suitable for use ... 2a: to make from raw materials by hand or by machinery ... 2b: to produce according to an organized plan and with division of labor." *Webster's Third New International Dictionary* 1378 (1993). It is similarly defined as, "1. a. To make or process (a raw material) into a finished product, esp. by means of a large-scale industrial operation. b. To make or process (a product), esp. with the use of industrial machines. 2. To create, produce, or turn out in a mechanical manner." *The American Heritage Dictionary*, 2nd College Edition 764 (1991).

Southwestern Bell, 182 S.W.3d at 238 (Stith, J., dissenting).

This brings us to the more recent decisions of this Court on the scope of the manufacturing exemptions, and in particular § 144.054.2. Beginning in *Brinker Mo., Inc. v. Dir. of Revenue*, 319 S.W.3d 433, 438 (Mo. 2010), the Court has quite sensibly required (consistent with the plain language of the statute as strictly construed) that in order to establish the manufacturing tax

exemptions, the activities must have an industrial nature. Thus, although restaurants certainly make food, and lots of it, they are not manufacturers of food products as contemplated by the General Assembly in § 144.030. *Id.* at 436-37.

Likewise, convenience stores that make pizzas and donuts are not manufacturers or processors of products under § 144.054.2. *See Aquila Foreign Qualifications Corp. v. Dir. of Revenue*, 362 S.W.3d 1, 5 (Mo. 2012) (noting that the General Assembly "chose industrial-type terms such as 'manufacturing,' 'processing,' 'compounding,' 'mining,' or 'producing'"). Nor are grocery store bakery departments, *see Union Elec. Co. v. Dir. of Revenue*, 425 S.W.3d 118 (Mo. 2014), or construction companies under § 144.054.2, *see Ben Hur Steel Worx, LLC v. Dir. of Revenue*, 452 S.W.3d 624 (Mo. 2015), and *Fred Weber, Inc. v. Dir. of Revenue*, 452 S.W.3d 628 (Mo. 2015). A "manufacturer" entitled to an exemption under § 144.054 must really be a manufacturer, and not merely a company that makes something, or in this case a company that communicates something.

The Commission acknowledged in its decision that if these recent cases are followed then the refund should be denied because "none of [MasterCard's] activities have anything like an industrial connotation." (LF 34, Decision, p. 20). This is true, and is the outcome that should follow. MasterCard is not the manufacturer of a product under § 144.054.2. Missouri

citizens and taxpayers, applying common sense, would not conclude that MasterCard manufactures tens of millions of products each day by communicating financial transactions and information. It is inconsistent with the plain language of the statute, the surrounding statutory provisions, caselaw, and would produce absurd and illogical results. As such, the Commission's decision refunding use tax collected on the sale of computer hardware to MasterCard should be reversed.

II. The Commission Erred in Refunding Use Taxes Collected on the Sale of Computer Hardware to MasterCard, Because § 144.054.2 is Applicable to Manufacturing or Industrial-Type Activities Not Credit Card Companies, In That the Statute Merely Expanded the Items Subject to Exemption, Not the Type of Activities.

Implicit in the arguments of IBM and the decision of the Commission is the suggestion that the General Assembly's combining of the litany of "manufacturing, processing, compounding, mining, or producing" in § 144.054.2 with the general statement that "organizing information through computer technology is 'manufacturing,'" *Concord Publ'g*, 916 S.W.2d at 191, somehow results in an entirely different – and much broader – category of activities considered manufacturing.

The supposedly expanded "manufacturing" activities would include communicating financial transactions and information through computer technology. This is not the case, nor is it the purpose of the additional manufacturing exemption in § 144.054.2. Instead, § 144.054.2 expands the items subject to exemption, not the type of manufacturing activities.

A. Applying § 144.054.2 to Activities Other than Manufacturing is Contrary to the Express Intent of the General Assembly.

The General Assembly's use of the words "manufacturing, processing, compounding, mining, or producing" with the statutory definition of "processing" must be understood as an effort to circumscribe the activities exempted by § 144.054.2. This is especially true given that the words and definition enacted by the General Assembly in § 144.054.2 already had substantial legislative and judicial meaning attached to them from their use in the other manufacturing exemptions. *See Cook Tractor Co., Inc. v. Dir. of Revenue*, 187 S.W.3d 870, 873 (Mo. 2006). Rather than expanding the range of activities exempt as manufacturing, § 144.054.2 was designed to expand

the number of items exempt (*e.g.*, electrical energy) for those engaged in manufacturing a product on an industrial scale.[4/]

Examining the language of § 144.054.2 (and § 144.030.2, for that matter) establishes that the General Assembly did not intend for the exemption to apply to non-manufacturing activities like financial transactions and communications. Otherwise, as set forth above, the General Assembly would have included those terms. Instead, § 144.054.2, in relevant part, provides an exemption only for "manufacturing, processing, compounding, mining, or producing." This language is unquestionably drawn directly from § 144.030.2(13), and the same type of activities are exempt under § 144.030.2.[5/] *See E & B Granite*, 331 S.W.3d at 317 (noting that both

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[4/] This is not to say that § 144.054 only concerns manufacturing. In other parts of subsections 2-4 of § 144.054, exemptions are expressly provided for activities other than manufacturing (*e.g.*, television or radio broadcasting). These activities are not at issue here.

[5/] It would be more plausible to assert that the General Assembly intended fewer types of activities to be exempted by § 144.054.2 than are exempted by subdivisions (2), (5), (6), and (14) of § 144.030.2 because these latter subdivisions include the term "fabricating," which was left out of § 144.054.2.

§ 144.054.2 and § 144.030.2(2) "relate to sales and use tax exemptions for manufacturers").

The Court in *Aquila*, 362 S.W.3d at 5, concluded that if the General Assembly had intended to exempt new activities in § 144.054.2, other than those previously exempted by § 144.030.2(13), it should have used more appropriate words to express its intent. *Id.* Given the General Assembly's devotion of an entire chapter to "Taxation of Financial Institutions" as well as words or terms that are more apt to the activities in this case, it is clear that the General Assembly did not intend to expand the manufacturing exemptions to the communication of financial transactions and information.

And it is not for any court to expand or adapt tax exemptions. As the Court made clear in *Int'l Bus. Machs. Corp. v. Dir. of Revenue,* 958 S.W.2d at 559, "[t]his Court has no authority to amend the sales tax laws in order to update them."

B. Communicating Financial Transactions or Information is Not the Type of Industrial Activity Ordinarily Associated with Manufacturing.

As previously discussed, §§ 144.010.1(14), 144.087.3, and 144.100, as well as Chapter 148, demonstrate that the General Assembly, consistent with common usage, distinguishes between manufacturing and financial institutions, transactions, and communications. The fact that there is an

entire chapter devoted to taxes for financial institutions, including exemptions, reflects the common understanding that manufacturing and the communication of financial transactions and information must be different.

Communication of financial transactions and information by a credit card company is no more associated with industrial manufacturing than is food preparation in a restaurant. The use of words such as manufacturing, processing, compounding, mining, and producing in § 144.054.2 conjures up images of manufacturing facilities producing various items by means of mass production rather than computers merely transferring information. Similarly, the activities in this case do not produce the type of end result ordinarily associated with manufacturing.

CONCLUSION

For the foregoing reasons, the Court should reverse the decision of the Administrative Hearing Commission with respect to the refund of use taxes on the purchase of computer hardware.

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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 system on the 2nd day of September, 2015, 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 7,601 words.

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