IN THE SUPREME COURT OF MISSOURI
No. SC 97582

INTERVENTIONAL CENTER FOR PAIN MANAGEMENT,

Appellant,

v.

DIRECTOR OF REVENUE,

Respondent.

Appeal from the Administrative Hearing Commission of Missouri
The Honorable Renee T. Slusher, Commissioner

BRIEF OF APPELLANT INTERVENTIONAL CENTER FOR PAIN MANAGEMENT

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

JURISDICTIONAL STATEMENT

Appellant Interventional Center for Pain Management (the Center) appeals the November 8, 2018, decision of the Administrative Hearing Commission finding that certain medical items used by the Center in compounding medications to create new drug products for administration to patients do not fall under the use tax exemption of section 144.054.2, RSMo.

The Center timely filed a petition for review in this Court under section 621.189 and Rule 100.02. This Court has exclusive appellate jurisdiction over this appeal under article V, section 3 of the Missouri Constitution because the Commission's decision involves the construction of Missouri's revenue laws.

STATEMENT OF FACTS

The question in this appeal is whether certain medical items used by the Center to mix and administer medication to patients are materials used in the compounding of a product as that phrase is used in section 144.054.2 and are therefore exempt from use tax. The facts below were taken largely from the Commission's findings of fact in its decision.

The Center is a medical business that treats and manages patients' pain. LF at 59; App 2. The Center has two locations in Missouri and one in Illinois. *Id*. Dr. Gurpreet Singh Padda is a physician at the Center. *Id*. The Center purchases large quantities of drugs and uses needles, syringes, and trays to compound and mix various medications together in order to obtain the necessary "therapeutic effect" for the patient. LF at 66; App 9. To compound medications, Dr. Padda extracts a drug with a syringe from a bigger, multi-dose bottle, and adds syringes of other medication together to make the compound drug, which is then injected into the patient. *Id*. The Center generally mixes together three or four drugs to create the compound drug. *Id*.

The Center cannot simply inject the drug as it was purchased. LF at 66; App 9. "By compounding the drugs, Padda makes the compounded drug into something that's usable for the patient." *Id*. Dr. Padda formulates the compounded drug based on the disease or joint location, the drug is not adjusted based on the individual patient. LF at 67; App 10; Tr. at 45-46. Regardless of the individual, if she has a particular disease or joint pain, she will receive the same compounded medication. *Id*.

After an audit by the Director of Revenue, the Center filed a complaint appealing the Director of Revenue's final assessments of use tax on certain medical items purchased. LF at 58, 1-55; App 1.

A. The medical items purchased by the Center.

The Center sought use tax exemptions under section 144.054.2 on its purchase of Accu-Tips, cannulas, Hustead needle kits, non-specialized needle trays, and Luer-Lok syringes totaling $263,028.62. LF at 61-66; App 4-9. Accu-Tips are prepared kits that contain needles and a variety of filters, syringes, and catheters to mix and prepare medications. LF at 61; App 4; Tr. at 44-45. Cannulas are similar to Accu-Tips in that they are used to mix and deliver medication to the body. Tr. at 48-49. Cannulas (or cannula shields) are used to focus the medication on the part of the body that needs it and prevent the medicine from flowing to unnecessary places. Tr. at 48; LF at 62-63; App 5-6.

Hustead needles are used to inject medicine into the cervical epidural space of the spine. LF at 63; App 6. The needles use the purchased medications (like Diazepam) combined with the air in the room to create a loss of resistance, ensuring the medication gets into the right epidural space. *Id*. at 63, 65; App 6, 8. Non-specialized needle trays contain different sized syringes and needles with filter systems. LF at 64; App 7. They are general purpose needle trays for the administration of different medications. *Id*. Finally, Luer-Lok syringes allow the doctor administering the medication to attach a second syringe to the Luer-Lok and mix different solutions in the same syringe. LF at 65; App 8.

The Commission held that, although categorized differently, all of the items for which the Center sought exemptions share commonalities that allow the Commission to analyze them together. LF at 71; App 14. All items permit the safe mixing and/or administration of medicine and are used in the process to withdraw, transport, or inject medications. *Id*. All items are sterile and disposed of after a single use. *Id*.

B. The Commission's application of section 144.054.2.

The Commission held that 12 CSR 10-110.601 defines compounding as "producing a product by combining two (2) or more ingredients or parts." LF at 74; App 17, 46. Thus, the Center's practice of combining two or more ingredients in a sterile environment by following a set formula or recipe to create a unique medication used to treat patients falls within the regulation's definition of compounding. *Id*.

Likewise, the Commission held that the term "product" as used in section 144.054.2 refers to an "output with market value" that is marketable to various buyers. *Id*. (citing *Fenix Const. Co. of St. Louis v. Dir. of Revenue*, 449 S.W.3d 778, 780 (Mo. banc 2014)). A product can either be tangible personal property or a service. *Id*. (citing *Int'l Bus. Machs. Corp. v. Dir. of Revenue*, 958 S.W.2d 554, 557 (Mo. banc 1997); *E & B Granite, Inc. v. Dir. of Revenue*, 331 S.W.3d 314, 317 (Mo. banc 2011)). The Commission found that when compounding, the Center uses a common formulation and very specific recipe per disease or joint location. LF at 74-75; App 17-18. Though not unique to each patient, the compounded drugs are unique to a specific joint within the patient's body. LF at 74-75; App 17-18. Accordingly, the Commission held that each

compounded drug is marketable to various medical patients suffering from similar conditions and is therefore a "product." *Id*.

Though the items purchased were used in compounding products, the Commission held that those items were not "materials" under section 144.054.2. LF at 70-75; App 13-18. The Commission noted that the term "materials," like the terms "compounding" and "product," is not defined in Chapter 144. LF at 70; App 13. The Commission cited this Court's decision in *E & B Granite*, where the Court noted the definition of "materials" contains "the raw product from which something is made or … an apparatus necessary to make something." LF at 71 (citing 331 S.W.3d at 318); App 14. The Court in *E & B Granite* held that raw ingredients were included in the definition of "materials," but did not further discuss whether an "apparatus" could qualify. LF at 71-72; App 14-15.

The Commission noted that the Court revisited the "apparatus" question in *Alberici Constructors, Inc. v. Dir. of Revenue*, 452 S.W.3d 632, 637 (Mo. banc 2015), where the Court held that cranes and welders were not materials but rather machinery. LF at 72; App 15. The Court concluded that, because the term machinery is used in section 144.030 and not in section 144.054.2, the legislature must have intended "machinery" to mean something different than "materials." *Id*.

The Commission also observed that the term "supplies" is used in section 144.030 but not in section 144.054.2. LF at 72-73; App 15-16. The Commission held that, in the dictionary, the term "supply" is defined as "items or a quantity (as provisions, clothing, arms, or raw material) available for use, exploitation, or development or esp. set aside to be dispensed at need." LF at 73; App 16. The Commission agreed with the Director that

the disputed medical items were more closely associated with "supplies" than "materials" and while section 144.040.2(5) and (6) exempt supplies, section 144.054.2 does not. *Id*. The Commission held that the items were bought in large quantities and set aside to exploit for a single use as needed. *Id*.

The Commission noted that this Court has never held that apparatuses fall within the definition of materials for purposes of section 144.054.2. Instead, the Commission found, this Court has arguably indicated that the term materials should be limited to raw products from which something is made. *Id*. (citing *Alberici*, 452 S.W.3d at 637). Thus, the Commission held that these items are not materials and are not exempt from use tax under section 144.054.2. *Id*.

C. The Director's Letter Ruling 7873.

On September 26, 2017, after the Commission held its hearing in this case but before the Commission released its decision, the Director released Letter Ruling 7873. LF at 75; App 18, 41-44. The request for a letter ruling was received from an applicant engaging in compounding pharmaceuticals that are then distributed to hospitals and surgical centers. *Id.* The letter ruling held that the applicant's purchases of syringes, needles, filter bags, shoe covers, coveralls, goggles, hoods, gloves, boot covers, and facemasks used during the compounding of medications are exempt from use tax under section 144.054.2. *Id*.

In addressing the letter ruling, the Commission in its brief noted that the Director did not attempt to distinguish this letter ruling to the facts of this case. LF at 75; App 18. Rather, the Director argued that section 144.054.2 applies only to "industrial-type

environments." *Id*. Although recognizing that the letter ruling did not provide adequate detail about the size of the applicant's compounding operation, LF at 75, n. 12, the Commission agreed with the Director that the analysis in the letter ruling did not apply to the Center's activities, LF at 75. App 18.

The Commission held that this Court in *Fred Weber, Inc. v. Dir. of Revenue*, 452 S.W.3d 628 (Mo. banc 2015), discussed the narrowing of section 144.054.2 to industrial processes. LF at 75; App 18. In *Fred Weber*, the Court concluded that paving companies that bought rock base and asphalt from the taxpayer were not "manufacturing," "compounding," or "producing" as used in section 144.054. *Id*. The Court held that the activities in section 144.054.2 "are what can best be described as large-scale industrial activities." LF at 76 (citing *Fred Weber*, 452 S.W.3d at 630-631); App 19. The Commission held that the Center's compounding operation likewise does not rise to the level of "large-scale industrial activity" as required by the Commission's interpretation of section 144.054.2. *Id*.

The Center timely filed a petition for review of the Commission's decision on December 7, 2018.

POINT RELIED ON

I. The Commission erred in holding that certain medical items purchased by the Center were not exempt from the use tax under section 144.054.2 because these items are materials used in compounding a product in that the common sense meaning of the statute's language encompasses these types of items and activities, a recent amendment from the legislature tacitly acknowledges that section 144.054.2 is not strictly limited to large-scale industrial activities, and the word "materials" as used in the statute is not limited to raw materials.

E & B Granite, Inc. v. Dir. of Revenue, 331 S.W.3d 314 (Mo. banc 2011)

§ 144.054, RSMo

12 CSR 10-110.601

12 CSR 10-110.201

ARGUMENT

I. The Commission erred in holding that certain medical items purchased by the Center were not exempt from the use tax under section 144.054.2 because these items are materials used in compounding a product in that the common sense meaning of the statute's language encompasses these types of items and activities, a recent amendment from the legislature tacitly acknowledges that section 144.054.2 is not strictly limited to large-scale industrial activities, and the word "materials" as used in the statute is not limited to raw materials.

Consistent with the Director's Letter Ruling 7873, the broad language of section 144.054.2 encompasses the medical items used by the Center in compounding drugs for treatment of its patients. *See* App 41-44.

The Court has also acknowledged that the language used in section 144.054.2 is broader than section 144.030. *See E & B Granite*, 331 S.W.3d at 317. Indeed, whereas section 144.030 exempts specific items in individual subsections, section 144.054.2 contains general language exempting a host of machinery, equipment, and materials used or consumed in various activities. By the plain language of the statute, the legislature intended to provide additional exemptions under section 144.054.2 that are not allowed by section 144.030. *Id*. Those exemptions include the medical items used by the Center.

In 2018, the Missouri legislature abrogated this Court's most recent decision interpreting the scope of section 144.054.2—*IBM Corp. v. Director of Revenue*, 491 S.W.3d 535 (Mo. banc 2016)—and reinstated the Court's *DST* and *Southwestern Bell* line of cases, which held that materials or equipment used in the transmutation of a human

voice over a telephone line or organizing information through computer technology are exempted from use tax under the "manufacturing" exemption. SB 768 at p. 4 (2018); App 35-40; §§ 144.030, 144.054, RSMo; App 24, 33. The legislature amended sections 144.030 and 144.054 to include materials or equipment used in the production, or production and transmission, of telecommunications services. *Id*. In the amendment, the legislature affirmed this Court's interpretation of the exemptions in *DST Systems, Inc. v. Director of Revenue*, 43 S.W.3d 799 (Mo. banc 2001), *Southwestern Bell Tel. Co. v. Director of Revenue*, 78 S.W.3d 763 (Mo. banc 2002) (*Bell I*), and *Southwestern Bell Tel. Co. v. Director of Revenue*, 182 S.W.3d 226 (Mo. banc 2005) (*Bell II*). *Id*.

The 2018 amendment to section 144.054.2 indicates that the legislature intended section 144.054.2 to not be limited to only large-scale industrial activities. This amendment, the Director's own regulations interpreting the term "materials" under section 144.054.2, and the Director's letter ruling that needles, syringes, masks, and goggles used in compounding medications qualify for a use tax exemption under section 144.054.2, warrant the conclusion that the Center's medical items were materials exempt from use tax under section 144.054.2. The Court should reverse and remand.

A. Standard of review and preservation.

This Court reviews the Commission's interpretation of revenue laws *de novo*. *E & B Granite*, 331 S.W.3d at 316. The taxpayer carries the burden of showing they are entitled to an exemption under the statute and exemptions from taxation are strictly construed against the taxpayer. *Bell II*, 182 S.W.3d at 228. Any doubt is resolved in favor of application of the tax. *Id*.

The Center preserved this point relied on by appealing the Director's final assessment to the Commission and arguing that these items are exempt from use tax under section 144.054.2. LF at 1-55; SLF at 1-13.

B. The Center's activities fall within section 144.054.2's exemption.

The 2018 amendment to section 144.054.2 made plain the legislature's intention not to limit section 144.054.2 to only large-scale industrial activities. SB 768 (2018); App 35-40; § 144.054.2, RSMo; App 33.

Prior to the 2018 amendment, section 144.054.2 read as follows:

> In addition to all other exemptions granted under this chapter, there is hereby specifically exempted from the provisions of sections 144.010 to 144.525 and 144.600 to 144.761, and from the computation of the tax levied, assessed, or payable under sections 144.010 to 144.525 and 144.600 to 144.761, electrical energy and gas, whether natural, artificial, or propane, water, coal, and energy sources, chemicals, machinery, equipment, and materials used or consumed in the manufacturing, processing, compounding, mining, or producing of any product, or used or consumed in the processing of recovered materials, or used in research and development related to manufacturing, processing, compounding, mining, or producing any product. The exemptions granted in this subsection shall not apply to local sales taxes as defined in section 32.085 and the provisions of this subsection shall be in addition to any state and local sales tax exemption provided in section 144.030.

Applying the manufacturing exemption from section 144.030, the Court in *DST* held that certain mainframe computers and various other materials used in organizing or processing information through computer technology are "used in manufacturing products" and therefore exempt from use tax under section 144.030. 43 S.W.3d at 802-804; *Bell II*, 182 S.W.3d at 235-236. In *Bell I* and *Bell II*, the Court held that basic telephone services were intangible products that are manufactured and the equipment

used to manufacture those products was exempt from use tax under section 144.030. *Bell I*, 78 S.W.3d at 768; *Bell II*, 182 S.W.3d at 235-237.

Eleven years after *Bell II*, the Court issued *IBM*, holding that the sale of hardware and software by IBM to MasterCard for use in processing credit card transactions was not exempt from use tax under section 144.054.2 because the hardware and software were not used in manufacturing a product. *IBM*, 491 S.W.3d at 536-537. The Court held that the expanding definition of "manufacturing" in the *Bell* cases put the Court "too far down a slippery slope." *Id*. at 541. In support, the Court cited cases issued after *Bell I* and *II* that refused to expand "manufacturing" to include other activities such as construction or the preparation of food. *Id*. at 540-541.

For example, in *Fred Weber*, the Court held that the paving of roads does not qualify as "manufacturing," "processing," or "compounding," under the exemption of section 144.054.2. 452 S.W.3d at 631. The Court noted that the plain and ordinary language of section 144.054.2 connotes large-scale industrial-type activities. *Id*. (citing *Union Elec. Co. v. Dir. of Revenue*, 425 S.W.3d 118, 124 (Mo. banc 2014)). The Court held that the paving of roads is not what can best be described as large-scale industrial activity, but rather construction, which is not exempted under the statue. *Id*; *see also Ben Hur Steel Worx, LLC v. Dir. of Revenue*, 452 S.W.3d 624 (Mo. banc 2015).

Similarly, in *Brinker Missouri, Inc. v. Director of Revenue*, 319 S.W.3d 433 (Mo. banc 2010), the Court rejected a taxpayer's argument that a restaurant was engaged in "manufacturing" when it prepares, cooks, and serves food. Rather, the Court held that, in lay terminology, one does not speak of a restaurant as manufacturing or producing food

or drink; instead restaurants prepare, cook, and serve food and drink to their customers. *Id*. at 437-438. The Court held that had the legislature wanted to include this type of activity, it would have used words like "restaurant," or "preparation" or "serving." *Id*. at 438; *see also Aquila Foreign Qualifications Corp. v. Dir. of Revenue*, 362 S.W.3d 1, 5 (Mo. banc 2012).

The Court in *IBM* noted that these cases reflect the Court's consensus to interpret the term "manufacturing" based on the "common sense meaning of the word." *IBM*, 491 S.W.3d at 541. The Court held that had the legislature intended financial transactions or computer communications to be subject to the exemption in section 144.054.2, it could have easily added language to the statute as it had in other exemptions. *Id*.

In 2018, however, the legislature added language to the end of section 144.054.2 affirming the "construction and application of this subsection as expressed by the Missouri supreme court" in *DST*, *Bell I*, and *Bell II*. SB 768 at p. 15; App 40. The 2018 amendment to sections 144.030 and 144.054 effectively abrogated *IBM* and reinstated the *Bell* and *DST* cases. SB 768 (2018) at p. 4, 15; App 38, 40. Thus, under the 2018 amendment and the holdings in *DST* and *Bell I* and *II*, the sale of a computer for use in the transmission or production of telecommunication services or the organization or processing of computer information fall under the use tax exemption of section 144.054.2.

In amending the statute, the legislature confirmed that section 144.054.2 applies to activities that may not be considered in lay terminology "large-scale industrial activities." SB 768 (2018) at p. 4; App 38 (noting that the amendment "does not make a substantive

change in the law and is intended to clarify that the term 'manufacturing' has included and continues to include the production of and transmission of 'telecommunications services'"). Thus, whereas *Union Electric* and *Fred Weber* found a legislative intent to limit section 144.054 to large-scale industrial activities, that limitation should no longer inform this Court's interpretation of the Center's activities and those activities should be held to fall under section 144.054.2.

If, however, the Court determines that the 2018 amendment is narrow, and only abrogated *IBM* to the extent it overturned the *Bell* cases, the logic of this Court in *Fred Weber, Ben Hur*, *Brinker*, *Aquila*, and *IBM*, still compels the conclusion that the Center's activities of mixing pharmaceuticals to create new medications falls within the common sense meaning of the word "compounding." Though one may not speak of cooking and serving food as "processing," or paving streets as "constructing," even the FDA speaks of mixing medications as compounding: "Drug compounding is often regarded as the process of combining, mixing, or altering ingredients to create a medication tailored to the needs of an individual patient. Compounding includes the combining of two or more drugs." *Compounding and the FDA: Questions and Answers*, U.S. Food & Drug Administration, https://www.fda.gov/drugs/guidancecomplianceregulatoryinformation/pharmacycompounding/ucm339764.

Further support for this interpretation comes from the Director's own Letter Ruling 7873 on September 26, 2017, addressing whether an applicant's purchase of certain syringes, needles, and filter bags "used in compounding the medications" fell under the use tax exemption of section 144.054.2. App 41-44. The Director ruled that

the "applicant engages in compounding various drug components into medications, which are new products, used in hospitals and surgical centers." App 42 (see Response 2). The Director held that the applicant's purchases of weigh boats, sterile tubing sets, sterile syringes, needles, and filter bags are exempt from use tax under section 144.054. App 42-43 (see Response 3). Under section 536.021.10, the letter ruling binds the Director or the Director's agents and their successors for a minimum of three years. § 536.021.10, RSMo.

The Director did not address this ruling in the Center's case before the Commission. Although the Commission found the Center's argument "notable," it held that, given this Court's indication that section 144.054.2 applies to large-scale industrial activity, the Center's activities do not fall within the exemption. LF at 76; App 19. While acknowledging that the letter ruling did not provide adequate detail regarding the size of the applicant's compounding operation in Letter Ruling 7873, the Commission inferred that the wording in the letter ruling suggests a much larger compounding process than the Center's. *Id*.; LF at 75, n. 12; App 18-19.

The Commission's interpretation of the letter ruling improperly adds language to the statute by limiting its application to operations of a particular size or scale. Without any support in the language of the statute, the Commission's interpretation of the letter ruling requires the Director, Commission, or any other entity applying this exemption to arbitrarily determine whether an operation is large enough to qualify as a "large-scale" operation, even when the taxpayer's activities fall within the common sense meaning of the words used in the statute to describe exempted activities.

Under the Commission's interpretation, if two medical companies both engage in identical compounding activity, yet one has three stores and the other has 300, the company that compounds medication across 300 stores falls under the use tax exemption while the smaller company does not. There is no language in the statute restricting these exemptions to companies of a certain size.

Even if this Court's holdings limiting section 144.054 to "large-scale industrial activity" remain after the amendment, the foundation for these holdings was the Court's refusal to expand an exemption past the common sense meaning of the statute's language—e.g. equating constructing or computer processing with "manufacturing," or preparation of food with "processing." In this case, however, the legislature expressly used a term comprehending the exact activity the Center engaged in: compounding. No expansion of the word is necessary.

The Court in *Fred Weber, Ben Hur*, *IBM, Aquila*, and *Brinker* also noted that terms more commonly associated with constructing, computer processing, and preparing and serving food appeared in other sections of Chapter 144. Nothing similar informs the application of section 144.054.2 to the Center's activities. Words related to the mixing of medication do not appear anywhere in that chapter. Rather, the only section in Chapter 144 tangentially related to the medical field appears in section 144.030.2(18), which exempts certain sales of medical equipment and prescription drugs in a different context,

not the type of compounding activity of the Center.[1] Thus, nothing in the statute argues against the reasonable conclusion that the legislature intended to include this type of activity within section 144.054.2's exemption.

The Center's activities fall within the term "compounding" in section 144.054.2 and the Director's own interpretation of the statute.

C. Section 144.054.2 is not limited to raw materials.

The Commission's finding that the term "materials" is limited to raw products from which something is made also is inconsistent with the language of the statute, this Court's precedent, and the Director's own regulations and letter rulings. LF at 73.

Neither this Court nor the legislature have definitively defined the term "materials" as used in section 144.054.2. In *Alberici*, the Court cited the definition of materials to include both "basis matter" (such as wood, metal, or plastic) from which the whole or the great part of something physical is made and an apparatus (tools) necessary for doing or making something. 452 S.W.3d at 637. In refusing to find that cranes and welders fell within the definition of materials, the Court found they more closely resemble machinery or equipment, two terms that were used in section 144.030 but not in section 144.054.2 at the time. *Id*. at 637-638. The Court held that the legislature's use of different terms is presumed to be intentional, and, by using "materials" instead of "machinery," the legislature intended for materials to mean something different. *Id*. at

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[1] The Commission found this exemption applied to certain drugs the Center purchased, but that exemption is not at issue in this appeal. LF at 69-70; App 12-13.

638. The Court held only that cranes and welders were not materials; it never held that materials were limited to raw materials.

Section 144.054.2 exempts "materials." There is no language limiting these materials to only raw materials. Like the term "machinery" in *Alberici*, however, the term "raw materials" appears twice in section 144.030: "… exclusive of the cost of electrical energy so used or if the ***raw materials*** used in such processing contain at least twenty-five percent recovered materials as defined in section 260.200. There shall be a rebuttable presumption that the ***raw materials*** used in the primary manufacture of automobiles contain at least twenty-five percent recovered materials." § 144.030.2(12), RSMo (emphasis added); App 25.

Using the same logic as *Alberici*, because the legislature passed section 144.054.2 after section 144.030.2(12), it is presumed that the legislature intended to omit the term "raw" from "materials" in section 144.054.2. *Compare* App 25 and App 33. The legislature knew how to limit "materials" to only raw materials and chose not to do so in section 144.054.2. By using two different terms in separate statutes, the legislature must have intended those terms to mean different things, with "materials" necessarily having a broader meaning than "raw materials."

Further, in *E & B Granite*, this Court rejected the Director's arguments that "materials" must be entirely consumed to qualify for the exemption. 331 S.W.3d at 318. The Court reasoned that section 144.054.2 is not limited to materials "consumed" but rather "used ***or*** consumed." *Id*. Under this analysis, the legislature must have intended a different, broader result than the Director claimed. *Id*.

The Director's own interpretation of this statute—in both the regulations and its letter ruling—indicates that the term "materials" includes the exact type of items at issue in this case. When a statute is silent or ambiguous on an issue—as the statute is here with respect to the term "materials"—a state agency has the power to form policy and make necessary rules to fill gaps left by the legislature. *Farrow v. Saint Francis Med. Ctr.*, 407 S.W.3d 579, 592 (Mo. banc 2013) (superseded by statute on other grounds). These regulations are entitled to a presumption of validity and should not be judicially invalidated except for "weighty reasons," and are to be sustained unless unreasonable and plainly inconsistent with the statutes. *Id*.

The regulations interpreting the term "materials" under the statute give real-world examples of how the Director should apply the exemption. For example, a toy manufacturer's purchase of sandpaper used to make wooden rocking horses is exempt from use tax because sandpaper "is a material that is consumed in producing a product." 12 CSR 10-110.201(3)(A); App 45. Likewise, an automobile manufacturer's purchase of soap to wash all automobiles as they leave the plant is exempt from use tax because "soap qualifies as a material used or consumed in manufacturing." *Id*. at (3)(B). Finally, a commercial photo developer's purchase of "crop cards" to hold individual negatives in the film developing process, which are discarded after a single use, and the tape used to connect negative strips are exempt from use tax "as materials used and consumed in producing a product." 12 CSR 10-111.011(4)(B); App 48.

Just like sandpaper, soap, tape, and crop cards, the syringes and needles used by the Center to compound medication may not be ***raw*** materials but are materials under

section 144.054.2 as the term has been interpreted by the Director's regulations. Just as the crop cards are thrown away or the soap is washed off after a single use, the medical items the Center seeks an exemption for are disposed of after a single use. LF at 73; App 16. Further, in Letter Ruling 7873, the Director held that these exact type of items—syringes and needles—are exempt from use tax under section 144.054.2, without any qualification based on the size of the compounding operation. App 41-44. Applying section 144.054.2 to the medical items used by the Center is neither unreasonable nor plainly inconsistent with the statute.

Section 144.054.2 is not limited to raw materials.

D. These medical items are materials, not supplies.

The Commission was incorrect in finding that these items are "supplies" rather than "materials." LF at 73; App 16. The Commission largely based its holding on the Director's argument that "supplies" should be defined as "items used or consumed in manufacturing that do not constitute raw product that is made into something else subsequently sold to a consumer." *Id*. Because the term "supplies" is used in section 144.030 and not in section 144.054.2, the Commission reasoned, the legislature must have intended the terms "supplies" and "materials" to apply to different things. Under the Commission's interpretation, "materials" would apply only to *raw* products from which something is made and "supplies" would apply to any other item used in creating that product. *Id*.

But the Commission's interpretation ignores the legislative choice not to include in section 144.054.2 the adjective "raw" to limit the meaning of the term "materials," as

well as the numerous examples of "materials" in the regulations and the Director's letter ruling. Sandpaper, soap, tape, and crop cards are not raw products that are made into something else subsequently sold to the consumer but ***are*** examples of "materials" that the Director's regulations recognize as exempted from use tax under section 144.054.2. *See* 12 CSR 10-110.201(3)(A) and (B); 12 CSR 10-10-111.011(4)(B); App 45, 48.

Likewise, syringes and needles may not be raw products from which something is made, but the Director's letter ruling found them to be exempt from use tax under section 144.054.2. App 42. The medical items the Center uses in compounding medication are identical—or at least of the same character—as the examples in the regulations and the letter ruling.

The Commission's limitation on "materials" to only raw products that are made into something is also inconsistent with the plain language of section 144.054.2 permitting materials "***used*** or consumed" in compounding a product. (Emphasis added). As the Court in *E & B Granite* found, "materials" under section 144.054.2 is broader and not limited to only materials that are consumed in the manufacturing process. 331 S.W.3d at 317-318.

The Center's medical items are not supplies, but materials used in compounding medication and should be exempt from use tax under section 144.054.2.

CONCLUSION

The items for which the Center sought exemptions are materials used in compounding a product. Even strictly interpreting the exemption against the Center, the plain language of the statute, the Director's regulations, and the legislature's recent

acknowledgment that this exemption is not limited to large-scale industrial activity all compel the conclusion that these medical items are exempt from use tax. The Commission's decision should be reversed and the case remanded.

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CERTIFICATE OF COMPLIANCE

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/s/ *Paul L. Brusati*