IN THE SUPREME COURT OF MISSOURI

No. SC95181

KRISPY KREME DOUGHNUT CORPORATION,
Appellant,

v.

DIRECTOR OF REVENUE,
Respondent.

ON PETITION FOR REVIEW
FROM THE MISSOURI ADMINISTRATIVE HEARING COMMISSION,
THE HONORABLE KAREN A. WINN, COMMISSIONER
No. 06-1044 RS

APPELLANT'S BRIEF

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JURISDICTIONAL STATEMENT

This appeal involves, among other things, the construction of section 144.014, RSMo 2000, a revenue law of the State of Missouri.[1] Accordingly, this Court has exclusive jurisdiction over this appeal pursuant to Article V, § 3 of the Missouri Constitution because the appeal involves the construction of a revenue law of this State. *MFA Petroleum Co. v. Director of Revenue*, 279 S.W.3d 177, 178 (Mo. banc 2009).

[1] Unless noted otherwise, all Missouri statutory citations are to the Revised Statutes of Missouri, RSMo 2000.

STATEMENT OF FACTS

A. General Facts

Between April 2003 and December 2005, the tax periods at issue (the "Tax Periods"), Krispy Kreme owned and operated five Krispy Kreme stores in Missouri. Those stores were located in Branson, Springfield (two stores), Kansas City and Independence, and their operations were the same in all material respects from store to store. The Kansas City store is no longer open, but was open during the Tax Periods. Commission decision at p. 2, ¶1, App. A2.

The stores are engaged in production and retail and wholesale sales of premium doughnuts. The establishments also sell related food items such as bagged coffee beans and ground coffee, coffee and related coffee drinks, hot chocolate, milk, bottled water, bottled juices, and other soft drinks. Some of the coffee drinks and hot chocolate are served hot. Certain drinks are served chilled, and doughnuts are sometimes sold warm. The remainder of Krispy Kreme's products are sold at room temperature. Commission decision at p. 2, ¶2, App. A2.

Over thirty percent of Krispy Kreme's total sales at the Missouri establishments are sales of doughnuts to retailers who resell those doughnuts. Those wholesale transactions are not at issue in this case. Commission decision at p. 3, ¶4, App. A3.

When Krispy Kreme filed its original Missouri sales tax returns for the Tax Periods, Krispy Kreme's state tax manager was unaware that Missouri had a lower sales tax rate for food sales. Krispy Kreme remitted sales tax at the full state sales tax rate

(4.225%)[2] on all of its retail sales at the Missouri establishments. Commission decision at p. 3, ¶9.

Krispy Kreme filed a claim for a refund of sales tax at a rate of 3% that it remitted on its sales of doughnuts, non-hot beverages, juices, milk, coffee beans, and ground coffee that its customers purchased. The refund claim does not include the remaining 1.225% state sales tax, the local sales tax on any retail sales, any tax remitted on retail sales of products sold for consumption on the premises, nor any tax remitted on sales of drinks, such as coffee or hot chocolate, that were served hot. The Kansas City store's sales are not part of the refund claim because almost all of its sales were for resale. Commission decision at p. 4, ¶10, App. A4.

The original refund claim was for $324,237.33. Subsequent to filing its appeal with the Commission, Krispy Kreme reduced its refund claim by $46,245.13, the tax on sales that were "dine in" (consumption on the premises of Missouri establishments). Krispy Kreme's refund claim is now $277,992.20. Commission decision at p. 4, ¶11, App. A4.

B. The Survey Showing Where and When Doughnuts Are Consumed

Pursuant to this Court's December 20, 2011 decision, this case was remanded to the Commission. At the hearing before the Commission on remand, Krispy Kreme

[2] Section 144.020 imposes state sales tax at a rate of 4 percent. Additional .1 percent and .125 percent sales taxes are imposed by Article IV, sections 47(a) and 43(a), respectively, making the total state sales tax rate 4.225 percent.

presented the testimony of Dr. Srinivasan (Ratti) Ratneshwar, then the Chairman of the University of Missouri Department of Marketing of the Trulaske College of Business. Dr. Ratneshwar designed and administered a survey of Krispy Kreme customers. The purpose of the survey was to show where and when Krispy Kreme customers consumed doughnuts that they purchased. The survey ("2012 Survey") showed that for the survey period (9/25/12 – 11/9/12), roughly 45 percent of retail sales of doughnuts purchased from the four Krispy Kreme stores were consumed at home, 14.4 percent were consumed at work, 2 percent were consumed at school, and 10 percent were consumed at some other place. Exhibit 2, p. 14; App. A42. The rest were either consumed in the store, on-the-go/in the car, or the customers did not remember where they consumed the doughnuts. In addition to the aggregate figure, this same information was recorded separately for each of the four stores at issue. The 2012 Survey also showed, for each store and in the aggregate, the percentages of the total sales price of the doughnuts purchased that were consumed in less than 1 minute, between 1 and 5 minutes, between 6 and 15 minutes, between 16 and 30 minutes, between 31 and 60 minutes and greater than 60 minutes after arriving at the place of consumption (home, work, school or some other place). Ex. 1; Ex. 2, pp. 14–19; App. A42 – A47.

Because the metric for the 2012 Survey was retail sales measured in dollars (not number of doughnuts) and because Krispy Kreme discounted doughnuts sold in quantities of a dozen or more, Dr. Ratneshwar obtained the price per doughnut from each survey

respondent's sales receipt and assigned that price for each doughnut addressed in the survey. Ex. 2, pp. 9–10, App. A37 – A38; Tr. 64.

Dr. Ratneshwar was well qualified to both design and administer the survey as he has substantial education and experience in both the design and administration of surveys. Tr. 22–28; Ex. 1.

Customers could take the survey as soon as the next day after making a purchase from one of the four stores at issue and as late as the third day after making a purchase. Ex. 2, p. 59, App. A87; Tr. 34. The 2012 Survey consisted of a number of straightforward questions regarding where customers consumed the doughnuts that they purchased and how quickly they consumed them after reaching the location of consumption. Ex. 2, pp. 59–79, App. A87 – A107.

Dr. Ratneshwar ran a number of rules to confirm the reliability of the results of his survey. First, he determined that the size of the purchases of the surveyed customers were consistent with the size of purchases for all customers. Tr. 42-46. In addition, he ran quality assurance of the results of the survey and determined with a 95 percent confidence level that the results were within a tight range. For instance, for all stores combined, his survey determined that almost 31 percent of doughnuts were consumed more than one hour after reaching a place of consumption, plus or minus 1 percent. Likewise, for all stores combined, his survey determined that almost 43.3 percent of doughnuts were consumed more than 15 minutes after reaching a place of consumption, plus or minus 1.2 percent. Ex. 2, p. 9, App. A37; Ex. 3; Tr. 46-53.

The Director called no witnesses on this issue, or any issue, and presented no contrary survey.

C. Application of the 2012 Survey To Include Sales Other Than Doughnuts

As indicated above, the four Krispy Kreme stores sold more than just doughnuts. They also sold items not prepared by the stores. Those sales included bottled or canned water, juice, or soft drinks, bottles or cartons of milk, bags of coffee beans or ground coffee, and certain non-food items. Those sales also included products prepared by the store, such as liquid coffee drinks and fountain drinks. For the purchases made by the survey respondents, Sam Hauser, Krispy Kreme's Senior Director of Tax, a licensed CPA, pulled from the computer database the detail for each transaction addressed in the survey. He did this in order to account for the total dollar amount of all retail sales made to the survey respondents and not just the total dollar amount of retail doughnut sales as reflected in the professor's survey results. Ex. 2, pp. 4–7, App. A32 – A35.

Mr. Hauser divided the entire sale made to each respondent into three categories: (1) sales of food products not prepared in the stores (*e.g.*, bags of coffee beans, bottled water or juice, etc.); (2) sales of food products that were prepared in the stores and that were not doughnuts (*e.g.*, liquid coffee and fountain drinks); and (3) sales of doughnuts (all of which were prepared in the stores). Because the products in category (1) were not "prepared" in the store, Mr. Hauser determined that those sales should be included on the

20 percent side[3] of section 144.014's 80/20 ratio. Because the products in category (2) were "prepared" in the store and because Mr. Hauser had no information where and when they were consumed, he assumed that those sales should be included on the 80 percent side of section 144.014's 80/20 ratio, an assumption that favored the Director in the calculation. Because the products in category (3) were prepared in the store and because they were addressed by the survey, Mr. Hauser determined that some part of those sales should be included on the 20 percent side of section 144.014's 80/20 ratio and some should be included on the 80 percent side of section 144.014's 80/20 ratio, depending on where and when they were consumed. If consumed in the stores or on-the-go/in the car, he determined that those doughnut sales should be included on the 80 percent side of the ratio, because the doughnuts were "immediately consumed." On the other hand, if consumed at another place such as home, work, or school, those sales should be included: (1) on the 80 percent side of the ratio if they were "immediately consumed" once at that

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[3] The "20 percent side" of the 80/20 ratio is simply shorthand for the portion of retail sales needed to qualify to make any sales at the reduced food rate under section 144.014. Under this statute, a vendor may charge the lower rate on its food sales if 20 percent or more of its gross receipts are from the sale of items *other than* "food prepared by such establishment for immediate consumption." The "80 percent" side is shorthand for that part of retail sales that do not count toward the 20 percent threshold of section 144.014 because they are sales of "food prepared by such establishment for immediate consumption."

other place; or (2) on the 20 percent side of the ratio if they were **not** "immediately consumed" once at that other place. Ex. 2, pp. 4–7, App. A32 – A35; Tr. 209-229.

Because at the time of trial no tribunal had construed the word "immediate" in section 144.014, Mr. Hauser determined that he should offer alternative analyses for that portion of doughnut sales deemed to be not "immediately consumed." He determined the dollar amount of doughnut sales that were not "immediately consumed" using three different time measurements: (1) consumption 16 minutes or more after arriving at another place; (2) consumption 31 minutes or more after arriving at another place; and (3) consumption 61 minutes or more after arriving at another place. Under each analysis, the combination of sales of food not prepared at the stores with doughnuts not "immediately consumed" at another place like home, school or work, was well in excess of 20 percent. If "immediate" consumption means consumption in less than 16 minutes after arriving at another place, then on an aggregated basis 50.74 percent of the stores' retail sales were sales of items *other than* food prepared by the stores for immediate consumption. Ex. 2, p. 22; App. A50. For the individual stores, that percentage ranged from 44.33 percent to 53.2 percent. Ex. 2, pp. 23–26; App. A51 – A54. If "immediate" consumption means consumption in less than 31 minutes after arriving at another place, then on an aggregated basis 44.2 percent of the stores' retail sales were sales of items *other than* food prepared by the stores for immediate consumption. Ex. 2, p. 22; App. A50. For the individual stores, that percentage ranged from 39.46 percent to 47.59 percent. Ex. 2, pp. 23–26; App. A51 – A54. If "immediate" consumption means consumption in less than 61

minutes after arriving at another place, then on an aggregated basis, 39.34 percent of the stores' retail sales were sales of items *other than* food prepared by the stores for immediate consumption. Ex. 2, p. 22; App. A50. For the individual stores, that percentage ranged from 35.49 percent to 44.34 percent. Ex. 2, pp. 23–26; App. A51 – A54. In all cases, the percentage of sales of items *other than* "food prepared by such establishment for immediate consumption" easily exceeded the twenty percent threshold of section 144.014.

The Director called no witnesses and offered no evidence on this issue.

D. Evidence That The 2012 Survey Results Apply to The Tax Periods

The Tax Periods in this case are April 2003 through December 2005, but the period of the 2012 Survey was September 25 through November 9, 2012. Krispy Kreme addressed the connection between the Tax Periods and the survey period through two witnesses, Mike Parker and Alison Holder. Each of those witnesses was of the opinion that the results of the survey were reflective of the Tax Periods. Tr. 148, 167, and 191.

Ms. Holder is the Vice President of Brand Development for Krispy Kreme. She has worked for Krispy Kreme since February 2000. In her various positions at Krispy Kreme, she was familiar with Krispy Kreme's products, its customer demographics, its marketing, its product pricing, its competitors and their pricing and, Krispy Kreme's customers' consumption habits. That is because Krispy Kreme regularly studies those things. Tr. 115–147. It was her opinion that none of those factors changed in any meaningful respect from the Tax Periods through the date of trial, including the survey

period for this case. It was her opinion that the results of the 2012 Survey were representative of the Tax Periods. Tr. 148, 167.

Ms. Holder and another witness, Mike Parker, testified that, because of the dozen doughnut discount, the price for seven doughnuts is, and had at all relevant times been, about the same as the price for a dozen doughnuts. Thus, customers are easily "up-sold" to purchase a dozen. Both she and Mr. Parker testified that the seven doughnut metric had remained uniform through the years, including the Tax Periods and the survey period. Ms. Holder supported her opinion with various exhibits. She identified Exhibit 11, which showed the dozen discount percentages for various years. The dozen discount percentage is the discount per doughnut when doughnuts are purchased in lots of a dozen versus individually. The exhibit did not have figures for 2005 or 2012, but did have figures for 2003, 2004, 2006, closely corresponding to the Tax Periods, and 2011 and 2013, closely corresponding to the 2012 Survey period (2012). The dozen discount percentage by year for these periods was: 2003 (39.7 and 39.7 for glazed and 42.1 and 43.9 for assorted[4]), 2004 (37.3 for glazed and 42 for assorted), 2006 (40.1 for glazed and 40.2 for assorted), 2011 (41.2 for glazed and 32.7 for assorted), and 2013 (38.6 for glazed and 36.6 for assorted). This showed that the discount motivation for buying a dozen doughnuts remained fairly uniform as Ms. Holder testified. Additionally, she identified Exhibit 12. That exhibit tracked, for both Missouri stores and nationally, the average number of doughnuts purchased per transaction. That statistic is important for it is more likely that

[4] Krispy Kreme refers to doughnuts other than original glazed as "assorted."

large quantities of doughnuts will be eaten somewhere other than the store or while travelling from the store. While Krispy Kreme did not keep that statistic for years prior to 2007 (Krispy Kreme's fiscal year starts in February so that year is reported as FY 2008), the average number of doughnuts purchased per sale nationally, and at the four stores in Missouri, was approximately 10 or 11 doughnuts for all of the eight years studied. That average was consistent with the average found in the 2012 Survey conducted for this case, where the average was 10.3 doughnuts per transaction. *See* Exhibit 13 and Tr. 142. These exhibits were provided to support Ms. Holder's opinion that there was no reason to believe that the 2012 Survey would not be reflective of customer activity from 2003-2005 because nothing significant had changed.

Ms. Holder testified that the marketing message Krispy Kreme uses did not change from 2003 through 2012. Tr. 123. She also testified that the Krispy Kreme brand health, customer satisfaction, customer use of products, customer demographics, and Krispy Kreme's competitors, have not changed over the years. Tr. 133-135. She further testified that customers' motivations for buying Krispy Kreme products did not change over the years. She knew that from all of the studies/surveys that Krispy Kreme conducts, which are about five to ten per year. Tr. 133. Ms. Holder also identified Exhibits 8, 9 and 10. These were the results of surveys dated 2004 (Ex. 10), 2005 (Ex. 8), and 2012 (Ex. 9). None of these surveys were prepared for the Missouri tax case. The 2004 survey, for years 2001 and 2003, showed that 49 percent of customers were going home after visiting a Krispy Kreme store. Ex 10, p. 53. Although not an identical metric, the 2012 Survey in

this case showed that 45.4 percent of the doughnuts purchased were consumed at home. Ex 2, p. 14.

Ms. Holder noted that the 2004 survey and the 2012 Survey showed that customer motivations for buying Krispy Kreme doughnuts had not changed: reward for doing something good, comfort for bad times, a craving, etc. *See* Tr. 138-140, Ex. 8, pp. 12-14, Ex. 9, pp. 42, 48.

Mike Parker also testified that the results of the 2012 Survey were representative of the Tax Periods. Tr. 191-192. Mr. Parker managed the four stores at issue from 2003 through 2013, overseeing their daily operations. He was intimately familiar with the operations of the four stores at issue. None of the stores had changed from 2003 through 2013, other than the Independence store received new floor tile in the production area, retrofitted fixtures and walls in the bathrooms and had the parking lot blacktopped. Tr. 177. He understood the stores' customers' consumption habits, the products sold by the stores, the top selling product of the stores, the type of competitors of the stores, the relative pricing of the products, the dozens discount trend, the demographics of the customers, and the marketing of Krispy Kreme products. Tr. 169–191. It was his opinion that none of those factors changed in any meaningful respect from the Tax Periods through the date of trial (including the 2012 Survey period).

The Director called no witnesses on this issue, or any issue.

E. The Commission's Decision On Remand

The Commission admitted Krispy Kreme's 2012 Survey showing where and when Krispy Kreme's products were consumed and concluded that if the survey was reflective of the Tax Periods "Krispy Kreme proved that the retail sales of doughnuts and other food products from the four stores during the Tax Periods meet the rules of § 144.014, and would be entitled to a refund of sales tax paid over the lower rate authorized by that statute during the Tax Periods, or $277,992.20." However, the Commission decided to assign "little weight to the 2012 Survey." The Commission stated in this regard:

> The real issue is how much weight to give [the 2012 Survey] as evidence of when and where the four stores' customers ate their doughnuts *during the tax periods.* Krispy Kreme attempted to bridge this foundational gap through Holder and Parker, who testified, in essence, that "things haven't changed much with our brand or with these stores." But as the Director points out, the witnesses – one employed by Krispy Kreme as its director of brand development, and the other being the owner of several Krispy Kreme stores – are obviously interested in the results of this case. Moreover, while their testimony addressed consumer habits generally, it did not address the key issue of *when* customers eat their doughnuts.
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> ***
>
> Thus, we assign little weight to the 2012 Survey for the purpose of this case. While we find it is admissible and relevant to the issue of

> consumption habits of Krispy Kreme customers at the four stores in 2012, we find it does not establish, by a preponderance of the evidence, that it reflects their consumption habits during the tax periods. We recognize that our conclusion raises the question: given the Supreme Court's framing of the issue in this case, how can a retailer prove that not more than 80% of its total gross receipts derives from food prepared by the establishment that is eaten at the place of preparation and purchase, or while traveling to, or immediately upon arrival at, another location without any further preparation? Such a question can never be answered with absolute certainty and precision, so is Krispy Kreme's 2012 Survey and testimony linking consumer habits from the survey periods to the tax periods sufficient? Or is it possible that adequate proof for the tax periods at issue simply cannot be found at this point, but a similar survey, made during future tax periods, will suffice for future contemporaneous refund claims?

Commission Decision, pp. 20 – 22, App. A20 - A22 (italics are emphasis original and underlining is emphasis added).

The Commission rendered this conclusion in the face of no facts in the record to contradict the testimony of Holder and Parker or the 2012 Survey and no finding of any lack of credibility on their part. Indeed, the Director offered no witnesses or evidence at all on the critical issues.

F. Facts Establishing the 80/20 Criteria Under A Modified Standard

In this appeal, Krispy Kreme seeks a reconstruction of section 144.014, namely a construction setting a more reasonable evidentiary standard that can be met by a taxpayer without incurring the expense of a customer survey. As explained below, this Court should reconstrue the "prepared for immediate consumption" rule to focus on the temporal requirement that *consumption* of food must follow its *preparation* without delay. In other words, "food prepared by such establishment for immediate consumption" is food that is prepared by an establishment for consumption right away after it is prepared. Under that standard, the undisputed facts, as found by this Commission on summary decision show that Krispy Kreme's retail sales of food it does not prepare, combined with its sales of food that it prepares knowing that the food will not be consumed for at least one hour after it was prepared, constitute well over twenty percent of its sales. December 23, 2010 Commission Decision, p. 3, ¶5, App. A110. Under this approach, a seller can determine whether it is qualified to sell food at the low rate, based on when its food is prepared relative to when it is sold or served to customers, without having to question customers about the location and timing of their consumption of the food.

STANDARD OF REVIEW

This Court reviews the Commission's interpretation of revenue laws *de novo*. *Missouri State USBC Ass'n v. Dir. of Revenue*, 250 S.W.3d 362, 363 (Mo. banc 2008). The Commission's factual determinations will be upheld if supported by the law and by substantial evidence upon the whole record. *Id.* A tax imposition statute is construed against the taxing authority and in favor of the taxpayer. *Am. Healthcare Mgmt., Inc. v. Dir. of Revenue*, 984 S.W.2d 496, 498 (Mo. banc 1999).

SUMMARY OF THE ARGUMENT

This appeal presents two issues. First, did the evidence that Krispy Kreme presented to the Commission satisfy the standard for the 80/20 rule that this Court set in *Krispy Kreme Doughnut Corporation v. Director of Revenue*, 358 S.W.3d 48 (Mo banc 2011)? Stated differently, is the Commission's decision to give little weight to the 2012 Survey unsupported by the evidence in the record? Second, should this Court reconstrue the language "sale of food prepared by such establishment for immediate consumption on or off the premises of the establishment" in section 144.014.2 to establish a reasonable standard that gives meaning to all of the words of the statute, particularly the "prepared … for immediate consumption" language and avoid the absurd result that only by incurring substantial expense by surveying its customers about where and when they consumed their food products can a vendor possibly establish a right to sell at the food rate?

First, the Commission concluded that <u>if the 2012 Survey was reflective of the Tax Periods</u> "Krispy Kreme proved that the retail sales of doughnuts and other food products from the four stores during the Tax Periods meet the rules of § 144.014." But the Commission gave little weight to the 2012 Survey to show consumer behavior during the Tax Periods. The Commission's decision to give little weight to the survey was against the weight of the substantial evidence in the record and it was arbitrary to assign it little weight. Indeed, the Director offered no contrary witnesses and no contrary evidence on the issue of applying the 2012 Survey results to the Tax Periods. Krispy Kreme's

uncontroverted evidence showed that for 2012 over 40 percent of sales consisted of items other than food prepared for immediate consumption, which is twice the section 144.014 standard of 20 percent. The uncontroverted evidence was that the operations of the four stores had not changed from 2003 through 2012 in any material respect. The uncontroverted evidence showed that Krispy Kreme's dozen discount percentage remained relatively constant, that its marketing messages remained constant, that its competitors had not changed, that its customer demographics had not changed, and that its customers' motivations for buying had not changed. It also showed that the average number of doughnuts purchased per customer had not changed from 2007 through 2013, and was between 10 and 11 doughnuts. While it had no records for 2003-2006, this statistic clearly was objective proof to support the opinions of the witnesses since larger quantity purchases would be less likely to be consumed right away and tied closely to the 10.3 doughnut average found in the 2012 Survey. Both Krispy Kreme's marketing executive and the stores' manager, each of whom had been in positions to observe the facts about which they testified from 2003 through 2013, were of the opinion that the 2012 Survey results were reflective of customer activity during the Tax Periods.

Appellate courts act with caution in exercising the power to set aside a decree or judgment on the ground that it is against the weight of the evidence." *Ivie v. Smith*, 439 S.W.3d 189, 205 (Mo. 2014). But it is also true that "reported cases show that reversal on this ground occurs regularly." *Pearson v. Koster*, 367 S.W.3d 36, 76 (Mo. 2012)

(citing over 60 cases where an 'against-the-weight-of-the-evidence' challenge succeeded). Here, the Commission decision is clearly against the weight of the evidence.

Second, Krispy Kreme respectfully requests the Court reconstrue section 144.014.2. The purpose of section 144.014 is to allow consumers a discount in the sales tax rate when they buy food. But this Court's extremely narrow construction of section 144.014.2 greatly limits the locations where that food tax rate can apply. This Court's current construction of section 144.014.2's 80/20 rule is as follows:

> Accordingly, "food prepared ... for immediate consumption on or off the premises" means all food that is eaten at the place of preparation and purchase, or while traveling to, or immediately upon arrival at another location without any further preparation.

This standard requires a vendor to determine where and when its customers have consumed the food that they bought. Only with that information, which must be acquired from customers *after* they have consumed their food, can a vendor meet the food rate 80/20 rule. In this case, Krispy Kreme sought to establish when its customers consumed the doughnuts they purchased through a customer survey, but because of the lapse of time between the Tax Periods and the survey, the Commission gave the survey little weight. The Commission recognized the problem that this Court's standard creates:

> We recognize that our conclusion [that the survey was not adequate proof] raises the question: given the Supreme Court's framing of the issue in this case, how can a retailer prove that not more than 80% of its total gross

> receipts derives from food prepared by the establishment that is eaten at the place of preparation and purchase, or while traveling to, or immediately upon arrival at, another location without any further preparation?

This difficult standard essentially gives the Director unfettered discretion to determine which vendors may sell at the reduced rate and which ones may not, since the burden of proof is on the taxpayer when challenging the Director's decisions. Section 621.050.2. This Court should reconstrue the 80/20 standard by giving the words of section 144.014.2 their plain meaning as written. The standard should focus on whether the vendor is preparing the food to be consumed right away (or "immediate[ly]"), such as when a restaurant prepares a hamburger, a t-bone steak, a cappuccino, or a Caesar salad (*e.g.* food that is prepared to order or food that cannot be retained for more than a short period before it must either be served or discarded) or whether the vendor is preparing food that it knows will not be eaten right away, such as when it prepares loaves of bread, bagels, cookies or doughnuts (*e.g.* food that can be prepared in quantity and will be retained and sold throughout the day or week). Under this approach, a vendor would meet the 80/20 rule if it knows that at least 20 percent of its product will not be immediately sold to customers after preparation, since customers cannot consume food until after it is purchased. Determining whether a vendor meets this objective standard will be easy, and less expensive, since the vendor has ready access to all of the information needed to make this determination. Such a standard is more in keeping with the reasonable expectations of the General Assembly.

POINTS RELIED ON

I.

THE COMMISSION ERRED IN REJECTING KRISPY KREME'S REFUND CLAIM BECAUSE UNDER SECTION 621.193 ITS DECISION IS CONTRARY TO THE ONLY EVIDENCE IN THE RECORD IN THAT THE ONLY EVIDENCE IN THE RECORD IS COMPELLING THAT THE 2012 SURVEY OF CUSTOMERS IS REFLECTIVE OF CUSTOMER BEHAVIOR FROM 2003-2005 BECAUSE NO ASPECT OF KRISPY KREME'S BUSINESS OR ITS CUSTOMERS' CONSUMPTION HABITS HAD CHANGED IN ANY SIGNIFICANT WAY.

Ivie v. Smith, 439 S.W.3d 189, 206 (Mo. banc 2014);

Pearson v. Koster, 367 S.W.3d 36, 76 (Mo. banc 2012);

Harris v. Westin Mgmt. Co. East, 230 S.W.3d 1, 3 (Mo. banc 2007).

II

THE COMMISSION ERRED IN REJECTING KRISPY KREME'S REFUND CLAIM BECAUSE, UNDER SECTION 621.193, ITS DECISION IS CONTRARY TO THE REASONABLE EXPECTATIONS OF THE GENERAL ASSEMBLY AND CONFLICTS WITH THE REASONABLE INTERPRETATION OF SECTION 144.014.2 IN THAT THE PLAIN MEANING OF "FOOD PREPARED … FOR IMMEDIATE CONSUMPTION" REQUIRES CONSIDERATION OF THE LENGTH OF TIME BETWEEN PREPARATION OF FOOD AND CONSUMPTION OF FOOD.

United Pharmacal Co. of Mo., Inc. v. Mo. Bd. of Pharmacy, 208 S.W.3d 907, 909 (Mo. banc 2006);

Murray v. Mo. Highway and Transp. Comm'n, 37 S.W.3d 228, 233 (Mo. banc 2001).

ARGUMENT

I

THE COMMISSION ERRED IN REJECTING KRISPY KREME'S REFUND CLAIM BECAUSE UNDER SECTION 621.193 ITS DECISION IS CONTRARY TO THE ONLY EVIDENCE IN THE RECORD IN THAT THE ONLY EVIDENCE IN THE RECORD IS COMPELLING THAT THE 2012 SURVEY OF CUSTOMERS IS REFLECTIVE OF CUSTOMER BEHAVIOR FROM 2003-2005 BECAUSE NO ASPECT OF KRISPY KREME'S BUSINESS OR ITS CUSTOMERS' CONSUMPTION HABITS HAD CHANGED IN ANY SIGNIFICANT WAY.

Section 144.014.1 sets a lower sales tax rate on the sale of "food." But only certain establishments are allowed to sell food at the food sales tax rate, those that meet the "80/20 test." Section 144.014.2 provides in pertinent part:

> For the purpose of this section … the term "food" shall not include food or drink sold by any establishment where the gross receipts derived from the sale of food prepared by such establishment for immediate consumption on or off the premises of the establishment constitutes more than eighty percent of the total gross receipts of that establishment, regardless of whether such prepared food is consumed on the premises of that establishment, including, but not limited to, sales of food by any restaurant, fast food restaurant, delicatessen, eating house, or cafe.

This language has proved problematic to all parties. This Court construed this language in *Krispy Kreme Doughnut Corporation v. Director of Revenue*, 358 S.W.3d 48 (Mo. banc 2011) ("*Krispy Kreme*"). It concluded that the operative language of the 80/20 test set a standard that can only be met by quizzing a food establishment's customers:

> The proper interpretation of the 80/20 test becomes apparent when all of the words "food prepared by such establishment for immediate consumption on or off the premises of the establishment" are given their full effect. Of particular importance are the words "on or off the premises," which modify "immediate consumption," clarifying that "immediate consumption" is not an abstract concept (food that *could* be consumed immediately) but a concrete event (actual consumption at the time of purchase or within the time necessary to travel to another location "off the premises"). Accordingly, "food prepared ... for immediate consumption on or off the premises" means all food that is eaten at the place of preparation and purchase, or while traveling to, or immediately upon arrival at another location without any further preparation.

Id. 358 S.W.3d at 53 (emphasis added).

Point II addresses the question whether this Court's construction should be reconsidered in light of the fact that it creates a standard that can be proven, if at all, only by going through the time-consuming and expensive process of surveying customers after they make their purchases and have consumed their food products. Here, as the

Statement of Facts demonstrates, Krispy Kreme engaged in that process by conducting a survey (the 2012 Survey) of customers after this Court rendered its decision. The Commission admitted the results of the 2012 Survey into the record, and concluded that if those results were reflective of the Tax Periods, "Krispy Kreme proved that the retail sales of doughnuts and other food products from the four stores during the Tax Periods meet the tests of § 144.014[.]" Indeed, the results of the survey showed that Krispy Kreme exceeded the twenty percent threshold of section 144.014's 80/20 test by almost double that requirement. However, the Commission decided to assign "little weight to the 2012 Survey." As the Statement of Facts makes abundantly clear, the only witnesses to testify at the trial on remand stated that the 2012 Survey was reflective of customer conduct for the Tax Periods because no meaningful aspect of the customers or Krispy Kreme operations had changed. In assigning little weight to the survey results, the Commission's decision was unsupported by the evidence and against the weight of the evidence. Krispy Kreme presented substantial and uncontroverted evidence that the 2012 Survey results were reflective of likely customer activity during the Tax Periods.

To show that it qualified under section 144.014, Krispy Kreme was required to show, by a mere preponderance of the evidence, that at least 20 percent of its total gross receipts for the Tax Periods came from sales other than "the sale of food prepared by [Krispy Kreme] for immediate consumption on or off the premises . . . ." As this Court construed this language, Krispy Kreme needed to show by a preponderance of the evidence that at least 20 percent of the four stores' gross receipts came from sales of

items other than "food that is eaten at the place of preparation and purchase, or while traveling to, or immediately upon arrival at another location without any further preparation." *Krispy Kreme*, *supra.*, 358 S.W.3d at 53. A preponderance of the evidence burden is "not high." *Harris v. Westin Mgmt. Co. East*, 230 S.W.3d 1, 3 (Mo. banc 2007). Krispy Kreme need only show that it is more probable than not that it qualified under section 144.014 during the Tax Periods.

On May 21, 2014, the Commission conducted a hearing about whether Krispy Kreme qualified to sell under the food sales tax rate in section 144.014 for the Tax Periods. Krispy Kreme presented a substantial amount of evidence at the hearing, while the Director of Revenue presented none. Nevertheless, in an order dated July 15, 2015, the Commission rejected Krispy Kreme's request for a refund, concluding that Krispy Kreme failed to meet its burden of proof.

Under section 621.193, the Commission's decision shall be upheld when it is "authorized by law and supported by competent and substantial evidence upon the whole record." This "substantial evidence" standard is awkward when applied to a finding that a party did not meet its burden of proof, as is the case here. The Director of Revenue produced no evidence, so it is difficult to say how the Commission's decision was supported by any evidence, let alone substantial evidence. Courts in other jurisdictions have recognized the problem with using a "substantial evidence" standard in situations like this one. *See, e.g.*, *Dale v. S & S Builders, LLC*, 188 P.3d 554, 559 (Wyo. 2008) ("We determined that the arbitrary and capricious standard should apply when there is no

disputed evidence on an issue because the substantial evidence test is awkward when applied to a finding for the non-burdened party."); *Hall v. Dillon Companies, Inc.*, 189 P.3d 508, 512 (Kan. 2008) ("The Board's determination that a party did not meet his or her burden of proof is a negative finding. Our standard of review for a negative finding of fact is that the party challenging the finding must prove arbitrary disregard of undisputed evidence or must prove some extrinsic consideration such as bias, passion, or prejudice."); *Davis v. Old Dominion Freight Line, Inc.*, 755, 20 S.W.3d 326, 328 (Ark. 2000) ("Where, as here, the Commission denies benefits because it determines that the claimant has failed to meet his burden of proof, the substantial-evidence standard of review requires us to affirm if the Commission's decision displays a substantial basis for the denial of relief.").

No Missouri court appears to have addressed directly the standard that applies when the Commission concludes that a party did not meet its burden of proof. An "against-the-weight-of-the-evidence" standard fits well here. Krispy Kreme adduced substantial evidence before the Commission, which the Commission ultimately disregarded. In this point, Krispy Kreme argues that the Commission improperly evaluated this evidence and, thus, its decision was against the great weight of the evidence.

Against-the-weight-of-the-evidence challenges succeed when a court "has a firm belief that the decree or judgment is wrong." *Ivie v. Smith*, 439 S.W.3d 189, 206 (Mo. banc 2014). "Appellate courts act with caution in exercising the power to set aside a

decree or judgment on the ground that it is against the weight of the evidence." *Id.* at 205. However, as Judge Price recently pointed out, "reported cases show that reversal on this ground occurs regularly." *Pearson v. Koster*, 367 S.W.3d 36, 76 (Mo. banc 2012) (citing over 60 cases where an 'against-the-weight-of-the-evidence' challenge succeeded).

Appellate courts defer to the trial court's determination of witness credibility. *White v. Dir. of Revenue*, 321 S.W.3d 298, 308 (Mo. 2010). This is because the trier of fact "is able to judge directly not only the demeanor of witnesses, but also their sincerity and character and other trial intangibles that the record may not completely reveal." *Ivie*, 439 S.W.3d 189 (Mo. banc 2014). However, "[e]vidence not based on a credibility determination . . . can be considered in an appellate court's review of an against-the-weight-of-the-evidence challenge." *Ivie*, 439 S.W.3d at 206; *see also MSEJ, LLC v. Transit Cas. Co.*, 280 S.W.3d 621, 623 (Mo. 2009) (holding that the Court need not defer to credibility determinations about "documentary evidence"). Much of Krispy Kreme's evidence before the Commission consisted of surveys about Krispy Kreme customer behavior, which does not depend on witness credibility. Thus, the Court need not defer to the Commission's evaluation of the survey evidence and can consider it anew here.

To determine what percentage of the four stores' gross receipts came from food prepared for immediate consumption on or off the premises, Krispy Kreme commissioned a survey in 2012. The 2012 Survey, designed by the Chair of the University of Missouri's Marketing Department, showed when and where Krispy Kreme customers consumed

doughnuts that they purchased over a two-and-a-half month time period in 2012. The 2012 Survey concluded, with a 95% confidence interval, that 30.9% of doughnuts were consumed more than one hour after reaching a place of consumption; 36% were consumed more than 30 minutes after reaching a place of consumption; and 43.3% were consumed more than 15 minutes after reaching a place of consumption.

But Krispy Kreme sells more than just doughnuts. It also sells items not prepared by the stores (*e.g.*, bottled water, juice, and soft drinks; bottles or cartons of milk; bags of coffee beans) and non-doughnut items prepared in store (*e.g.*, liquid coffee drinks and soft drinks). These items factor into whether Krispy Kreme qualifies under section 144.014. As a result, Sam Hauser, Krispy Kreme's Senior Director of Tax and a licensed CPA, analyzed each transaction in the 2012 Survey to account for the total dollar amount of all retail sales made to survey respondents, not just doughnut sales. This allowed him to divide each purchase into three categories: (1) sales of food products not prepared in stores; (2) sales of food products other than doughnuts, and prepared in the stores; and (3) sales of doughnuts (all of which are prepared in-store).

Mr. Hauser then assigned these products on either side of the section 144.014's "80/20 rule." The "80 percent" side covers food prepared in-store for immediate consumption. The "20 percent" side encompasses all other sales, including food prepared in-store that is *not* for immediate consumption. Products in category (1) were not prepared in-store, so those were allocated to the 20 percent side of the ratio. Products in category (2) were prepared in-store, but Mr. Hauser had no information about when and

where they were consumed. As a result, he included them on the 80 percent side. Finally, doughnuts in category (3) were prepared in-store, but the 2012 Survey revealed when and where the doughnuts were consumed. Thus, depending on where and when the doughnuts were consumed, Mr. Hauser allocated some portion of those sales to the 20 percent side of section 144.014's ratio and some to the 80 percent side. Specifically, Mr. Hauser determined that if the doughnuts were consumed in the stores or in-transit, they should be included on the 80 percent side. If the doughnuts were consumed at another place such as home, work, or school, those sales should be allocated: (1) on the 80 percent side of the ratio if they were immediately consumed once at the other place; or (2) on the 20 percent side of the ration if they were *not* immediately consumed at the other place. Ex. 2, pp. 4-7; Tr. 209-229.

No Missouri court has construed the term "immediate" in section 144.014, so Mr. Hauser analyzed three possible definitions: food consumed at least 16 minutes after reaching another place; food consumed at least 31 minutes after reaching another place; and food consumed at least 61 minutes after reaching another place. Applying this framework, Mr. Hauser determined the following about Krispy Kreme's retail sales in 2012:

- 50.74% of the stores' retail sales were of food consumed at least 16 minutes after arriving at another location or other products not prepared in the store;

- 44.20% of the stores' retail sales were of food consumed at least 31 minutes after arriving at another location or other products not prepared in the store; and
- 39.43% of the stores' retail sales were of food consumed at least 61 minutes after arriving at another location or other products not prepared in the store.

The Commission accepted the 2012 Survey and Mr. Hauser's analysis as competent and substantial evidence of customers' consumption habit *in 2012*. The Commission further concluded that if the 2012 Survey evidence, coupled with Mr. Hauser's analysis, is competent evidence about customers' consumption habits during the Tax Periods, then Krispy Kreme has proven that the stores qualified under section 144.014's 80/20 rule during that time period.

However, the Commission gave the 2012 Survey "little weight" on the issue of customers' consumption habits during the Tax Periods, concluding that it "does not establish, by a preponderance of the evidence, that it reflects consumption habits during the tax periods." App A22. The Commission therefore denied Krispy Kreme's requested refund.

The Commission's conclusion was unreasonable and wrong. To qualify under section 144.014, only 20 percent of gross receipts for a given time period need to be from sales of other than food prepared for immediate consumption. In 2012, using the broadest definition of "immediate," namely consumption of up to one hour after arriving at the

location of consumption, Krispy Kreme sold nearly double the percentage of food not for immediate consumption—39.43%—required for it to qualify under section 144.014. And Krispy Kreme presented substantial evidence that consumer consumption behavior remained remarkably stable from the Tax Periods to 2012.

First, the size of the average customer purchase has barely budged for at least eight years. From 2007 to 2014, the average number of doughnuts purchased per sale nationally, and at the four stores at issue in this appeal, was approximately 10 or 11 doughnuts. Ex 12. This average was consistent with the 2012 Survey, where the consumers bought an average of 10.3 doughnuts per transaction. Ex 13. The Commission criticized this evidence because it goes back only to 2007, two years after the end of the Tax Period. But it is simply implausible that the average transaction size, which has been so stable for so long, changed significantly between 2005 and 2007. This is especially true where the only witnesses to testify indicated that the metric had not changed since the Tax Periods.

Second, Krispy Kreme also showed that the reason customers choose to go to Krispy Kreme hardly has changed from the Tax Periods to 2012. Uncontroverted evidence from before, during, and after the Tax Periods shows that Krispy Kreme's customers' motivations for buying doughnuts has remained the same. The Commission compared consumer surveys of customers from 2004 and 2012. Ex. 8, 9. According to the Commission, both surveys show that "craving" drives visits to Krispy Kreme and that sensory images such as the lighted "Hot Doughnuts Now" sign are important triggers for

Krispy Kreme purchases. App. A20. The Commission concluded that these two surveys "are some evidence that the motivations for purchasing Krispy Kreme doughnuts have remained similar" from the Tax Period to 2012. *Id.*

Krispy Kreme also presented a 2004 survey, for years 2001 and 2003, which showed that 49 percent of customers were going home after visiting a Krispy Kreme store. Ex 10, p. 53. Although not an identical metric, the 2012 Survey in this case showed that 45.4 percent of the doughnuts purchased were consumed at home. Ex 2, p. 14. Finally, Krispy Kreme presented evidence showing the "dozen discount percentages" for various years. The "dozen discount percentage" is the discount per doughnut when doughnuts are purchased in lots of a dozen versus individually. The exhibit did not have figures for 2005 or 2012, but did have figures for 2003, 2004, 2006, closely corresponding to the Tax Periods, and 2011 and 2013, closely corresponding to the 2012 survey period. Ex 11. The fact that the discount motivation for buying a dozen doughnuts remained stable across that time period is yet more evidence that Krispy Kreme consumer behavior remained steady from the Tax Periods to 2012. The Commission conceded as much, stating that Krispy Kreme's evidence "tend[s] to show that motivations for visiting Krispy Kreme stores and buying doughnuts have remained similar from 2003 through 2012." Commission decision, p. 21, App. A21.

This evidence—the average transaction size and the stability of Krispy Kreme consumer behavior—is significant for at least two reasons. First, the remarkable stability of consumer behavior over time supports Krispy Kreme's argument that the 2012 Survey

is probative of consumer behavior during the Tax Period. This is particularly true because consumer behavior would have had to change drastically between the Tax Periods and 2012 for Krispy Kreme *not* to qualify under section 144.014 during the Tax Periods. Indeed, on a percentage basis, and even under a very broad definition of "immediate," Krispy Kreme's sales of items other than food for immediate consumption would have to have risen by almost 100 percent, on a percentage basis, from the Tax Periods to 2012 for Krispy Kreme to be ineligible for the lower sales tax during the period in question. Given the stability of other measures over the time period, this is implausible.

Second, Krispy Kreme's evidence suggests that the average customer in 2004, as now, purchased doughnuts which he or she saved for later. According to a 2004 survey, 21% of customers stopped at Krispy Kreme because "I saw the 'Hot Doughnuts Now' sign was on" and 21% stopped because "I saw Krispy Kreme when driving by." Ex 10, p. 57. According to this same survey, the most frequent occasions for a visit to Krispy Kreme were "Had a craving for Krispy Kreme" (46%), "Wanted to have a sweet snack" (28%) and "Wanted a quick snack" (29%). Ex 10, p. 59. The Commission concluded that "[t]hese reasons for purchasing doughnuts do not, intuitively, support the proposition that a large percentage of doughnuts are not purchases for immediate consumption." App. A21. But it conceded that a "customer may have visited Krispy Kreme because of an immediate craving and purchased a dozen doughnuts, eaten two, and taken the rest home for later consumption." *Id.* The Commission is spot on with this observation. It

simply strains credulity to believe that the average consumer—who has bought between 10 and 11 doughnuts per trip to Krispy Kreme for at least eight years—eats all of them immediately as a "snack."

The Commission cast aside this evidence nonetheless. It objected that: (1) the data on the average number of doughnuts purchased per transaction does not extend to the Tax Periods themselves; and (2) the survey evidence does not speak directly on *when* customers eat their doughnuts during the Tax Periods, the key issue in this case. Krispy Kreme addressed why the Commission's objections are misplaced above. In short, the stability of Krispy Kreme customer motivations strongly suggests that consumer behavior, including when consumers eat doughnuts purchased at Krispy Kreme, has changed very little between the Tax Periods and 2012. Given this, it defies belief that the average doughnut purchase transaction changed significantly between 2007 and the Tax Period.

It also bears repeating that the Court need not defer to the Commission's conclusions. Krispy Kreme's survey evidence does not depend on witness credibility determinations. For that reason, the Court is free to reach its own conclusions on the significance of the survey evidence in this case. *Ivie*, 439 S.W.3d at 206.

The Commission heard evidence from two people, a current and former Krispy Kreme employee, who testified that consumer behavior has not changed in any meaningful manner since the Tax Periods. And they backed up their observations with documents that were not prepared in anticipation of this case. The Commission stated that these witnesses were "interested in the results of this case" as current or former

Krispy Kreme employees. App. A20. However, it neither rejected their testimony nor expressly questioned their credibility. As a result, their testimony is evidence that the Court can consider in reaching its conclusion.

The Commission concluded that the 2012 Survey, coupled with Mr. Hauser's uncontested analysis, established that Krispy Kreme qualified for section 144.014's food sales tax rate by a wide margin in 2012. But the Commission found that the 2012 Survey had little bearing on consumer behavior during the Tax Periods. This decision cannot be upheld on appeal. Krispy Kreme presented substantial evidence showing that consumer behavior changed minimally, if at all, from the Tax Periods to 2012. As a result, the Commission's conclusion that Krispy Kreme failed to prove—by a mere preponderance—that it qualified under section 144.014 during the Tax Periods is against the great weight of the evidence. The Court should reverse the Commission and enter judgment for Krispy Kreme.

II

THE COMMISSION ERRED IN REJECTING KRISPY KREME'S REFUND CLAIM BECAUSE, UNDER SECTION 621.193, ITS DECISION IS CONTRARY TO THE REASONABLE EXPECTATIONS OF THE GENERAL ASSEMBLY AND CONFLICTS WITH THE REASONABLE INTERPRETATION OF SECTION 144.014.2 IN THAT THE PLAIN MEANING OF "FOOD PREPARED … FOR IMMEDIATE CONSUMPTION" REQUIRES CONSIDERATION OF THE LENGTH OF TIME BETWEEN PREPARATION OF FOOD AND CONSUMPTION OF FOOD.

A. The Commission's, and this Court's, Construction of Section 144.014.2 is at Odds With the Words of the Statute and the Cannons of Statutory Construction

In interpreting a statute, this Court seeks "to ascertain the intent of the legislature, as expressed in the words of the statute." *United Pharmacal Co. of Mo., Inc. v. Mo. Bd. of Pharmacy*, 208 S.W.3d 907, 909 (Mo. banc 2006) (citations omitted). Statutory language is given its plain and ordinary meaning, and each statutory provision must be read in context. *Utility Service Co., Inc. v. Dept. of Labor and Industrial Relations*, 331 S.W.3d 654, 658 (Mo. banc 2011) (citations omitted). In construing the statute, this Court presumes that the legislature did not include superfluous language. *Norwin G. Heimos Greenhouse, Inc. v. Director of Revenue*, 724 S.W.2d 505, 508 (Mo. banc 1987). When legislative intent cannot be determined from the plain meaning of the statutory

language, this Court applies rules of statutory construction to resolve any ambiguity. *United Pharmacal Co.*, 208 S.W.3d at 910.

The plain language of section 144.014, when read in context, forecloses the Commission's and this Court's interpretation. By its plain terms, section 144.014's reference to "food prepared by [an] establishment for immediate consumption on or off the premises" means food that is prepared to be consumed without delay. Because this "statutory language is not defined expressly, it is given its plain and ordinary meaning, as typically found in the dictionary." *Derousse v. State Farm Mut. Auto. Ins. Co.*, 298 S.W.3d 891, 895 (Mo. banc 2009). Dictionaries contemporaneous to section 144.014.2's enactment define the word "immediate" as "occurring, acting, or accomplished without loss of time" or "made or done at once." *Webster's Third New International Dictionary* 1129 (1993); *see also Black's Law Dictionary* 751 (7th ed. 1999) (defining "immediate" as "[o]ccurring without delay; instant"); *Merriam-Webster's Collegiate Dictionary* 579 (10th ed. 1994) (defining "immediate" as "occurring, acting, or accomplished without loss or interval of time"). Because "words used in proximity to one another must be considered together," *Albanna v. State Bd. of Registration for Healing Arts*, 293 S.W. 423, 431 (Mo. banc 2009), these definitions instruct that consumption of food described in section 144.014.2 must follow its preparation "at once," "without loss of time," or "without delay."

This statutory construction fits comfortably within the context in which the phrase "food prepared by [an] establishment for immediate consumption" is used. Section

144.014.2 lists the following examples of establishments that can qualify under the 80/20 rule: "restaurant[s], fast food restaurant[s], delicatessen[s], eating house[s], or cafe[s]." Section 144.014.2. These are establishments that traditionally prepare food that is meant to be eaten immediately after preparation. Thus, restaurant dishes — such as a grilled-to-order steak, a pan-fried fish, or a pasta dish — are served and consumed at once after preparation and are typically consumed "on … the premises." Similarly, a hamburger or an order of French fries prepared by a fast food restaurant will be consumed without any delay after preparation, and is frequently consumed "off the premises." The type of food served by these establishments generally has a very short shelf life, and the very purpose of these establishments is to prepare and serve food to order that will be eaten by their patrons as soon as it is prepared. Given section 144.014's express reference to these establishments, it is reasonable to interpret the term "immediate" as referring to the interval of time (or, rather, lack therefore) between preparation and consumption.

Some food establishments enumerated in section 144.014.2 prepare both food intended to be consumed immediately after preparation and food that could be consumed after some delay. Thus, a fast food restaurant may offer a cappuccino, which is consumed without delay after preparation, but also offer loaves of bread, cookies, bagels, and, yes, doughnuts, each of which is prepared long prior to consumption. Depending on the proportion of each type of food such an establishment offers, it may either satisfy the 80/20 rule, with the benefit of a lower tax rate for its customers, or fail to meet that rule and be required to charge its customers the higher general tax rate. In these

circumstances, a construction of the term "prepared by [an] establishment for immediate consumption" that differentiates between food prepared for consumption at once and food prepared for consumption with some delay after the preparation provides a workable rule under which an establishment listed in section 144.014.2 can determine whether its sales satisfy the 80/20 rule. Importantly, it can do so without locating its customers and inquiring after-the-fact where and when they consumed their food.

As a result of the first appeal of this case, this Court determined that the operative language "food prepared by [an] establishment for immediate consumption" meant "all food that is eaten at the place of preparation and purchase, or while traveling to, or immediately upon arrival at another location without any further preparation." *Krispy Kreme*, *supra.*, 358 S.W.3d at 53. The entire focus of this standard is on two things: (1) where customers consume their food; and (2) when they consume it. This standard gives no meaning to the word "prepared" and creates a result that could not have been within the reasonable expectations of the General Assembly under section 621.193.

As evidenced by the facts in this case, the Court has created an extremely difficult standard to prove. To determine whether it met the 80/20 rule based on this Court's standard, which focuses on the behavior of customers after they leave a seller's location, Krispy Kreme conducted a survey of its customers to determine when and where they consumed doughnuts. It did so shortly after the 80/20 rule was announced by this Court, but years after the Tax Periods. The survey was designed and administered by a highly qualified expert. The results of that survey were tied to the Tax Periods by two people,

each of whom was employed by Krispy Kreme during the Tax Periods and continuing until after the survey period. One was the manager of the four Missouri stores at all relevant times and the other was a Krispy Kreme marketing expert. Each testified that no significant fact of operation or its understanding of its customers' consumption habits changed from the Tax Periods to the survey period and that the 2012 Survey results are representative of the Tax Periods. There was no contrary testimony offered by the Director. Yet, the Commission found that Krispy Kreme was unable to prove that it met the standard set by this Court because there was no direct evidence of where and when Krispy Kreme's customers consumed food during the Tax Periods. In so concluding, the Commission appears to acknowledge that this Court's construction of the 80/20 rule is unworkable:

> We recognize that our conclusion raises the question: given the Supreme Court's framing of the issue in this case, how can a retailer prove that not more than 80% of its total gross receipts derives from food prepared by the establishment that is eaten at the place of preparation and purchase, or while traveling to, or immediately upon arrival at, another location without any further preparation?

Commission decision at 22, App. A22.

Because it is so difficult to prove, the Court's standard effectively gives the Director unfettered discretion to determine who may sell at the food rate, and who may not. That is because the burden of proof on this issue is upon the taxpayer. Section

621.050.2. Unfortunately for taxpayers, they frequently won't know that the Director disagrees with their position until after they receive an assessment from the Director for additional sales tax (in the case where a taxpayer believes that it meets the standard). The goal of section 144.014 was to save consumers tax on their purchases of food. But the Director can, as a practical matter, thwart that goal by simply making retailers prove, under an unworkable standard, that they meet the 80/20 rule. As this case shows, that proof is expensive to adduce and may not satisfy the factfinder in any event. Indeed, the Commission posits that perhaps "adequate proof … cannot be found at this point." Commission decision p. 22, App. A22. As this Court admonished, "[c]onstruction of statutes should avoid unreasonable or absurd results." *Murray v. Mo. Highway and Transp. Comm'n*, 37 S.W.3d 228, 233 (Mo. banc 2001) (citation omitted).

In its 2010 decision in this case, the Commission wrestled with two "plausible" constructions of "immediate" in the context of section 144.014. It wrongly rejected Krispy Kreme's construction, concluding that "we do not believe that our legislature intended that retailers quiz or survey their customers as to when they plan to eat the food they buy." Commission December 23, 2010 decision, p. 15, App., A122. The Commission wrongly rejected Krispy Kreme's construction, the one advanced here, because, contrary to the Commission's statement, that construction does not require Krispy Kreme to quiz or survey its customers. Indeed, Krispy Kreme established that it met that standard merely by studying how long its prepared products were stored before they were sold, knowing that consumption occurs after the sale. *Id.* ¶ 5, App. A110. But

the Commission was correct in its observation that surveying or quizzing customers on their consumption habits could not have been intended by the legislature.

The current construction yields an unreasonable result.

B. This Court Can and Should Reconstrue Section 144.014.2

This is not the first time the Court has been called on to revisit its construction of a revenue law. In *Columbia Athletic Club v. Director of Revenu*e, 961 S.W.2d 806 (Mo. banc 1998), this Court was called upon to construe the language of section 144.020.1(2) imposing sales tax on "fees paid to, or in any place of amusement, entertainment or recreation, games and athletic events[.]" Particularly, the question was whether the Gold's Gym health club was a "place of amusement, entertainment or recreation." The Court concluded that it was not because:

> It is uncontested that Appellant's fitness center is neither a place of amusement nor a place of entertainment. As to the third category, the use of the conjunction "and" requires that all three elements--recreation, games and athletic events--must be present, and it is not sufficient to determine only whether the facility is a place of recreation. Because the fitness center does not offer games or athletic events, it cannot be characterized as a place of recreation, games and athletic events.

Id., 961 S.W.2d at 808. Shortly thereafter, the Court was called on to revisit its construction when another and similar health club, Wilson' Total Fitness, was found liable for sales tax since it offered tennis and other recreational sports in addition to the

services offered by Gold's Gym. *See Wilson's Total Fitness Center, Inc. v. Director of Revenue*, 38 S.W.3d 424 (Mo. banc 2001). In *Wilson's* the Director called for a reconstruction of section 144.020.1(2) because this Court's construction of the statute in *Columbia Athletic Club* was unworkable. This Court accepted the Director's invitation. First, it noted why the Commission found Wilson's taxable while Gold's Gym was not:

> Comparing Wilson's to the facts set forth in Columbia Athletic Club, we find many similarities, including individualized instruction for fitness programs and various exercise machines. We also note that if activities normally considered recreational, such as karate, ballroom dancing, and tennis, for which the extra fees and taxes are paid, are taken out of the comparison with Columbia Athletic Club, the two fitness clubs are very similar. However, only members are entitled to participate, for a fee, in those activities normally considered recreational. It appears that the membership fees are necessary for Wilson's to offer additional activities to members for a smaller fee.
>
> Even when removing from consideration the taxable fees, Wilson's advertising and promotional approach is completely different than Columbia Athletic Club. Wilson's advertisements and promotional material place greater emphasis on the recreational aspects rather than on the health-related aspects of membership. Those activities commonly known as

recreational are not a minimal component of the enterprise. Therefore, we find that the primary purpose of the club was recreational.

Then the Court noted why the standard it set was unworkable:

> This conclusion, however, leads to the anomalous result that, in the same community, one health and fitness center's membership fees are subject to the state sales tax while another health and fitness center's membership fees are not.
>
> The difficulty encountered by the AHC in attempting to sift through such details illustrates the difficulty inherent in the approach adopted in Columbia Athletic Club, which focuses upon the "dual nature" of exercise and attempts to determine its "primary purpose". *Id*. at 810. "In other words, are the recreational aspects of the exercise that is facilitated incidental to the health benefits, or are the health benefits incidental to the recreational aspects?" *Id*. at 810.
>
> There is no need for us to restate the arguments set out between the principal opinion and the dissent in *Columbia Athletic Club*. Whether or not the distinction drawn there is valid in theory, it is unworkable in fact, as shown in this case.
>
> The "fine line between exercise that is primarily focused on health benefits and exercise that is primarily focused on recreation" simply cannot be distinguished in a meaningful and consistent manner. *Id*. at 810.

> Accordingly, *Columbia Athletic Club* is overruled and the *de minimis* test previously set out in *Spudich v. Director of Revenue*, 745 S.W.2d 677 (Mo. banc 1988), is reinstated. Athletic and exercise or fitness clubs are places of recreation for the purposes of section 144.020.1(2), and the fees paid to them are subject to sales tax.

Id., 38 S.W.3d at 426.

Like the decision in *Columbia Athletic Club*, the Court's construction of section 144.014 in *Krispy Kreme* is unworkable and could not have been the reasonable expectation of the General Assembly. Accordingly, this Court should reconstrue section 144.014 and determine that "food prepared . . . for immediate consumption on or off the premises" is food that the vendor knows at the time of preparation will be consumed right away, or "immediately," after preparation and if it is not so consumed, will be discarded within a short period of time. Under this approach, a vendor like Krispy Kreme, that can show that well over 20 percent of its sales are from food that it either does not prepare or food it prepares knowing it will not be consumed for over an hour after preparation, may charge the lower rate on its food sales. The undisputed facts established before the Commission on summary decision show that Krispy Kreme proved that it met this standard by a comfortable margin. *See* December 23, 2010 Commission Decision, p. 3, ¶5, App. A110.

CONCLUSION

For the above-mentioned reasons, this Court should reverse the Commission's erroneous conclusion that Krispy Kreme's establishments do not satisfy section 144.014's 80/20 rule.

Respectfully submitted,

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Dated November 25, 2015

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RULE 84.06(c) CERTIFICATION

The undersigned counsel certifies that this brief includes the information required by Rule 55.03, complies with the limitations provided for in Rule 84.06(b) and contains 12,140 words.

/s/ Edward F. Downey

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and accurate copy of the foregoing was served by the court's electronic filing system on all counsel of record on this 25th date of November, 2015:

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