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

REPLY BRIEF OF APPELLANT/CROSS-RESPONDENT DIRECTOR OF REVENUE

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It appears that we have arrived at the absurd; according to IBM, "a 'yes' or 'no' answer" to a credit card transaction "produces a new product." Respondent's Brief, p. 6. Under such an expansive interpretation of the manufacturing exemption in § 144.054.2, RSMo,[1/] there is no business interaction that would not constitute the manufacturing of a product. Indeed, any business or person that uses even a single computer (or a phone for that matter) to collect, organize, or communicate any information would be a manufacturer of a product, with the attendant right to tax-free "electrical energy and gas . . . water, coal, and energy sources, chemicals, machinery, equipment, and materials." § 144.054.2.

This Court has repeatedly held that "[c]onstruction of statutes should avoid unreasonable or absurd results." *See Reichert v. Bd. of Educ. of City of St. Louis,* 217 S.W.3d 301, 305 (Mo. 2007). IBM's interpretation – and the Commission's decision – would produce just such an unreasonable or absurd result. But that is not all. IBM's interpretation of the manufacturing of a product under § 144.054.2 is inconsistent with the language of the statute, the surrounding statutory provisions, and case law. Indeed, why should the

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

communication of financial transactions be forced into a manufacturing exemption when there is an entire chapter of the Revised Statutes of Missouri (Chapter 148) devoted to financial institutions, including sales and use tax exemptions. Furthermore, the General Assembly recently passed sales and use tax exemptions for data storage centers, including "data processing, hosting, and related services." § 144.810, RSMo (2015 Supp.).

Communicating financial transactions, as in this case, does not fit the statutory exemption exactly in § 144.054.2 for the manufacturing of a product. As such, the Commission erred in granting an exemption and the decision should be reversed.

ARGUMENT

It bears repeating that an exemption such as the one sought in this case is "strictly construed against the taxpayer," *Branson Properties USA, L.P. v. Dir. of Revenue*, 110 S.W.3d 824, 825 (Mo. 2003), and 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).[2/] IBM has failed in its burden to show that the communication of financial transactions fits exactly the manufacturing exemption in § 144.054.2.

IBM has also dropped its cross-appeal, having raised no argument on the matter in its Respondent's brief. *See White v. Robertson-Drago Funeral*

[2/] This is particularly important since IBM suggests that "this Court has interpreted the term [manufacturing] 'liberally.' " Respondent's Brief, p. 12 (citing *Concord Publishing House v. Dir. of Revenue*, 916 S.W.2d 186, 191 n.5 (Mo. banc 1996)). Not so. IBM's citation to a footnote in *Concord Publ'g House* is misplaced. The Court in *Concord Publ'g House* did not construe the term "manufacturing" liberally but instead merely stated that this Court had "recently construed 'manufacturing' more liberally" than "cases from other jurisdictions." *Id.*

Home, Inc., 552 S.W.2d 47, 49 (Mo. App. S.D. 1977) (having failed to raise the cross-appeal in the brief it is abandoned and should be dismissed).

Communicating Financial Transactions and Information is Not the Manufacturing of a Product Under § 144.054.2.

In *Int'l Bus. Machs. Corp. v. Dir. of Revenue*, 958 S.W.2d 554, 559 (Mo. 1997), this Court made an important point for purposes of analyzing this case. It noted that the decision in "*Bridge Data* is founded on the premise that this Court's function is to update the sales tax laws." *Id.* at 559. "To 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).

Here, IBM is seeking to update the sales tax laws to make the communication and transfer of credit card transactions – with as little as electronically saying "yes" or "no" to the transactions – into the manufacturing of a product. Never before has this Court adopted such an expansive interpretation, one that certainly does not comport with a strict construction of the statutory exemption. The statutory language, after all, does not include words or terms such as "data processing," "financial institutions," "credit cards," "communications," "transactions," or "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.

What is more, it is the General Assembly that must update the law, not the Commission or the courts. There is no doubt the General Assembly knows how to do so. Indeed, there is an entire chapter of the Revised Statutes of Missouri (Chapter 148) devoted to "Taxation of Financial Institutions," including sales and use tax exemptions. And the best example of such an effort is a recent statute that IBM references in its brief – § 144.810, RSMo (2015 Supp.). In this new section, the General Assembly passed a law giving virtually the same exemptions as provided in § 144.054.2 (*i.e.* electrical energy, gas, water, machinery, equipment, and computers) to certain data storage centers. *Compare* § 144.054.2 *with* § 144.810.2(1)-(3), RSMo (2015 Supp.).

Not surprisingly, the General Assembly in § 144.810.1 used such terms as "[d]ata processing, hosting, and related services" to define the kind of activities and locations subject to the new exemption for data centers.[3/] The

[3/] This also undermines IBM's suggestion that "[u]sing warehoused transaction data" is somehow manufacturing. Respondent's Brief, p. 9. It would make little sense to add this exemption if data processing, hosting, and related services were already manufacturing.

General Assembly even recognized "computers" as an exempt item for qualified data storage centers. *See* § 144.810.2(2), RSMo (2015 Supp.). Thus, the General Assembly knows how to update the sale tax laws without requiring the Director, the Commission, or this Court to fit a square peg into a round hole.

IBM dismisses the potential consequences of adopting its expansive interpretation of the manufacturing exemption in § 144.054.2. The Director, for example, suggested in her opening brief that the work of lawyers would constitute the manufacturing of a product under IBM's approach. But according to IBM, lawyers only communicate information, they do not process the information into an entirely new product. Respondent's Brief, p. 22. That is hardly the case.

Every day, lawyers receive information from their clients, through research, and from investigations. Then, in the most generic sense, lawyers "process" the information (almost exclusively on computers) and "produce" a variety of "new products" – contracts, memos, pleadings, etc. And it is not just "small-scale one-of-a-kind" transactions. Respondent's Brief, p. 22. Lawyers are routinely involved in large projects where they are reviewing hundreds or thousands of pages of material and information and making basic "yes" and "no" decisions as well as "producing" complex outputs.

The line of cases beginning with *Bridge Data Co. v. Dir. of Revenue,* 794 S.W.2d 204 (Mo. 1990) and ending with *Southwestern Bell Tel. Co. v. Dir. of Revenue*, 182 S.W.3d 226 (Mo. 2005) brought the Court to the brink of the unreasonable and absurd. *See Southwestern Bell Tel. Co.*, 182 S.W.3d at 239 (J. Stith dissenting) (noting the slide down the "slippery slope"). Although these cases are not on point, as IBM argues, this case should stop the slide into applying manufacturing exemptions to any transmission of information or financial transactions by a business, just as this Court's decisions appropriately did for other types of non-manufacturing activities. *See, e.g., 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).

A "manufacturer" entitled to an exemption under § 144.054.2 must really be a manufacturer, and not merely a company that performs a service, or in this case a company that communicates or transfers financial information. The plain language of § 144.054.2, the surrounding statutory provisions, and the case law points to large-scale industrial "manufacturing," which the Commission conceded is not the case here. (LF 34). MasterCard's communication of financial transactions or information does not "fit[] the statutory language exactly," and the Commission's decision to issue a refund of use taxes should be reversed. *Cook Tractor Co., Inc.*, 187 S.W.3d at 872.

CONCLUSION

For the foregoing reasons, as well as those set forth in the Director's opening brief, 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.

Respectfully submitted,

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CERTIFICATE OF SERVICE AND COMPLIANCE

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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 1,645 words.

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