SC95029

IN THE SUPREME COURT OF MISSOURI

OFFICE DEPOT, INC.,

Respondent,

v.

DIRECTOR OF REVENUE,
Appellant.

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

BRIEF OF APPELLANT

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JURISDICTIONAL STATEMENT

This case came before the Administrative Hearing Commission ("Commission") on a complaint filed by Office Depot, Inc. ("Office Depot") seeking a refund of use tax it paid on product catalogs and advertising materials that were mailed to Office Depot customers in Missouri. The question posed by this petition is whether Office Depot "uses" those items in Missouri, under the definition of "use" in § 144.605(13)[1]. To answer that question will require the construction of that revenue law. Thus the petition is appropriately filed in this Court. Mo. Const. Art. V, § 3; § 621.189.

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

STATEMENT OF FACTS

Office Depot, Inc., sells office products and services in 25 retail stores in Missouri. App. A4. It uses product catalogs and other printed materials to advertise its products to Missouri customers. *Id.*

Rather than print and mail the catalogs and advertising materials itself, Office Depot contracts with R.R. Donnelley and Sons Co. to perform those tasks. *Id.* Although R.R. Donnelley had a printing business in Jefferson City, Mo., the printing for Office Depot was done in another state. *Id.*

R.R. Donnelly used paper that Office Depot purchased—again, outside of Missouri—and had it delivered to R.R. Donnelley's facilities. *Id.* at A5. The paper, with the printing complete, was then mailed by R.R. Donnelley to Missouri addresses specified by Office Depot. *Id.*

During the period at issue here, Office Depot paid $749,739.57 for the paper, and $652,500.83 for printing and mailing. *Id.* Office Depot paid $83,954.43 in use tax based on its total costs. *Id.* Office Depot then asked the Director of Revenue for a refund of the entire amount. *Id.* The Director denied that request, and Office Depot timely filed an appeal with the Administrative Hearing Commission. *Id.*

On April 30, 2015, the Commission found that Office Depot was entitled to the full refund. *Id.* at A10. On May 29, 2015, the Director petitioned this Court for review.

POINT RELIED ON

The Administrative Hearing Commission erred in ordering a refund of use tax, because Office Depot exercised a right or power of ownership or control in Missouri over the paper and the printed product in that Office Depot controlled delivery of the product to its Missouri customer.

Southwestern Bell Yellow Pages, Inc. v. Dir. of Revenue,

94 S.W.3d 388 (Mo. 2012)

§ 144.605(13)

ARGUMENT

1. The statute imposes use tax on tangible property that comes into the state when the taxpayer exercises "any right and power" of "ownership or control over it."

The use tax statute has two functional parts. One levies a tax on the privilege of "using" goods in Missouri:

> 144.610. 1. A tax is imposed for the privilege of storing, using or consuming within this state any article of tangible personal property….

The other defines—very broadly—"using," or more precisely, "use":

> 144.605(13) "Use", the exercise of any right or power over tangible personal property incident to the ownership or control of that property, except that it does not include the temporary storage of property in this state for subsequent use outside the state, or the sale of the property in the regular course of business;

We have, then, a statute:

- that broadly imposes a use tax when the taxpayer exercises "any right or power over tangible personal property incident to the ownership or control of that property";

- which tax "eliminates the incentive to purchase from out-of-state merchants in order to escape local sales taxes thereby keeping in-state merchants competitive with sellers in other states, and it also provides a means to augment state revenues."

Fall Creek Const. Co., Inc. v. Dir. of Revenue, 109 S.W.3d 165, 169 (Mo. 2003).

Here, the ultimate question under the statute is whether Office Depot "exercise[d] any right or power over" the catalogs that it caused to be printed and delivered to addresses in Missouri. If Office Depot exercised the same "right or power over" these catalogs and advertising materials as it would have had in a transaction with a Missouri printer (and thus subject to Missouri sales tax), then the use tax applies. Because Office Depot had such "right or power"—whether of "ownership or control"—it was required to pay the use tax, and is not entitled to the refund ordered by the Administrative Hearing Commission.

2. This Court addressed very similar situations in *May Dep't Stores* and *Southwestern Bell Yellow Pages*—and courts in other states did so between this Court's decisions.

This Court considered a similar circumstance in *May Dep't Stores Co. v. Dir. of Revenue*, 748 S.W.2d 174 (Mo. 1988). There, curiously, the Court answered the question without even citing the broad definition of "use" in § 144.605(13), and giving only the briefest reference to the facts. That case involved "catalogs describing [the taxpayer's] merchandise to be printed in Illinois." *Id.* at 175. The taxpayer "supplie[d] mailing labels to the printer, who mail[ed] the printed catalogs directly to the addresses." *Id.* The Court found that the taxpayer did "not engage in the 'storage, use or consumption' of the catalogs in Missouri." *Id.*

The Court did not fully explain its conclusion. It came closest with this statement: "It [May Dept. Stores] cannot be said to store, use or consume the catalogs in Missouri by giving directions which are executed outside the state." *Id.* Someone, of course, "used" the catalogs in Missouri. The Court's reference to "directions executed outside the state" suggests that the Court concluded that the fact that the U.S. Postal Service (presumably the carrier when the catalogs were "mailed") delivered the catalogs was enough to mean that the company that developed the content and ordered the printing of the catalogs and specified the means and destination for delivery was not itself

"using"—*i.e.*, not "exercising a right or power incident to ownership or control over"— the catalogs in the state, despite the sales that company presumably derived or expected to derive from that delivery.

This Court's *May Dep't Stores* decision was criticized elsewhere. The Tax Court of New Jersey rejected this Court's "narrow view." *Comfortably Yours, Inc. v. Dir., Div. of Taxation*, 12 N.J. Tax 570 (N.J. Tax 1992). That court quoted the Idaho Supreme Court's conclusion that K mart's newspaper inserts, like catalogs, were created and delivered "for the purpose of making sales and profits." *K Mart Corp. v. Idaho State Tax Comm'n*, 727 P.2d 1147, 1149 (Idaho 1986), quoted with approval, 12 N.J. Tax at 577. And it quoted the Tennessee Supreme Court's conclusion that as to catalogs, "[t]he taxable privilege of use extends to the utilization of property for profit-making purposes." *J.C. Penney Co., Inc. v. Olsen*, 796 S.W.2d 943, 946 (Tenn. 1990), quoted with approval, 12 N.J. Tax at 577.

The New Jersey court expressly rejected the idea, which it derived from *May Dep't Stores*, though this Court did not say the words, that there must be either "physical possession of the promotional materials (catalogs, newspaper inserts or similar advertising matter) in the taxing state" or the "exercise[of] power and control over the materials through contracts with in-state newspapers or direct mail houses." 12 N.J. Tax at 577. As that court explained, adopting the "narrow" rule used in *May Dep't Stores* would,

contrary to the purpose of a use tax, "place printing firms located in New Jersey at a competitive disadvantage, as those firms would be required to collect sales tax on the sale of the catalogs to this New Jersey plaintiff." *Id.*

The Arizona Court of Appeals followed *Comfortably Yours* in rejecting this Court's "narrow" reading of "use" in *May Dep't Stores*. The Arizona case also involved catalogs printed out-of-state. *Service Merch. Co., Inc. v. Arizona Dep't of Revenue*, 937 P.2d 336, 337 (Ariz. 1996). The printers affixed address labels from the Service Merchandise mailing list, then turned over the catalogs to common carriers for shipping to the main United States Postal Service office in Phoenix, or delivered them to the Postal Service directly for mailing to Arizona homes. *Id.* at 338. Service Merchandise, like May Department Stores, Comfortably Yours, and Office Depot, claimed that because the movement of the catalogs into the state and their delivery was done not by the taxpayer but by common carriers, the taxpayer did not "use" the catalogs in Arizona. *Id.* The Arizona court rejected that claim.

Placing its claim within the facts as described by this Court in *May Dep't Stores* (taxpayer's acts were "giving directions which are executed outside the state, 748 S.W.2d at 175)), Service Merchandise conceded that "it exercised rights incidental to ownership while the catalogs were *outside* Arizona," but "denie[d] that it exercised such rights in Arizona." 937 P.2d at 338. The court found, to the contrary, that "the rights to control when, where,

how, to whom and whether the catalogs would be delivered were exercised in Arizona through Service Merchandise's agents." *Id.* As the court pointed out, "distribution is a right incidental to ownership." *Id.* at 339. By contrast, "[a] non-owner could not decide to send the materials to particular customers. Nor could a non-owner decide to relinquish title to the materials by giving them to the potential customers." *Id.* Thus, the court concluded that the taxpayer "'used' the catalogs in Arizona"—consistent with "[c]ourts from other jurisdictions [that had] held that distribution of catalogs and fliers is an act incidental to ownership" (*id.*), but contrary to the conclusion this Court reached in *May Dep't Stores*.[2]

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[2] One portion of the *Serv. Merch.* opinion that does not directly address the *May Dep't Stores* holding is worth noting. The Arizona court points out that prior to May 1988—*i.e.*, when this Court decided *May Dep't Stores* in March 1988—there was some question about the extent to which the U.S. Constitution would permit use tax to be imposed in the circumstances of catalog delivery. *See*, *Serv. Merch.*, 937 P.2d at 340-341. But that "Commerce Clause question [was] answered by the United State Supreme Court's decision in *D.H. Holmes Co. Ltd. v. McNamara*, 486 U.S. 24 (1988)." 937 P.2d at 340. That the constitutional question was before the U.S. Supreme Court at the moment *May Dep't Stores* was decided could have been an unexpressed

Two years later, the Nebraska Supreme Court faced a similar situation in *J.C. Penney Co. v. Balka*, 577 N.W.2d 283 (Neb. 1998).[3] The case involved J.C. Penney catalogs that were printed in other states by R.R. Donnelley & Sons. *Id.* at 284. Not only was the printer the same one involved here, but what J.C. Penney had R.R. Donnelly do was what Office Depot had R.R. Donnelley do:

> [J.C. Penney] supplied the paper, shipping wrappers, and address labels for the catalogs, and R.R. Donnelly provided the ink and binding materials. [J.C. Penney] paid for the production, preparation, fabrication, printing, imprinting, and binding of catalogs that were delivered to Nebraska customers. … [J.C. Penney] determined, at its New York office, how these catalogs were to be shipped.

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motivation for applying the Missouri law so as to avoid having to tackle the federal constitutional question.

[3] The Nebraska Supreme Court had faced a similar situation in *Val-Pak of Omaha, Inc. v. Dep't of Revenue*, 545 N.W.2d 447 (Neb. 1996). There, the court reached a decision consistent with *J.C. Penney*, but did so in large part by relying on a regulation relating to advertising expenditures that has no direct Missouri counterpart.

Id. The catalogs were sent various ways:

> [T]o a common carrier in Warsaw, Indiana, which then transported them to U.S. Post Office facilities in Nebraska … [or] via third-class mail directly to Nebraska addresses.

Id. at 285. The Court found that the acts of J.C. Penney were sufficient to constitute "use" under the statute, despite delivery via common carrier:

> Here, as part of its business of selling products in Nebraska, J.C. Penney placed its catalogs in the stream of commerce and directed to whom they were to be delivered …. Under those circumstances, we must conclude that J.C. Penney exercised in Nebraska a right or power over the catalogs it caused to be prepared and owned. It therefore used the catalogs in Nebraska, as the term "use" is defined ….

Id. at 286.

This Court returned to the field fourteen years later, in *Southwestern Bell Yellow Pages, Inc. v. Dir. of Revenue*, 94 S.W.3d 388 (Mo. 2002). As in *May Dep't Stores*, the taxpayer hired a printer to

> print, and bind the paper into directories. The printer shipped the directories to a Missouri independent

> contractor, employed by and under the direction of Southwestern Bell, to distribute the yellow page directories.

Id. at 389. But among the facts recited by this Court was one that did not appear in the facts recited in *May Dep't Stores*: the purchase of the paper by the taxpayer. "To produce the directories, Southwestern Bell purchased rolls of blank paper stock from various paper mills located outside of Missouri for delivery to a printer also located outside Missouri." *Id.* Nonetheless, Southwestern Bell claimed that it did "not owe use tax on the paper purchased outside the state because the paper was consumed and transformed into the yellow page directories and thus never 'used' in Missouri as contemplated by section 144.610, RSMo 2000." *Id.* at 390.

This Court rejected that claim, instead pointing out—in language as broad as that used for the opposing conclusion in *May Dep't Stores*—that "[t]here [was] no question that Southwestern Bell actually used the paper within the state of Missouri." *Id.* at 391. This time, the Court relied directly on the words of the statute, *i.e.*, on the definition of "use" as including "the exercise of any right or power over tangible personal property incident to the ownership or control of that property." *See id.* at 391-392. The Court had little trouble finding that

> Southwestern Bell exercised rights over the raw paper, incident to its ownership thereof, when it … purchased the raw yellow paper, arranged for the printing and binding of the yellow page directories, transported the directories into Missouri, and distributed the yellow page directories to Missouri residents and businesses

(*id.* at 392), even though the transportation and distribution was performed by third parties under contract.

We are left, then, with precedent from this Court holding that:

- When all acts in the state are the result of directions executed elsewhere, the taxpayer seeking the benefit of the deliveries does not "use" the material in this state—but without addressing how a taxpayer could contract for the printing and delivery of materials to specific Missouri residents and still not have "right or power over [that] tangible personal property."
- When the delivery includes paper that the taxpayer purchased out of state, on which

> someone out-of-state, under contract with the taxpayer, printed material, and someone else delivered the printed material as directed by the taxpayer, the paper is subject to use tax.

The Administrative Hearing Commission found that the facts here fit into the first mold, not the second. And because it is bound by this Court's precedent, that finding led to a decision in favor of the taxpayer.

3. This Court should apply the statute as it is written—and in doing so, reverse *May Dep't Stores*.

As discussed in (4) below, the AHC was wrong: it should have held for the Director based on the more recent and more pertinent authority, *Southwestern Bell Yellow Pages*. But instead of following that path, this Court should overrule *May Dep't Stores*. That decision cannot be reconciled with the language of the statute.

As noted above, under the statute the question is whether Office Depot "exercise[d] any right or power over" the printed materials "incident to the ownership or control" when it had them created out of state, but delivered to particular addresses in Missouri—"to existing Missouri customers with whom Office Depot has had a business relationship that was established by past dealings." App. A4. So phrased, the answer seems simple. The Commission's

findings uniformly demonstrate that Office Depot at least controls, if it does not actually own, the catalogs and advertising materials as they travel to the homes and businesses of Office Depot customers and prospective customers in Missouri:

- "Office Depot promotes and advertises its products and services to existing and potential customers in Missouri, in part, through a contract for the mailing of product catalogs and other advertising materials." App. A4.
- "Office Depot contracts … to print and mail its product catalogs and advertising materials … to Office Depot's existing customers in the state of Missouri…." App. A4.
- The "product catalogs and advertising materials [were] provided by Office Depot…." App. A4.
- "Office Depot provided specific addresses … in Missouri[] … and directed R.R. Donnelly to mail all of its product catalogs and advertising materials to those addresses." App. A5.

The Commission, despite those findings, made no effort to determine whether Office Depot owned or controlled the catalogs and advertising materials as they entered and were delivered in Missouri. Its analysis was short-circuited by *May Dep't Stores*. App. A8. But in *May Dep't Stores,* this Court did not mention, much less apply, the broad language of the statute—thus reaching a result that cannot be reconciled with that language, and that defeats the purpose of the use tax by giving an incentive to hire out-of-state printers in order to avoid paying sales tax.

This Court should reverse *May Dep't Stores* and insist that *the language of the statute* be used as the standard for determining whether use tax is owed. The question under the statute must always be whether the taxpayer "exercise[d] any right or power over tangible personal property incident to the ownership or control of that property." The Director and, on review, the Commission and then the appellate court, must look at the facts and answer that question.

Again, in *May Dept. Stores* this Court did not do that. Indeed, it seems to suggest that there is some kind of exception where the "tangible personal property" is brought into and delivered in Missouri pursuant to "directions

which are executed outside the state." 748 S.W.2d at 175.[4] But where does the statute say that if I cross a Mississippi River bridge into Illinois, cross State Law Road or drive on U.S. 54 into Kansas, or drive 10 miles north from Tarkio into Iowa, and only then make the calls or send the messages instructing my printer to deliver to Missouri addresses goods I own or control, I have somehow avoided exercising ownership or control so as to affect my use tax liability? The statute does not permit such a reading. And it is contrary to the purpose of the use tax.

Thus the Court should disavow the Commission's reading of the statute and overrule *May Dep't Stores*. In doing so, the Court would be following precedents that include *Southwestern Bell Yellow Pages*: overruling a "previous opinion [that] did not conform to the language of the statute nor the intent of the legislature." 94 S.W.3d at 392.

[4] As discussed in note 2, pending federal litigation suggests an explanation, not applicable by the time the Court heard *Southwestern Bell Yellow Pages*, for that approach.

4. In the alternative, the Court should distinguish *May Dep't Stores* from this case and follow *Southwestern Bell Yellow Pages* because of the express findings that Office Depot and Southwestern Bell purchased, and at least implicit findings that they continued to control, if not own, the paper used.

Curiously, the "previous opinion" overruled in *Southwestern Bell Yellow Pages* was not *May Dep't Stores*. Indeed, in *Southwestern Bell Yellow Pages* the Court did not even mention *May Dep't Stores*. Because the facts here are comparable to those in *Southwestern Bell Yellow Pages*, Office Depot should be required to pay the use tax even if the Court decides not to overrule *May Dep't Stores*.

The key fact that this case and *Southwestern Bell Yellow Pages* have in common, that is missing from the facts as recited in *May Dep't Stores*, is that the taxpayer—there, Southwestern Bell; here, Office Depot—bought the paper on which the catalogs and advertising materials were printed. 94 S.W.3d at 389 ("To produce the directories, Southwestern Bell purchased rolls of blank paper stock … for delivery to a printer …" "); App. A5 ("Office Depot purchased paper from outside of Missouri to use in the production of its product catalogs and advertising materials …. Office Depot had the paper delivered to R.R. Donnelly's facilities ….").

In holding that "*May Dept. Stores* is on point" (App. A8), and that *Southwestern Bell Yellow Pages* is distinguishable, the Commission deemed the purchase and ownership of the paper "irrelevant." App. A9. But if it is not relevant, where is the distinction between *May Dept. Stores* and *Southwestern Bell Yellow Pages* that permitted this Court to rule in the latter case without mentioning the former one?

The Commission found that Office Depot purchased and thus owned the paper. The Commission never found that Office Depot transferred ownership of—much less, control over, as would be required to avoid the use tax—the paper to anyone until the printed materials arrived on the customers' doorsteps. And, assuming that the point mattered, it was up to Office Depot to prove it. *See* § 621.050.2; *Alberici Constructors, Inc. v. Dir. of Revenue,* 452 S.W.3d 632, 638 (Mo. 2015) (taxpayer "bears the burden of proving it did not owe use taxes … and, therefore, is entitled to a refund").

The reason that Office Depot could not prove it did not owe use tax is evident from what the Commission found: Although the paper was delivered to R.R. Donnelley, it was used to print Office Depot's catalogs and advertisements, then delivered to the addresses in Missouri that Office Depot specified, thus always remaining within Office Depot's control, if not its ownership. And as seems apparent from *Southwestern Bell Yellow Pages*, that is all that the use tax statute requires.

5. The use tax imposed on Office Depot is to be calculated based on the total price of the finished tangible personal property used in Missouri—here, the cost of the paper, printing, and other services.

Regardless of whether the Court reverses or distinguishes *May Dept. Stores* in order to ensure that tax is imposed on property that Office Depot owns or controls, the amount of the tax should be based on the full cost of the catalogs and advertising materials that Office Depot used in Missouri. Anything else would retain for Office Depot an advantage to using an out-of-state printer—the type of advantage that the use tax is intended to eliminate.

The use tax is imposed by § 144.610.1 "in an amount equivalent to the percentage imposed on the sales price in the sales tax law in section 144.020." Section 144.020.2 in turn imposes "a tax equivalent to four percent of the purchase price paid or charged." "Sales price" is broadly defined to include "the cost of materials used, labor or service cost, losses or any other expenses whatsoever." § 144.605(8).

Office Depot engaged R.R. Donnelly to manufacture raw materials into final products. Office Depot provided R.R. Donnelly with the blank paper. R.R. Donnelly used the paper and its other materials, such as ink and binding materials, to manufacture Office Depot's catalogs and advertising materials. The consideration paid to R.R. Donnelly to manufacture the

product catalogs and advertising materials is part of the total cost of the final products mailed to Office Depot's Missouri customers per Office Depot's instructions—*i.e.*, it is part of the "cost of materials used, labor or service costs." § 144.605(8).

The total cost also includes the costs of mailing. R.R. Donnelly did not separately state those costs from the other costs to produce the items. But even if the cost of mailing had been separately stated, it would be subject to use tax. Under § 144.605(8), there is no deduction for "any other expenses whatsoever, except that . . . 'sales price' shall not include . . . the amount charged for labor or services rendered in installing or applying the property sold." The charge for delivery falls within the definition of sales price as "any other expenses whatsoever." As set forth in definition, the only services not subject to use tax are "labor or services rendered in installing or applying the property sold." The costs to mail the product catalogs and advertising materials are subject to use tax under the use tax definitions.

CONCLUSION

For the reasons state above, the decision of the Commission should be reversed and the decision of the Director of Revenue affirmed.

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CERTIFICATE OF SERVICE AND COMPLIANCE

I hereby certify that a true and correct copy of the foregoing was served electronically via Missouri CaseNet 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 4,234 words.

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