**IN THE**
**SUPREME COURT**
**STATE OF MISSOURI**

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**No. 85181**

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**T-3, INC.,**
**Appellant,**

**v.**

**DIRECTOR OF REVENUE, STATE OF MISSOURI,**
**Respondent.**

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**ON PETITION FOR REVIEW**
**FROM THE MISSOURI ADMINISTRATIVE HEARING COMMISSION**
**THE HONORABLE KAREN A. WINN, COMMISSIONER**

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# BRIEF FOR APPELLANT

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**BRYAN CAVE LLP**

**Juan D. Keller, #19864**
**B. Derek Rose, # 44447**
**One Metropolitan Square**
**211 N. Broadway, Suite 3600**
**St. Louis, MO 63101**
**Telephone: (314) 259-2000**
**Facsimile: (314) 259-2020**

**Edward F. Downey, #28866**
**221 Bolivar Street, Suite 101**
**Jefferson City, MO 65101**
**Telephone: (573) 556-6622**
**Facsimile: (573) 556-6630**

**Attorneys for Appellant**

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## JURISDICTIONAL STATEMENT

The principal issue before the Court involves the construction of Section 147.010.[1] In particular, the question before this Court is whether the Missouri franchise tax is imposed on a taxpayer's assets that are not located in Missouri. Thus, this Court's review will necessarily involve the construction of Section 147.010, which is a revenue law of the State of Missouri. This Court has exclusive jurisdiction pursuant to Article V, § 3 of the Missouri Constitution.

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

## STATEMENT OF FACTS

### A. T-3's Operations

The facts in this case were submitted by a joint stipulation and are not in dispute (L.F. 109). T-3 Holding Company ("T-3") is a Missouri corporation that is, and has always been, headquartered in Missouri (L.F. 110). In 1998, T-3 was, and currently is, employed in business as an investment holding company (L.F. 110). Thus, T-3 holds investments, consisting of municipal bonds, mutual funds, investments in subsidiaries, and cash (L.F. 110).

With respect to some of T-3's investments, the entities in which T-3 has invested are located in Missouri, have assets in Missouri or do business in Missouri (L.F. 110). With respect to other investments (including investments in municipal bonds issued by non-Missouri municipalities and mutual funds investing in securities of entities doing business solely in foreign countries) the entities in which T-3 invests are not located in Missouri, have no assets in Missouri and do no business in Missouri (L.F. 110).

### B. T-3's 1998 Missouri Franchise Tax Return

T-3 filed its Missouri franchise tax return for 1998 and determined its Missouri franchise tax base by apportioning its capital investment assets by including in the numerator all assets in which the entity invested in was located in Missouri, had assets in Missouri, or did business in Missouri, and including in the denominator all assets (L.F. 111). T-3 added to the numerator its cash and intercompany dividend receivables (L.F. 111). For example, with respect to investments in municipal bonds for non-Missouri municipalities, T-3 included such investments in the denominator, but not in the numerator (L.F. 111). T-3 did not include its investments in affiliated companies in calculating its apportionment percentages; those investments were thus

neither in the numerator nor the denominator (L.F. 111). On its 1998 return, T-3 reported an apportionment percentage of 31.9247% (L.F. 111).

**C. Audit of 1998 Return**

In April 1999, an auditor working for the Director[2] and the Secretary of State ("Auditor") commenced an examination of T-3's 1998 Missouri franchise tax return (L.F. 112). The Auditor did not accept T-3's apportionment of assets (L.F. 112).

On June 18, 1999, T-3's accountant sent a letter to the Auditor explaining T-3's position (L.F. 112). The Auditor did not accept this position (L.F. 211). On September 13, 1999, the Secretary of State mailed an assessment notice to T-3 reporting a total amount due of Missouri franchise tax, interest and penalties for 1998 of $8,136.10 (L.F. 113). T-3 timely protested the assessment by letter dated October 6, 1999 (L.F. 113).

On or about May 11, 2000, the Director sent T-3 a rejection notice stating that T-3's 2000 Missouri franchise return (which was filed using the same allocation method as the 1998 return) was being returned. The explanation on the notice stated:

> "Alternative method of apportionment as accepted by the office of the secretary of state years 1993, 1994 & 1995. Years 1996 through 1998 are

[2] Pursuant to a letter of authority from the Secretary of State to the Director dated February 2, 1987, the Director was authorized to conduct Missouri franchise tax audits for periods in which the Missouri franchise tax was administered by the Secretary of State (L.F. 114).

currently being reviewed by the General Counsel's office"

(L.F. 113).[3]

T-3 received a second rejection notice dated June 5, 2000, which provided, "Please resubmit original documents with copy of approval of alternative method" (L.F. 113).

On October 12, 2001, the Director issued her Final Decision upholding the proposed assessment for 1998, but abating penalties (L.F. 114). T-3 timely filed a complaint with the Administrative Hearing Commission ("Commission") contesting the Final Decision (L.F. 109).

**D. Administration of the Missouri Franchise Tax**

Prior to January 1, 2000, the Missouri franchise tax was administered by the Secretary of State (L.F. 114). Effective January 1, 2000, the Director was charged with administering the Missouri franchise tax (L.F. 114).

On August 28, 1995, Regulation 15 CSR 30-150.170 was promulgated with an effective date of March 30, 1996, a copy of which is attached as Appendix A (the "Regulation") (L.F. 114). On October 21, 1998, Regulation 15 CSR 30-150.170 was amended (L.F. 114). The amended version, recodified as Regulation 12 CSR 10-9.200 had an effective date of April 30, 1999 (L.F. 114).

Neither the Director nor the Secretary of State has published any documents, other than Regulation 12 CSR 10-9.200 (not effective during 1998), setting forth a requirement that a taxpayer receive written approval of the Director or the Secretary of State prior to utilizing an

[3] Unlike the related cases of *TSI Holding Company v. Director of Revenue*, Case Number 85179 and *Tubular Steel Industries, Inc. v. Director of Revenue*, Case Number 85180, T-3 did not seek an alternative method of apportionment for periods prior to 1998 (L.F. 113).

alternate method of apportionment of assets for Missouri franchise tax purposes (L.F. 114). Neither the Director nor the Secretary of State has published any documents referencing any standards by which a taxpayer may receive written approval from the Director or the Secretary of State to utilize an alternate method of apportionment of assets for Missouri franchise tax purpose (L.F. 114).

During the period in which the Secretary of State administered the Missouri franchise tax, the Secretary of State generally accepted Missouri franchise tax returns utilizing alternate methods of apportionment evidenced by a written approval letter unless and until such alternate methods were reviewed by a staff attorney and revoked by the Secretary of State at the attorney's suggestion (L.F. 115).

During the period in which the Director administered the Missouri franchise tax, the Director disregarded any agreements in prior tax years in determining whether an alternate method of apportionment is acceptable for subsequent tax years (L.F. 115).

**E. The Commission's Decision**

On March 3, 2003, the Commission entered its decision, a copy of which is attached as Appendix B, upholding the Final Decision (L.F. 109-122). In its decision, the Commission concluded that T-3 was not entitled to apportion its Missouri franchise tax base pursuant to Section 147.010 (L.F. 118-119). The Commission stated that T-3's situation was distinguishable from that in *Union Electric Company v. Morris*, 222 S.W.2d 767 (Mo. 1949) in that in *Union Electric*, the parent corporation owned 100% of the stock of the foreign subsidiaries, and thus had a degree of control over the subsidiaries while T-3 did not have similar control over the entities in which it invested (L.F. 119).

In *dicta*, the Commission also stated that T-3's investments in municipal bonds and mutual funds constitute "property and assets employed" in Missouri (L.F. 119-120).

This appeal followed the Commission's decision.

## STATEMENT OF THE ISSUES

Section 147.010.1, as interpreted by this Court, excludes from the Missouri franchise tax base investments in the capital stock of entities that do not employ assets in business within Missouri. T-3 holds capital investments in entities that do no business in and have no assets in Missouri. T-3 also owns municipal bonds where the capital so loaned is used exclusively outside of Missouri. Is T-3 required to include those assets in its Missouri franchise tax base?

Section 147.010.1 provides that in apportioning the franchise tax base, a taxpayer shall determine the ratio of "property and assets employed in this state" to "property and assets wherever located" and multiply that ratio by its total assets. The Regulation provided during the Tax Periods that the "property and assets" used for such ratio shall consist only of accounts receivable, inventories, and land and fixed assets, unless an alternative method of apportionment that fairly apportioned assets is appropriate. T-3 had no accounts receivable, inventories, or land and fixed assets, so that its ratio under the "normal" apportionment formula would have been zero (0/0). T-3 sought to apportion its invested capital assets for computation of its franchise tax base by direct allocation to the places where the assets its capital investment represented were actually used in business. Does T-3's alternative method of apportionment more fairly apportion its assets than a method that results in an apportionment ratio of zero (0/0)?

## STANDARD OF REVIEW

The decision of the Commission shall be reversed: (1) if it is not authorized by law; (2) if it is not supported by competent and substantial evidence upon the whole record; (3) if any mandatory procedural safeguards was violated; or (4) where the Commission has discretion, it exercises that discretion in a way that is clearly contrary to the Legislature's reasonable expectations. Section 621.193; *Concord Publishing House, Inc. v. Director of Revenue*, 916 S.W.2d 186 (Mo. banc 1996).

Furthermore, Section 147.010 is a taxing statute. Taxing statutes are construed against the Director, and if the right to tax is not plainly conferred by statute, it will not be extended by implication. *United Air Lines, Inc. v. State Tax Commission*, 377 S.W.2d 444, 448 (Mo. banc 1964), *quoting Leavell v. Blades*, 141 S.W. 893, 894 (Mo. 1911) ("When the tax gatherer puts his finger on the citizen, he must also put his finger on the law permitting it.").

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

## POINTS RELIED UPON

**I. THE ADMINISTRATIVE HEARING COMMISSION ERRED IN UPHOLDING THE ASSESSMENT BECAUSE, UNDER SECTIONS 621.189 AND 621.193, THAT DECISION IS NOT AUTHORIZED BY LAW OR SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE IN THAT SECTION 147.010 DOES NOT ALLOW THE DIRECTOR TO IMPOSE THE MISSOURI FRANCHISE TAX ON T-3'S PROPERTY AND ASSETS EMPLOYED IN BUSINESS OUTSIDE OF MISSOURI.**

*Union Electric Company v. Morris*, 222 S.W.2d 767 (Mo. 1949);

*State ex rel. Marquette Hotel Investment Company v. State Tax Commission*, 221 S.W.2d 721 (Mo. banc. 1920);

*Household Finance Corporation v. Robertson*, 364 S.W.2d 595 (Mo. banc 1963);

Section 147.010, RSMo 2000.

## II. THE ADMINISTRATIVE HEARING COMMISSION ERRED IN UPHOLDING THE ASSESSMENT BECAUSE, UNDER SECTIONS 621.189 AND 621.193, THAT DECISION IS NOT AUTHORIZED BY LAW OR SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE IN THAT THE ALTERNATE METHOD OF APPORTIONMENT USED BY T-3 FAIRLY REFLECTS ITS ASSETS USED IN BUSINESS IN MISSOURI, IN THAT THE SECRETARY OF STATE PREVIOUSLY APPROVED T-3'S USE OF THE ALTERNATE METHOD OF APPORTIONMENT AND IN THAT THE REGULATION'S METHOD OF APPORTIONMENT DOES NOT FAIRLY APPORTION ALL "ASSETS AND PROPERTY" OF T-3.

*Union Electric Company v. Morris*, 222 S.W.2d 767 (Mo. 1949);

*Boatmen's Bancshares, Inc. v. Director of Revenue*, 757 S.W.2d 574 (Mo. banc 1988);

Section 147.010, RSMo 2000.

## ARGUMENT

## I. THE ADMINISTRATIVE HEARING COMMISSION ERRED IN UPHOLDING THE ASSESSMENT BECAUSE, UNDER SECTIONS 621.189 AND 621.193, THAT DECISION IS NOT AUTHORIZED BY LAW OR SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE IN THAT SECTION 147.010 DOES NOT ALLOW THE DIRECTOR TO IMPOSE THE MISSOURI FRANCHISE TAX ON T-3'S PROPERTY AND ASSETS EMPLOYED IN BUSINESS OUTSIDE OF MISSOURI.

### A. Section 147.010 Requires T-3 to Apportion its Missouri Franchise Tax Base

Section 147.010.1 imposes the Missouri franchise tax upon the par value of a corporation's outstanding shares and surplus. The statute provides as follows:

> "If such corporation employs a part of its outstanding shares in business in another state or country, then such corporation shall pay an annual franchise tax equal to one-twentieth of one percent of its outstanding shares and surplus employed in this state if its outstanding shares and surplus employed in this state [exceed] two hundred thousand dollars, ***and for purposes of sections 147.010 to 147.120, such corporation shall be deemed to have employed in this state that proportion of its entire outstanding shares and surplus that its property and assets employed in this state bears to all its property and assets wherever located.***"[4]

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

The issues before this Court are: (1) whether T-3 may apportion its Missouri franchise tax base (Point I) and, if so, (2) whether its alternative apportionment formula more fairly reflects, for purposes of the Missouri franchise tax base, those assets employed in business in Missouri (Point II).

T-3 does not own land or fixed assets. It is an investment holding company that derives its income from investments in other companies or entities. Examples are investments in corporations (by purchasing their stock) or investments in municipalities (by purchasing their bonds). The entities in which T-3 invests use T-3's invested capital to purchase assets that they, in turn, use in their businesses. If those entities are subject to a franchise tax on their assets, then they should be paying franchise tax on the assets purchased with T-3's investment capital.

T-3 seeks to exclude from the Missouri franchise tax base only those assets that are investments in entities that have no assets in, and conduct no business in, Missouri. The Director, who took over administration of the franchise tax, argued to the Commission that T-3 is not allowed to apportion its assets for purposes of determining the franchise tax base because its investment in entities that employed assets wholly outside of Missouri did not constitute T-3's employment of its shares outside Missouri. The Commission agreed with the Director.

The Commission's decision rests largely upon one flawed conclusion of law: that a corporation does not "employ its shares" outside of Missouri when the capital represented by those shares is employed in business wholly outside of Missouri. Its conclusion turns on its head the requirement that a tax statute must plainly confer the right to tax the assets at issue. *United Air Lines, Inc. v. State Tax Commission*, 377 S.W.2d 444, 448 (Mo. banc 1964). The Commission's conclusion of law is also plainly contrary to *Union Electric Company v. Morris*, 222

S.W.2d 767 (Mo. 1949), a case that has represented Missouri law on this issue for over fifty years.

T-3 employs its cash and intercompany dividend receivables 100% within Missouri. It employs other of its assets in Missouri. It included all of those assets in the Missouri franchise tax base. However, several of its assets are employed outside of Missouri. For example, T-3 owns several municipal bonds issued by municipalities outside of Missouri. The bond principal is employed exclusively outside of Missouri. Likewise, T-3 owns shares of mutual funds that in turn have employed their capital solely in companies that do no business in Missouri and have no assets in Missouri. Because these investments represent capital employed wholly outside of Missouri, T-3 is entitled to apportion its Missouri franchise tax base.

### B. This Court's decision in *Union Electric* Requires T-3 to Apportion Its Missouri Franchise Tax Base

In *Union Electric Company v. Morris*, 222 S.W.2d 767 (Mo. 1949), this Court addressed facts very similar to the facts at hand and concluded that the value of a Missouri taxpayer's shares of stock in Illinois subsidiaries was not included in the Missouri taxpayer's franchise tax base because the shares represented assets employed outside of Missouri. There, Union Electric owned shares of stock in two subsidiaries that did business and held assets only in Illinois. As here, the Director claimed that the value of the shares of such stock were to be included in Union Electric's franchise tax base.[5] This Court rejected that argument, first noting that the franchise tax statute was to be strictly construed in favor of the taxpayer and against the

[5] The franchise tax statute was Section 4997.135, R.S.A. 1943, which was substantively the same as Section 147.010 in every material respect.

taxing authority. *Id.* at 770. The Court then recognized that the Missouri General Assembly "intended to make the extent of the use of the franchise a basis for the computation of the franchise tax" and that the franchise is used "in accordance with the property actually used in the business." *Id. citing State ex rel. Marquette Hotel Investment Company v. State Tax Commission*, 221 S.W.2d 721, 723 (Mo. banc 1920). The Court concluded that the stock held in the Illinois companies was not used in business in Missouri:

> "While respondent's capital was invested in the shares of stock and while the shares of stock were owned and held by respondent a domestic corporation in this state, the capital so invested and evidenced by such shares of stock was not employed in business in this state, but was employed where the property and business of the two foreign corporations was located. The property and assets and earnings, to which the shares of stock entitled respondent to a distributive share, were admittedly not located in this state."

Accordingly, the Court's holding was as follows:

> "Reading and considering the statute as a whole and giving effect to its several provisions, ***we must hold that respondent does in fact employ part of its outstanding shares in business in another state***; that the amount evidenced by the market value of the shares of stock held in the two Illinois corporations is not 'property and assets in this state,' nor are such shares of stock "property and assets in this state" within the meaning of those words as used in the statute; that such property and assets were not 'employed in this state'; and that the ***market value*** of such shares of stock should not have been included in the tax base for

computing the amount of respondent's corporate franchise tax for said years."[6]

*Id*., 222 S.W.2d at 772.

This Court's decision in *Union Electric* is and has been the law for over fifty years, and it controls. Neither the Director nor the Commission disputed that T-3's capital investments in certain mutual funds or municipal bonds were employed by corporations and municipalities outside of Missouri. There is no meaningful difference between T-3's investments at issue and those in *Union Electric*. Quite simply, the assets that were represented by the mutual fund shares or municipal bonds at issue were not used in business in Missouri.

A straight-forward application of the *Union Electric* decision to the facts of this case makes perfect sense. The Director's construction results in multiple taxation of the same assets. Under the Director's construction, the corporations in which T-3 invests through its interest in mutual funds would be subject to franchise taxes on the assets they hold in the states where they do business. The mutual funds would, in turn, be subject to franchise taxes in the states where they do business and, because the value of the shares of stock they hold is based in part on the value of the assets held by the corporations whose stock they hold, the value of those assets would be taxed again. T-3 would then, in turn, be subject to tax on the value of its shares of the

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[6] In support of the conclusion that shares are employed outside of Missouri when capital is employed outside of Missouri, *see Household Finance Corporation v. Robertson*, 364 S.W.2d 595, 602 (Mo. banc 1963) ("[W]e have concluded that [the phrase in question] means that 'such corporation shall be deemed to have employed in this state that portion of its entire outstanding shares that its property and assets employed in this state bear to all its property and assets wherever located.'").

mutual funds and, because those shares are indirectly again based upon the value of the assets of the corporations, the value of those corporations' assets would be subject to tax for a third time. The Missouri legislature could not have intended such an absurd result. *See* Section 621.189.[7]

Therefore, because the assets at issue that T-3's capital investment represented were used entirely outside of Missouri, Section 147.010.1 ***requires*** T-3 to apportion its Missouri franchise tax base. The Commission's conclusion to the contrary is a misapplication of law, a misapplication of fact, and contrary to the reasonable expectations of the General Assembly.

[7] *See Boatmen's Bancshares, Inc. v. Director of Revenue*, 757 S.W.2d 574, 576 (Mo. banc 1988) (Missouri corporation's capital investments in and advances to Missouri subsidiaries not subject to the Missouri franchise tax because those subsidiaries already pay franchise tax on the assets purchased with such capital) and *Household Finance Corporation v. Robertson*, 364 S.W.2d 595 (Mo. banc 1963) (foreign corporation's capital investments in and advances to Missouri subsidiaries not subject to the Missouri franchise tax because those subsidiaries already pay franchise tax on the assets purchased with such capital).

### C. The Commission's Decision

As explained above, the Commission's conclusion that T-3 must pay franchise tax on capital employed outside of Missouri is contrary to Section 147.010 and the cases construing it. The Commission's asserted bases for so concluding were that: (1) T-3 did not have an office or file franchise tax returns in any state other than Missouri; (2) T-3's investments in municipal bonds issued by non-Missouri municipalities did not represent the use of capital outside Missouri; and (3) T-3's investments in mutual funds owning shares of non-Missouri corporations is distinguishable from this Court's decisions in *Household* and *Union Electric* because T-3 did not own all the share of those companies. None of these bases are consistent with Missouri law.

#### 1. Interstate Offices and Franchise Tax Returns

The first basis stated by the Commission for ignoring *Union Electric* and upholding the assessment against T-3 was the fact that T-3 had no offices outside of Missouri and did not file franchise tax returns outside of Missouri (L.F. 118-19). These facts, while true, are irrelevant. Section 147.010.1 provides that a company that employs its assets outside of Missouri is to compute its franchise tax on the assets employed in business in Missouri. There is no requirement anywhere in the statute that a corporation have offices in other states or file franchise tax returns in other states. This is likely because the legislature understood that, in a case such as this, T-3 has "de facto" offices through the corporations in which it has invested its funds. If those were requirements, this Court would have discussed those requirements in *Household* and in *Union Electric*. The fact that these newly discovered requirements are not in the statute or this Court's prior decisions demonstrates that the Commission's reliance on these facts is misplaced. Indeed, such a requirement would make no sense. In essence, the

Commission appears to require that taxpayers prove double taxation in another state or states in order to be permitted to apportion their respective Missouri franchise tax bases (corporation owning shares must file returns and pay tax on those shares in another state even though the corporations whose shares are owned must pay tax on their assets in that other state).

As set forth above, this rationale applies to mutual funds whose assets consist of shares of corporations that ***do*** file franchise tax returns. Consequently, T-3 can be considered as filing "de facto" franchise tax returns through such corporations. There is no doubt that corporations owning assets used in other States are subject to the various franchise tax statutes of such other States. There is nothing in Section 147.010 conditioning the requirement to apportion the Missouri franchise tax base upon the franchise tax policies of our sister States. Therefore, the Commission's imposition of this nonstatutory condition must be rejected by this Court.

**2. Municipal Bonds**

The Commission stated that the investments in municipal bonds did not constitute the employment of capital outside of Missouri (L.F. 120-21). The basis for that conclusion was the Commission's determination that T-3 conducted its investment operations in Missouri and received its return from the capital in Missouri. However, this Court expressly rejected this rationale in *Household Finance Corporation v. Robertson*, 364 S.W.2d 595, 602-03 (Mo. banc 1963). There, the taxpayer argued that its cash held in bank accounts outside of Missouri and available for loans to Missouri customers by Missouri branches was not used in business in Missouri. This Court disagreed, stating that the place where the funds were actually made available for loans was where the funds were employed in business. Here, T-3's investments in bonds

represented capital that was actually used by the recipient cities in states other than Missouri. The place where the capital is employed, and not the place where the decision is made to employ it, is determinative. Otherwise, Union Electric would have paid franchise tax on the value of stock in its Illinois subsidiaries.

The Commission's ruling in this regard turns this Court's precedent on its head. The Commission concluded that the location of the investment activities is determinative and that the location where the capital is utilized was irrelevant. Because that conclusion conflicts with this Court's determinations in *Union Electric* and *Household Finance*, it should be again rejected by this Court.

### 3. Investments in Mutual Funds

The Commission conceded this Court's holding in *Union Electric*: that the investment in shares of subsidiary corporations that do not conduct business in Missouri and have no assets in Missouri is not included in the investing corporation's Missouri franchise tax base (L.F. 120). Under this rule, T-3 should not include in its franchise tax base the investments in mutual funds owning shares of corporations doing business exclusively outside Missouri. However, the Commission purported to distinguish *Union Electric* from this case on the basis that in *Union Electric*, the parent corporation owned 100% of the stock of the Illinois subsidiaries, while T-3 owned only a portion of the entities in which it invested (L.F. 120). Nothing in the *Union Electric* decision or Section 147.010 indicates that the percentage of ownership is determinative. Rather, the focus is on whether the assets that the investment represents are used in business wholly outside of Missouri. Indeed, it makes no sense for a corporation's assets to be effectively taxed twice if that corporation is not wholly owned but taxed only once if it is

wholly-owned. Thus, the Commission's purported distinction of *Union Electric* is not supported by law or reason.

In summary, because T-3 employs part of its assets in business outside of Missouri, it is required under Section 147.010 to apportion its Missouri franchise tax base.

## II. THE ADMINISTRATIVE HEARING COMMISSION ERRED IN UPHOLDING THE ASSESSMENT BECAUSE, UNDER SECTIONS 621.189 AND 621.193, THAT DECISION IS NOT AUTHORIZED BY LAW OR SUPPORTED BY COMPETENT AND SUBSTANTIAL EVIDENCE IN THAT THE ALTERNATE METHOD OF APPORTIONMENT USED BY T-3 FAIRLY REFLECTS ITS ASSETS USED IN BUSINESS IN MISSOURI, IN THAT THE SECRETARY OF STATE PREVIOUSLY APPROVED T-3'S USE OF THE ALTERNATE METHOD OF APPORTIONMENT AND IN THAT THE REGULATION'S METHOD OF APPORTIONMENT DOES NOT FAIRLY APPORTION ALL "ASSETS AND PROPERTY" OF T-3.

### A. Introduction

Assuming that T-3 is entitled or required to apportion its tax base for purposes of determining its Missouri franchise tax under Section 147.010 (Point I), the remaining issue is whether T-3 is required to follow the regular apportionment formula set forth in the Regulation (15 CSR 30-150.170 during the Tax Periods) or whether an alternative apportionment formula was warranted. Although far from clear, the Commission apparently rejected T-3's alternative apportionment formula (L.F. 222-3), even though: (1) apportionment under the Regulation's regular formula results in an apportionment ratio of zero (0/0 because T-3 had no accounts receivable, inventories or land and fixed assets), and; (2) neither the Director nor the Commission ever questioned the fairness, accuracy or precision of T-3's alternative apportionment formula that directly allocated each asset.

The Commission acknowledged that the Regulation provides "that a corporation having assets both within and without Missouri should calculate the percentage of its assets

attributable to Missouri[.]" (L.F. 222). The Regulation's regular apportionment formula determines the apportionment percentage by placing in the numerator all Missouri accounts receivable, inventories and land and fixed assets and by placing in the denominator all accounts receivable, inventories and land and fixes assets located everywhere. Since T-3 had no accounts receivable, inventories or land and fixes assets anywhere, both the numerator and denominator would be zero (0/0). This result shows exactly why T-3's alternative formula was warranted. The Commission identified this issue, but basically ignored it by failing to give any reason why T-3's alternative formula was not fair, accurate or precise.

### B. The Alternative Method of Apportionment Fairly Reflects T-3's Assets Employed in Missouri

The literal application of the Regulation and the Secretary of State's franchise tax forms demonstrates the necessity for an alternative method of apportioning T-3's franchise tax base due to the unique nature of its business. The Regulation clearly allows for it.[8] Significantly, Section 147.010 literally dictates an allocation based upon "property and assets," and not based upon just "accounts receivables, inventories, and land and fixed assets." T-3's alternative apportionment formula allocates all of its property and assets; the Regulation's regular formula fails to do so in the context of T-3's business. One can only wonder whether the Director or

[8] TSI does not ask this Court to determine that it is not liable for Missouri franchise tax, notwithstanding TSI's entitlement to such a result under a literal interpretation of the Regulation and the franchise tax forms (because the numerator of the fraction is zero) because such a result would be clearly unfair in light of TSI's business operations in Missouri.

Commission would take such an extreme position if T-3 owned, in addition to its other assets, one fixed asset, ***and it was outside of Missouri***.[9]

The alternate method of apportionment used by T-3 fairly reflects T-3's business assets utilized in Missouri. Neither the Director nor the Commission have proffered a single argument that the alternate method of apportionment, in the words of the Regulation, does not "fairly reflect" "the proportion of [a taxpayer's] outstanding shares and surplus that its property and assets employed in this state bears to all its property and assets wherever located." Indeed, how could they? The position of the Director and the Commission is that ***all assets are includable in the tax base*** unless a taxpayer has certain types of assets (accounts receivable, inventories or land and fixed assets). Under the Commission's decision, T-3 would pay Missouri franchise tax on capital employed outside of Missouri simply because it had none of these types of assets. This result is contrary to *Union Electric* because it would have the effect of imposing franchise tax on capital that is, as in *Union Electric*, not employed in business in Missouri. This result is also contrary to the purpose of the law to impose the tax based upon the extent of the exercise of the franchise in Missouri, based upon "the amount of outstanding capital stock; and second, upon any surplus property employed in its business in the state." *Boatmen's Bancshares, Inc. v. Director of Revenue*, 757 S.W.2d 574 (Mo. banc 1988).

T-3 is not exercising its franchise to the extent its capital is used in business outside of Missouri as with the assets T-3 excluded in the alternative method of apportionment. This Court in *Union Electric* concluded that Union Electric's shares of stock in subsidiaries that had no assets in Missouri were assets not to be included in Union Electric's franchise tax base. It apparently did not matter to the Court whether Union Electric held certain other assets (like

[9] The numerator would still be zero, but the denominator would then be more than zero.

accounts receivable) entirely within or without Missouri because that fact was not mentioned. T-3's allocation formula fairly reflects this Court's construction of the franchise tax in *Union Electric* because T-3 pays a franchise tax on its capital employed in business in Missouri while it does not pay franchise tax on its capital employed in business outside Missouri.

## CONCLUSION

For all of the foregoing reasons, T-3 properly completed its Missouri franchise tax returns for the Tax Periods. Accordingly, this Court should reverse the Commission with instructions to enter an Order that T-3 has no additional Missouri franchise tax liability for the Tax Periods.

Respectfully Submitted,

BRYAN CAVE LLP

Juan D. Keller, #19864
B. Derek Rose, #44447
One Metropolitan Square
211 North Broadway, Suite 3600
St. Louis, Missouri 63102
Telephone: (314) 259-2000
Facsimile: (314) 259-2020

Edward F. Downey, #28866
221 Bolivar Street, Suite 101
Jefferson City, MO 65101
Telephone: (573) 556-6622
Facsimile: (573) 556-6630

Attorneys for Appellant

## CERTIFICATE OF SERVICE

I hereby certify that two true and accurate copies of the foregoing, as well as a labeled disk containing the same, were mailed first class, postage prepaid or hand-delivered this _____

day of June 2003, to Jim Layton, Assistant Attorney General, Missouri Attorney General's Office, P.O. Box 899, Jefferson City 65102.

## CERTIFICATE REQUIRED BY SPECIAL RULE 1(C)

I hereby certify that the foregoing brief includes the information required by Supreme Court Rule 55.03 and complies with the limitations contained in Supreme Court Special Rule 1(b). The foregoing brief contains 5,535 words.

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