

IN THE SUPREME COURT OF MISSOURI

No. SC97932

DI SUPPLY I, LLC, AND ITS INDIVIDUAL MEMBERS, APPELLANTS,

v.

DIRECTOR OF REVENUE, RESPONDENT.

ON PETITION FOR REVIEW
FROM THE MISSOURI ADMINISTRATIVE HEARING COMMISSION
THE HONORABLE SREENIVASA RAO DANDAMUDI, COMMISSIONER

BRIEF OF APPELLANT

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JURISDICTIONAL STATEMENT

This case involves an appeal from an assessment of Missouri sales tax and interest, imposed by the Missouri Director of Revenue on DI Supply's sales of tangible personal property to various hotels and upheld by the Missouri Administrative Hearing Commission. The items purchased by the hotels include sheets and bedding, mattresses, towels, and other furnishings placed in hotel rooms for the sole use of hotel customers. The hotels collected tax on the charges paid by hotel customers for the use of the rooms and the room furnishings.

The issue before the Court in this matter involves the construction of the Missouri sales tax law found in Chapter 144, RSMo., and in particular the resale exclusion from tax found in § 144.010(13), RSMo.¹ Specifically, the issue is whether DI Supply's sales of tangible personal property to hotels for the sole use of hotel customers are excluded from tax as sales for resale.

The sales tax statutes in Chapter 144, RSMo., are revenue laws of this state, and therefore this Court has exclusive appellate jurisdiction over this matter under Article V, § 3 of the Missouri Constitution.

¹ All statutory references are to the Missouri Revised Statutes (2016), as amended, unless otherwise noted.

STATEMENT OF FACTS

The record in this case includes the pleadings filed by the parties with the Administrative Hearing Commission (“Commission”), the transcript of the hearing conducted by the Commission (cited as “Tr. ___”), and the exhibits introduced into evidence at the hearing (cited as “Ex. ___”). The Commission’s decision under appeal is included in both the Legal File (L.F. 124-146) and the Appendix to this brief (App. A1-A24). The material facts are not in dispute.

A. The Parties and Assessments

DI Supply sells furnishings and supplies to hotels operated by Drury Hotels Company LLC (“DHC”) under various hotel brands (“Drury Hotels”). The Drury Hotels are owned by Drury Development Company (“DDC”) and Drury Southwest, Inc., (“DSW”) or their subsidiaries. Tr. 51, 122, 139, 150. Some of the Drury Hotels are located in Missouri (“Missouri Drury Hotels”). Tr. 51, 120, 121; Ex. B. The transactions at issue were sales by DI Supply to the Missouri Drury Hotels.

DI Supply was formed over twenty years ago to ensure consistency in supplying products to Drury Hotels and to assist in the management of the Drury Hotels by purchasing products and negotiating contracts for the purchase of these products. Tr. 52. DI Supply is owned by DHC. DHC manages the Missouri Drury Hotels on behalf of DDC and DSW, respectively. None of the Missouri Drury Hotels are owned by DHC or DI Supply. Tr. 50, 61, 119, 120, 139.

The Director conducted an audit of DI Supply for the tax periods March 2012 through February 2015 (“Tax Periods”) and issued assessments in the total amount of:

Sales Tax	Penalty	Interest	Total
\$613,159.38	\$30,657.94	\$68,772.06	\$712,589.38

Ex. 1, 7 and A; Tr. 17 and 26. The “penalty” included in the assessments is a five percent addition to tax under section 144.250.3. Tr. 29. The Commission upheld the Director’s assessments of sales tax and interest but not the penalties. The penalties are therefore not at issue in this appeal. L.F. 22-23.²

B. The Sale of Room Furnishings

The assessments are based on sales by DI Supply to the Missouri Drury Hotels of room furnishings, which included: bath towels, bed sheets, blankets, throws, bedspreads, dusters, box spring covers, mattress covers, coffee tables, desks, desk chairs, armoires, dvd players, mirrors, hair dryers, beds, mattresses, box springs, pillows, night stands, dressers, ottomans, ice buckets, irons, ironing boards, lamps, lamp shades, microwave ovens, clock radios, refrigerators, televisions, trash receptacles, bath mats, meeting room chairs, replacement parts for furniture, rollaway beds, telephones, shower curtains, sofas, coat hangers, soap/shampoo dispensers, pictures, framed mirrors, light bulbs, shower/tub benches, ashtrays, informational cards to be placed in rooms, and luggage racks,

² Although the Commission’s decision indicates that “Petitioners” are “DI Supply I, LLC,” (L.F. 1), the Director’s assessments were issued to “DI Supply I, LLC” and to the individual members of the LLC, Joseph B. Pereles and Lambert Carr Trovillion. Ex. 1, Tab A. The Complaint filed by Appellants with the Commission named “DI Supply I, LLC, and Its Individual Members” as Petitioners. Ex. 1. Appellants presented evidence to the Commission that the current name of the entity is “DI Supply, LLC.” Tr. 49. Accordingly, this appeal was filed on behalf of all the Petitioners, including DI Supply, LLC, and its individual members.

(collectively “Room Furnishings”). Ex. 1, Tab B; Ex. 8; Tr. 122, 139, 152-153. The record in this case includes detailed schedules of all of the sales at issue. Ex. 8 and 9. The Commission’s findings of fact include the dollar amount of sales of most of the items sold by DI Supply. L.F. 130 – 132; App. A7 – A9.

DI Supply did not collect sales tax on its sales of Room Furnishings to the Missouri Drury Hotels during the Tax Periods based on advice from its attorney and accountants that tangible personal property in the hotel rooms for use by hotel customers while renting rooms is purchased for resale and not subject to Missouri or local sales or use tax. Tr. 56, 58-59; Ex. 2 and 3.

DI Supply provided the Director’s auditor with a schedule listing its sales of Room Furnishings to the Missouri Drury Hotels during the Tax Periods for which the hotels claimed a resale exclusion. Tr. 166-167. The schedule included sales of Room Furnishings totaling \$11,813,332.57. Ex. 1, Tab B; Tr. 166. The Director assessed tax on \$11,735,107.75 of DI Supply’s sales of Room Furnishings. Ex. 7; Tr. 26, 28, 168 - 170. The difference of about \$80,000 appears to reflect sales the auditor agreed with DI Supply as not subject to Missouri tax. Tr. 27-28, 168-170.

Following the audit and prior to the hearing, DI Supply’s employees along with employees of DHC, DDC and DSW, reviewed the schedule provided to the Director’s auditor and concluded that some of the sales included on the schedule were not sales for resale. Tr. 124. These sales consisted of: (1) items that became fixtures in the Missouri Drury Hotels, such as bathroom vanities, curtains, shower rods, and beveled edge mirrors that are permanently attached to the walls of the hotel rooms (*i.e.*, items that were not

tangible personal property), and (2) items used by the hotels' management, rather than the hotels' customers, such as furnishings and supplies used in the hotels' office areas. Ex. 9; Tr. 140, 170-171. The total amount of sales included in the assessments that DI Supply agreed are subject to tax is \$1,375,747.14 and the tax on these sales is \$71,882.79. Ex. 9; Tr. 124, 171; L.F. 128; App. A6.

C. Cost of Room Furnishings Factored into Rental Price of Hotel Rooms

When DDC or DSW develop a new Drury Hotel, they consider all of the costs involved, as well as the expected return on their investment. Tr. 125, 141. The costs include the cost of the Room Furnishings, which constitute 7 to 10 percent of the overall cost of development (not including land costs). Tr. 126, 142-143. This translates to between \$7,000 and \$12,000 per room. Tr. 133, 143.

The cost of Room Furnishings is also a consideration for DDC and DSW in deciding to renovate a hotel because these costs can comprise as much as 50 percent of the total cost of renovations. Tr. 127, 144. When making renovations to their hotels, DDC and DSW consider the impact the renovations will have on room charges, which is referred to as a "pay-back analysis." Tr. 145.

Some renovations allow the hotels to increase the room rates; in other instances, renovations are necessary for the hotels to remain competitive at their existing room rates, and thereby avoid losing revenue. Tr. 127-129, 144-145. To proceed with renovations, the companies' projections must show that the increase in revenue or the avoidance of lost revenue will offset the cost of the renovations within eight or nine years. Tr. 145. For example, in 2007, DDC decided to replace all of the televisions in

their hotel rooms with high definition televisions (“HDTVs”). Tr. 128. DDC created a three year plan for this change, with a projected cost of around \$1,500 to \$2,000 per room. DSW also replaced the televisions in their hotels, and together DDC and DSW spent around \$18 million on the HDTVs. Tr. 129. The companies initially hoped to increase room rates as a result of this improvement in the Room Furnishings. However, by the end of the three year period, they determined that the hotel guests’ expectations had changed, and the HDTVs were necessary to preserve the hotel’s existing room rates and maintain their competitive position in the market. Tr. 129, 145-146.

When setting room rates, the Missouri Drury Hotels compare their “product,” which includes the guest room, as well as the guest room furnishings, the décor package, and room amenities, to other hotels’ products, and develop a pricing strategy that will be competitive with the other hotels. Tr. 153. For example, the Missouri Drury Hotels include microwaves and refrigerators as standard amenities while such furnishings are not standard for many of their competitors. The inclusion of these furnishings provide the Missouri Drury Hotels a price advantage over their competitors, allowing the Missouri Drury Hotels to charge higher room rates than their competitors. Guests will also expect to pay more for their rooms when the furnishings have been replaced or upgraded in a renovation. Tr. 155.

D. The Customer Survey

DI Supply commissioned Dr. Lisa K. Scheer, Ph.D., to conduct a survey of hotel customers for the purpose of understanding how customers of the Missouri Drury Hotels viewed their transactions with the hotels, and to provide evidence that the customers

purchase, consume, or rent the furnishings of their hotel rooms. Tr. 70 - 71. Dr. Scheer is the Emma S. Hibbs Distinguished Professor and Professor of Marketing at the University of Missouri. Tr. 65; Ex. 5. She is “a respected authority in the field of marketing and capable of designing reliable customer surveys.” L.F. 126; App. A2.

Dr. Scheer conducted a survey of 236 customers who stayed in Missouri hotels or motels between 2012 and 2017. Ex. 6; App. A38. The survey respondents included 72 customers who had stayed at a Missouri Drury Hotel during that period. *Id.* Dr. Scheer was solely responsible for the design of the survey. Tr. 71, 74. She used the services of Qualtrics, a “reputable online research company” to obtain one of the samples of hotel customers who were surveyed. Tr. 72, 75; L.F. 133; App. A11. The other sample of customers was provided by DHC and was selected at random from a database of 244,000 Drury Hotels’ customers who stayed at Missouri Drury Hotels from 2012-2017. Tr. 72, 75, 116. Dr. Scheer also purchased on-line survey hosting services from Qualtrics. Tr. 72.

To enhance the reliability of her survey findings, Dr. Scheer developed three different types of questions, all aimed at the core issue of the survey. Tr. 80. She also included “reasonableness checks” and “attention-checks” to determine if the responses she received were reliable. Tr. 82-83, 89. Her questions were also designed to minimize bias. Tr. 85. She explained that at least 200 respondents are necessary for a survey to present a representative cross section of the public, and her survey exceeded this threshold with 236 respondents. Tr. 88.

The results of the survey were consistent across both sample groups. Ex. 6; App. A38; Tr. 81, 86-87. Dr. Scheer also did a separate analysis of a subset of the sample provided by Qualtrics. This subset included only those customers who had stayed at a Missouri Drury Hotel. Tr. 75-76, 100. The survey results from this subset were consistent with the overall responses received from the two sample groups. Ex. 6, p. 5, 24; App. A44, A63; Tr. 81, 86-87.

The goal of Dr. Scheer's survey was to gain an accurate representation of the attitudes, opinions and perceptions of the Missouri hotel customers. Tr. 71. Dr. Scheer's primary survey findings are:

- Customers anticipate that a hotel room containing a larger bed, larger television, larger table and couch would be priced substantially higher (12-14% more) than a room of the same size and shape, decorated with the same flooring, materials, wall coverings and bedding, but containing a smaller bed, television and table and less seating (*i.e.*, a chair).
- Customers were asked "What do you expect to find in your standard, non-suite hotel room for your personal use? Stated differently, what is included in the basic room rate?" Nearly all customers (over 95%) indicated that they expect a bed and a television are included in the room rate. Over half of customers also expect to find chair(s), clock, coffee maker, desk, lamp(s), microwave, pen/pencil, pictures/wall décor, refrigerator, shampoo, soap, table(s), towels, wall mirror and writing paper.
- Over 83% of customers expressed the opinion that everything in the hotel room is included in the price, except for those

elements clearly offered for an extra charge. Very strong majorities also indicated that, when staying in a hotel room, they rent the use of the furniture in the room, that the room is for their personal and private use, and that they expect to have a comfortable bed, the furniture to be in good condition, and the television and other items to work.

In conclusion, the results from these three very different types of questions are highly consistent. Customers have clear opinions that various items, such as a bed, television, towels, other furniture, etc. will be in the hotel room and are included in the basic room rate. They have clear expectations regarding the presence and functionality of key elements including the bed, furniture and television. And finally, they expect that rooms identical in every way except for the size of the bed, television, table and seating will vary in price, with the room with larger furniture priced 12-14% higher.

This research reveals that customers view the contents inside a hotel room, and their use of those contents during a stay, as an essential part of the core service of a hotel.

Ex. 6, p. 1; App. A40.

Dr. Scheer's survey results demonstrate that the customers of the Missouri Drury Hotels believe they are paying for the right to use the Room Furnishings located in the hotel rooms as part of the room rate. They are willing to, and in fact do, pay higher room rates for hotel rooms that have premium Room Furnishings. Ex. 6; App. A38. Dr. Scheer's conclusions are consistent with the Commission's "common understanding of what a customer would reasonably expect to find included in a hotel room." L.F. 13. The Commission found "these expectations relevant" to the issue in this case. L.F. 12.

E. Actual Use of the Room Furnishings

The average length of stay at the Missouri Drury Hotels is, and was during the Tax Periods, approximately 1.8 nights. Tr. 115. All customers receive the right to use the Room Furnishings in connection with their stays. Tr. 130, 147, 154-155, 159-160, 183. Most of the Room Furnishings are not consumed by a single customer in a one-night stay. Tr. 159. Instead, they are consumed by a large number of customers, consuming the assets collectively over time, and are accounted for accordingly. Tr. 159-160. For example, towels, washcloths and pillowcases tend to wear out more quickly and are therefore expensed for accounting purposes. Tr. 130, 146. In some instances, they may be damaged by a customer and used only once. Tr. 147.

Other items are capitalized and depreciated over time. The depreciation rate used in connection with each furnishing estimates the consumption of that furnishing by hotel customers over time. Tr. 129-130, 147-148. The depreciation period or useful life of the Room Furnishings typically range from four to eight years. Tr. 129, 131, 147-148. In-room coffee makers, for example, are depreciated over a period of five years. Tr. 148. Beds, sofas and chairs are depreciated over eight years. Tr. 148. Some furniture, however, such as dressers or armoires may be consumed over a period of 10 years. Tr. 131.

F. Collection of Tax

The Missouri Drury Hotels collect and remit tax on the charges they collect for rental of furnished rooms. Tr. 165. During the Tax Periods, the Missouri Drury Hotels collected and remitted slightly more than \$26 million in sales tax, the majority of which

was for hotel room rentals, but also includes meeting rooms. Tr. 165-166, 184. Sales tax is also collected on other charges not included in room rates, including the rental of rollaway beds. Tr. 183. DI Supply was assessed tax on the rollaway beds that were purchased by the hotels and rented to the hotels' customers. Tr. 183.

A small percentage (less than ten percent) of the Missouri Drury Hotels' sales are to exempt entities, where no sales tax is collected. Tr. 166.

STANDARD OF REVIEW

The decision of the Commission shall be reversed if: (1) it is not authorized by law; (2) it is not supported by competent and substantial evidence upon the whole record; (3) mandatory procedural safeguards are violated; or (4) it is clearly contrary to the reasonable expectations of the General Assembly. Section 621.193; *Whitehead v. Director of Revenue*, 962 S.W.2d 884, 885 (Mo. banc 1998). The first and fourth standards are at issue in this case. 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).

POINT RELIED ON

I. THE ADMINISTRATIVE HEARING COMMISSION ERRED IN UPHOLDING THE DIRECTOR'S ASSESSMENT AND DENYING THE RESALE EXCLUSION CLAIMED BY APPELLANT BECAUSE UNDER SECTION 621.193 THE DECISION IS NOT AUTHORIZED BY LAW AND CREATES A RESULT CLEARLY CONTRARY TO THE REASONABLE EXPECTATIONS OF THE GENERAL ASSEMBLY IN THAT: (1) THE COMMISSION MISINTERPRETED AND MISAPPLIED SECTIONS 144.010.1(13) AND 144.605(7) BY CONCLUDING THAT PROPERTY THAT WAS PURCHASED FOR RESALE WAS NEVERTHELESS TAXABLE; AND (2) THE RESULT OF SUCH MISINTERPRETATION IS CONTRARY TO THE REASONABLE EXPECTATIONS OF THE GENERAL ASSEMBLY IN THAT THE MISINTERPRETATION RESULTS IN MULTIPLE TAXATION OF THE SAME PROPERTY.

Kansas City Power & Light Co. v. Director of Revenue, 83 S.W.3d 548 (Mo. banc 2002);

Brambles Industries, Inc. v. Director of Revenue, 981 S.W.2d 568 (Mo. banc 1998);

Ronnoco Coffee Company, Inc. v. Director of Revenue, 185 S.W.3d 676, 677 (Mo. banc 2006);

Six Flags Theme Parks v. Director of Revenue, 179 S.W.3d 266 (Mo. banc 2005);

Section 144.010.1(13), RSMo.;

Section 144.605(7), RSMo.

ARGUMENT

I. THE ADMINISTRATIVE HEARING COMMISSION ERRED IN UPHOLDING THE DIRECTOR'S ASSESSMENT AND DENYING THE RESALE EXCLUSION CLAIMED BY APPELLANT BECAUSE UNDER SECTION 621.193 THE DECISION IS NOT AUTHORIZED BY LAW AND CREATES A RESULT CLEARLY CONTRARY TO THE REASONABLE EXPECTATIONS OF THE GENERAL ASSEMBLY IN THAT: (1) THE COMMISSION MISINTERPRETED AND MISAPPLIED SECTIONS 144.010.1(13) AND 144.605(7) BY CONCLUDING THAT PROPERTY THAT WAS PURCHASED FOR RESALE WAS NEVERTHELESS TAXABLE; AND (2) THE RESULT OF SUCH MISINTERPRETATION IS CONTRARY TO THE REASONABLE EXPECTATIONS OF THE GENERAL ASSEMBLY IN THAT THE MISINTERPRETATION RESULTS IN MULTIPLE TAXATION OF THE SAME PROPERTY.

Introduction

Customers staying at a hotel expect their hotel rooms to have certain furnishings, including a bed, a television, towels and other furniture. When they rent a hotel room, they expect, and in fact do, take physical possession of the room and the furnishings therein, to which they exclusively have the right to use and enjoy. People renting hotel rooms understand, and in fact are, paying for the right to use and enjoy the furnishings as part of the room rate. The Commission agreed that these obvious and undisputed facts were consistent with the Commission's "common understanding of what a customer would reasonably expect to find included in a hotel room." L.F. 136; App. A14.

Nonetheless, the Commission concluded that the transfer of the right to use the Room Furnishings did not constitute a resale by the Missouri Drury Hotels to their customers. Because this conclusion is contrary to the definition of resale under Missouri law and contrary to the reasonable expectations of the General Assembly, this Court should reverse the Commission's decision.

A. The Purpose of the Resale Exclusion: Avoidance of Multiple Taxation

Missouri sales tax is imposed on, among other things, the “retail sale in this state of tangible personal property.” Section 144.020.1(1). The term “sale at retail,” is defined by section 144.010.1(13) as follows:

“Sale at retail” means any transfer made by any person engaged in business as defined herein of the ownership of, or title to, tangible personal property to the purchaser, *for use or consumption and not for resale in any form as tangible personal property*, for a valuable consideration.³

In *Sipco, Inc. v. Director of Revenue*, 875 S.W.2d 539, 541 (Mo. banc 1994), this Court explained that by excluding sales for resale from tax, Missouri's sales and use tax laws “avoid multiple taxation of the same property as it passes through the chain of commerce from producer to wholesaler to distributor to retailer.” For example, if a manufacturer sells a product to a wholesaler, who in turn sells that same product to a distributor, who in turn sells it to a retailer, who in turn sells it to a customer who uses or consumes the product, only the final sale to the end consumer is a “sale at retail” that is subject to sales tax. All of the other sales in this scenario are for resale and outside the scope of the tax imposed by the Missouri sales tax law.

³ Emphasis added here and throughout unless otherwise noted.

This basic framework has been applied in a “long line of cases” that make clear that “in situations where a business provides goods to its customers . . . and factors the cost of the goods into the price of other items subject to sales tax, then to impose sales or use tax liability on the purchase of those goods ‘would amount to double taxation and would not serve the express purpose’ of the sales tax or use tax.” *President Casino v. Director of Revenue*, 219 S.W.3d 235, 243-244 (Mo. banc 2007), quoting *King v. National Super Markets, Inc.*, 653 S.W.2d 220, 222 (Mo. banc 1983); accord, *State ex rel. Denny's v. Goldberg*, 578 S.W.2d 925, 927–28 (Mo. banc 1979); *Weather Guard, Inc. v. Director of Revenue*, 746 S.W.2d 657, 658 (Mo. App. E.D. 1988).

The Commission’s decision, if upheld by this Court, would subject the Room Furnishings to the double taxation that the General Assembly intended to avoid. During the Tax Periods, the Missouri Drury Hotels collected and remitted slightly more than \$26 million in sales tax on the rental of furnished rooms. Tr. 165-166. Since the cost of the Room Furnishings was factored into these charges, the cost of those items was already taxed prior to the Director’s assessment.⁴

B. The Elements of the Resale Exclusion

As noted above, the means by which the General Assembly demonstrated its intent

⁴ The fact that a small percentage of the room rentals were to customers claiming an exemption from sales tax does not undermine DI Supply’s claim, since section 144.018.1 provides in pertinent part that a purchase of tangible personal property or taxable service retains its character as a resale excluded from tax even if the subsequent sale is subject to tax but exempt under Chapter 144. See also *Five Delta Alpha, LLC v. Director of Revenue*, 458 S.W.3d 818 (Mo. banc 2015) (purchase of aircraft for subsequent lease was subject to resale exclusion even though the lease was to a common carrier exempt from tax under Section 144.030.2(20)).

to avoid pyramiding of sales taxes (*i.e.*, a tax on a tax) is the resale exclusion. To effect the avoidance of pyramiding, this Court has observed that the elements of a “resale” are precisely the same as the elements of a sale, which are: “(1) a transfer, barter or exchange (2) of the title or ownership of tangible personal property or the right to use, store or consume the same (3) for a consideration paid or to be paid.” *Aladdin’s Castle v. Director of Revenue*, 916 S.W.2d 196, 198 (Mo. banc 1996); *see also*, *Sipco*, 875 S.W.2d at 542; and *Kansas City Royals Baseball Corp. v. Director of Revenue*, 32 S.W.3d 560, 562 (Mo. banc 2000). This three part test is based on the statutory definition of “sale” found in section 144.605(7)⁵ which provides:

“**Sale,**” any transfer, barter or exchange of the title or ownership of tangible personal property, or the right to use, store or consume the same, for a consideration paid or to be paid, and any transaction whether called leases, rentals, bailments, loans, conditional sales or otherwise, and notwithstanding that the title or possession of the property or both is retained for security.

In this case, the Missouri Drury Hotels transferred the right to use or consume the Room Furnishings for consideration in the form of the room rate. Accordingly, as set forth in more detail below, the transfer constitutes a resale and therefore the hotels’ purchases of the Room Furnishings are excluded from Missouri sales tax, notwithstanding the Commission’s erroneous decision to the contrary.

⁵ Although Section 144.605(7) is a use tax statute, this analysis applies in both sales and use tax cases. *See Brambles Industries, Inc. v. Director of Revenue*, 981 S.W.2d 568, 570, fn. 5 (Mo. banc 1998).

1. The Missouri Drury Hotels Transferred the Right to Use and Consume the Room Furnishings to Their Customers

As noted above, the definition of “sale” includes a wide variety of transactions including leases, bailments, loans or other conditional sales that encompass a transfer of the right to use, consume or store property, but not a transfer of title or ownership. This Court has confirmed this point in numerous cases.

In *Kansas City Power & Light Co. v. Director of Revenue*, 83 S.W.3d 548 (Mo. banc 2002) (“*KCP&L*”), this Court ruled that electricity purchased by the Hyatt Regency Crown Center Hotel in Kansas City, Missouri, and used to heat, cool, and provide power in the hotel’s customer spaces, was purchased by the hotel for resale to the hotel’s customers. The hotel’s utility company, Kansas City Power & Light Co., was therefore entitled to a refund of the sales tax that it collected and remitted on these sales of electricity to the hotel.

As this Court explained, “if a person purchases a tangible or intangible product in order to sell it to another, the purchase is not subject to sales tax.” *Id.* at 551. By placing thermostats in the spaces rented by the hotel customers that allowed the customers to control the heating and cooling in those spaces, the hotel resold electricity to the customers along with the rental of the hotel rooms. In so doing, this Court rejected the Director’s argument that there had not been a transfer of the right to use electricity because the customers could not take the electricity with them when they left the hotel. *Id.* at 552. Specifically, this Court noted:

This argument ignores the fact that Missouri's statutes provide that a transfer of property qualifies as being held for resale not only where title to it is passed to another, but also where a transfer is made by which "the right to use, store or consume" the property is passed to another for consideration.

Id., quoting section 144.605(7).

In *Brambles Industries, Inc. v. Director of Revenue*, 981 S.W.2d 568 (Mo. banc 1998), this Court applied this principle to an explicit lease transaction. In prior cases, this Court held that packing materials used to protect merchandise during shipping were resold by a retailer to its end customer as part of the sale of merchandise since ownership of the packing materials was transferred. *King v. National Super Markets, Inc.*, 653 S.W.2d 220 (Mo. banc 1983) (grocery bags purchased by a grocery store are not subject to tax because they are sold to the store's customers along with groceries); *Sipco, Inc. v. Director of Revenue*, 875 S.W.2d 539 (Mo. banc 1994) (dry ice used in shipping pork products is purchased for resale by the pork processor); *House of Lloyd v. Director of Revenue*, 884 S.W.2d 271, 275 (Mo. banc 1994) (packing materials used to ship merchandise is purchased for resale).

In *Brambles*, Proctor and Gamble ("P&G") used pallets to ship merchandise to its customers, but unlike the taxpayers in the prior cases, P&G did not transfer ownership or title to the pallets because P&G merely leased (rather than owned) the pallets in the first place. This Court reversed the Commission's conclusion that the pallets did not qualify for the resale exclusion because title was not transferred, explaining:

to the degree that a lease would be a sale for resale if an outright sale had been made, section [144.010(4), which defines “gross receipts” subject to tax,] requires that the proceeds from such a lease be excluded from gross receipts.

Id. at 570. To the extent that there were any doubts, this Court stated unequivocally that “it is not necessary . . . for title or ownership of the property to be transferred to the subsequent purchaser in order for the lease proceeds to be excluded from tax.” *Id.*

Consistent with this view, in *Ronnoco Coffee Company, Inc. v. Director of Revenue*, 185 S.W.3d 676, 677 (Mo. banc 2006), this Court held that the provision of coffee grinding and brewing equipment that Ronnoco could remove at any time, the use of which Ronnoco restricted to making, storing and distributing only Ronnoco coffee products, constituted a resale. Under these facts, this Court concluded that the *loan* of the equipment was a “resale” under both the sales and use tax statutes. *Id.* at 680. This Court expressly found that the fact that customers were required to return the equipment to the taxpayer “does not defeat the fact that customers give consideration for *the right to use* the equipment under the terms of the agreement.” *Id.* at 681.

In reaching its conclusion in *Ronnoco*, this Court cited the Court of Appeals’ decision in *Weather Guard, Inc. v. Director of Revenue*, 746 S.W.2d 657 (Mo. App. E.D. 1998). The taxpayer was a wholesaler in the business of selling insulation. The taxpayer purchased machines that it provided to retailers, who in turn loaned the machines to customers to use in installing insulation. 746 S.W.2d at 657. The machines remained the property of the taxpayer, and could only be used by the customers to install insulation sold by the taxpayer. *Id.* at 658. The Court of Appeals observed that the machines “were

not held for resale in the ordinary sense of the word, because they were not permanently transferred to the retailers and customers.” It concluded, however, that “it is obvious. . . that a rental qualifies as a sale.” *Id.* Because the machines were rented to the customers along with their purchase of insulation (on which they paid sales tax), the taxpayer’s purchase of the equipment was for resale. As the Court of Appeals stated, “[T]o impose a use tax would amount to double taxation.” *Id.*

This Court has approved numerous types of transactions as transfers of the right to use or consume property within the meaning of the resale exclusion. *See, e.g., Six Flags Theme Parks, Inc. v. Director of Revenue*, 179 S.W.3d 266, 269 (Mo. banc 2005) (“*Six Flags II*”) (holding that inner tubes required to be used on the premises of a water park were rented to patrons of the park); *Six Flags Theme Parks v. Director of Revenue*, 102 S.W.3d 526 (Mo. banc 2003) (“*Six Flags I*”) (holding that temporary use of a video game machine constituted a rental of the machine); *Westwood Country Club*, 6 S.W.3d 885 (Mo. banc 1999) (temporary use of golf carts to be used on specific paths during a round of golf is a rental of the cart); *PF Golf, LLC v. Director of Revenue*, 404 S.W.3d 888 (Mo. banc 2013) (accord).⁶

⁶ Because a rental comes within the definition of a “sale” under section 144.605(7), the inner tubes, video game machines, and golf carts were all purchased for resale. The taxpayers in these cases, however, had the option under section 144.020.1(8) to pay tax on the items purchased for subsequent rental rather than claiming the resale exclusion. Because they chose to do so, no tax was owed on the rental payments. The taxpayers could have instead claimed the resale exclusion, and collected tax on the rental payments. This approach to taxing rental transactions serves “the goal of taxing the property only once.” *Six Flags II*, 179 S.W.3d at 268.

The transfer of the right to use the Room Furnishings is more substantial than the transfers in the aforementioned cases. For example, while the hotel customers in the *KCP&L* case could indirectly control the use of electricity in their rooms by adjusting thermostats, the Room Furnishings are under the direct and immediate control of the customers for use as intended (*i.e.*, customers can watch the television, sleep in the bed, sit on the furniture, and use the towels to dry themselves). The restrictions on the use of the Room Furnishings are no more stringent than those in the other cases this Court has decided favorably on the resale exclusion. For example, the customers in *Ronnoco* could use the coffee making equipment only for its intended purpose of making Ronnoco coffee; the golfers in *Westwood* and *PF Golf* were limited to operating their rented golf carts only on the paths of the golf courses; and the swimmers and video game players in *Six Flags I & II* were prohibited from removing the rented inner tubes and video games from their respective areas of the amusement park.

Furthermore, the length of time that the right to use and consume the Room Furnishings is substantially longer than in other cases in which the Court held a resale occurred. The average length of stay at the Drury Hotels is 1.8 days, which is a substantially longer time than the video games, inner tubes, or golf carts were used in the cases cited above. Tr. 115, 130, 146, 154-155, 183.

In short, the Missouri Drury Hotels transferred the right to use and consume the Room Furnishings to their customers. As a result, the first two elements of the resale exclusion are satisfied.

The Commission's opposite conclusion is contrary to Missouri law. Specifically, the Commission imposed new conditions on the resale exclusion, effectively asserting that a transfer of the right to use or consume property does not occur unless the recipient can fully consume property in a single hotel stay and the recipient has significant control over the property. L.F. 139 – 141; App. A17 - A19. The Commission did not, because it could not, attempt to square these new conditions with this Court's prior decisions. In addition to ignoring this Court's precedents in the *Six Flags* and golf cart cases, the Commission's characterizations of the cases it did address are unavailing. For example, it is difficult to fathom that the end users of the coffee equipment in *Ronnoco* "exercised a greater degree of control over" the coffee equipment (which could only be used to brew *Ronnoco* coffee), than hotel customers exercise over a television in a hotel room. *See* L.F. 140; App. A18. The restrictions on the use of these items would be analogous if the Missouri Drury Hotels required its patrons to watch only Drury Hotel promotional videos on the televisions.

Furthermore, the Commission's attempts to distinguish *KCP&L* merely serve to demonstrate that hotel patrons use electricity and Room Furnishings in similar ways. *See* L.F. 138; App. A16. Customers do not receive title or ownership to the electricity, but simply a right to use and consume it. *KCP&L*, 83 S.W.3d at 552. The electricity can only be used on the premises of the hotel; "the customer cannot take the electricity with him or her when leaving the hotel." *Id.* Additionally, the customers can only use the electricity through electrical appliances and fixtures on hand at the hotel; their ability to use the electricity is limited. And like the Room Furnishings, the electricity that was

resold to hotel customers in *KCP&L* was used solely in “customer space” which included hotel rooms, meeting spaces, and banquet rooms.⁷

In any event, the Commission’s own language demonstrates that it misapplied the law with respect to the right to transfer or consume. Specifically, the Commission recognized that the hotel customers received a “temporary right of use” to the Room Furnishings. L.F. 141; App. A19. Notwithstanding the Commission’s dismissal of this as insufficient to establish a resale, under section 144.605(7) and this Court’s decisions concerning the resale exclusion, the transfer of the right to use property—even if temporary—is a resale. The additional requirements imposed by the Commission in this case are not supported by law.

Perhaps in recognition of the weakness of its arguments in this regard, the Commission argues that it may ignore this Court’s prior precedents because they “predate *Brinker*.” L.F. 141; App. A18; *Brinker Missouri, Inc. v. Director of Revenue*, 319 S.W.3d 433 (Mo. banc 2010). In *Brinker*, this Court ruled that a restaurant could not claim a resale exclusion on its purchases of furniture and tableware. *Brinker*, 319 S.W.3d at 438. Presumably, the Commission believes that *Brinker* implicitly overruled or called into question this Court’s precedents on the right to use or consume property. This is clearly incorrect for at least two reasons: (1) the *Brinker* decision distinguished but did not repudiate any of the cases the Commission denigrates for preceding *Brinker* (e.g.,

⁷ In both *KCP&L* and this case, the taxpayer did not claim every item of overhead purchased by a hotel is resold by the hotel to its customers. Instead the resale claim is limited to items of tangible personal property that are used solely by the hotel customers. Ex. 9; Tr. 140, 170–171.

Ronnoco and Weather Guard), and more importantly; (2) the determination that the taxpayer did not qualify for the resale exclusion in *Brinker* was based on the *consideration* element rather than the *right to use or consume* element. As stated by the Court:

Here, the chairs, tables, dishes, tableware and similar items are used to serve or supply the food conveniently to Brinker's customers and allow them to have a place at which to sit to eat it. *No additional charge is made to customers for the privilege of sitting in a chair, eating at a table, or using glasses or silverware.* Customers are not charged different sums depending on how many of these serving items they use or at what kind of chair or table they sit, and 'to go' customers are charged the same price for food as are eat-in customers. *To charge a separate fee certainly would be detrimental to Brinker's business because customers come to Brinker's restaurants to eat the food, not to rent use of bowls, cups, and tables;* the items as to which a use tax exclusion or exemption is sought are used simply as a delivery mechanism for what customers are buying—the food and beverages.

Id. at 440.

The Missouri Drury Hotels transferred the right to use or consume the Room Furnishings. Consequently, this element of the resale exemption is satisfied. The Commission's conclusion to the contrary should be reversed.

2. The Customers of the Missouri Drury Hotels Paid Consideration for the Right to Use and Consume the Room Furnishings

The final element of the resale exclusion requires the customer to pay for the right to use or consume the transferred property. In *KCP&L*, this Court held that consideration

is paid for property transferred in connection with a hotel room if the cost of the property is factored into the room rate. 83 S.W.3d at 553. Because the undisputed evidence demonstrates that the Missouri Drury Hotels take into account both the quality and type of Room Furnishings in setting room rates, the consideration element of the resale exclusion is satisfied.⁸

Furthermore, unlike the items for which the resale exclusion was sought in *Brinker*, the undisputed evidence demonstrated that the hotel customers intended to purchase the right to use Room Furnishings when paying the room rate for a hotel room. The results of the customer survey developed and administered by Dr. Lisa Scheer “reveals that customers view the contents inside a hotel room, and their use of those contents during a stay, as an essential part of the core service of a hotel.” Ex. 6, p. 1; App. A40. These survey results confirm that the transfer of the right to use the Room Furnishings to the customers is an integral part of the bargain between the customers and the hotels. The transfer of the right to use the Room Furnishings is not merely incidental, but rather is a significant part of the transaction. Moreover, customers are willing to pay more for a room containing premium furnishings, such as larger bed, larger television, and larger table and couch. Ex. 6; App. A38. Consequently, unlike the plates and bowls in *Brinker*, the Room Furnishings were not used “simply as a delivery mechanism for what customers are buying;” but rather were integral to the bargain between the hotels

⁸ The cost of Room Furnishings is significant. For a new hotel, they comprise 7-10 percent of the overall development costs while for renovations they constitute as much as 50 percent of the overall costs (excluding land costs). Tr. 126-127, 142-144.

and their customers. Tr. 155; *Brinker*, 319 S.W.3d at 440. The customers' payments thus included consideration for the use of the Room Furnishings.

C. In the Alternative, the Resale Exclusion Should Be Allowed for the Hotels' Essential Furnishings

The Commission itself recognized that many of the Room Furnishings were integral to the room rental transaction:

For some items, DI Supply's contention is compelling. A bed, for instance, constitutes such an integral part of a hotel room experience that it is impossible to cognize paying for a room without one. But DI Supply does not seek an exemption for just a bed or a room's most essential furnishings; it argues that every item – excluding fixtures – is resold.⁹

L.F. 140; App. A17.

Notwithstanding the fact that the undisputed evidence demonstrates that *all* of the Room Furnishings were integral to the customers' view of the room rental, the Commission dismissed certain purchases such as pens, outlet strips, informational cards and ironing boards as "bric-a-brac" and non-essential. L.F. 140; App. A17. Even if this Court were to agree with this counterfactual conclusion, there is no basis for dismissing DI Supply's claim with respect to the items that even the Commission agreed were integral to the transactions between the hotels and their customers. *See* L.F. 133-134; App. A10-A11; Ex. 6, p.1; App. A40 (noting that the majority of all customers indicated

⁹ To the extent the Commission's statement implies that DI Supply's claim includes every item within the hotel (*i.e.*, every item of overhead), it is mistaken. The claim includes only those items used *solely* by hotel customers.

that beds, televisions, chairs, clocks, desks, lamps, microwaves, pictures, refrigerators, tables, towels, and wall mirrors are essential to a room rental). Even under the Commission's view of the case, the resale exclusion should apply and the assessments should be set aside with respect to these items.

D. Additionally in the Alternative, the Resale Exclusion Should Be Allowed for Nondurable Items Replaced Frequently Due to Use by Hotel Customers and Expensed for Accounting Purposes

Likewise, counter to the Commission's assertions to the contrary, the undisputed record demonstrated that DI Supply purchased some items which must be replaced frequently and sometimes after only one use by customers. Tr. 130; *cf.* L.F. 139; App. A16. For example, the witnesses explained that towels, washcloths, and bed linens fall into this category, as well as any items that are expensed by the hotels for accounting purposes. Tr. 130, 146–147. Based on the record, low-cost items including pillows, shower curtains, bath mats and pens also meet this standard. *See* L.F. 130-132; App. A7-A9; Ex. 8. Accordingly, even if this Court accepted the Commission's imposition of an additional requirement to the resale exclusion that the customer must have the ability to fully consume the item, the assessments on these items is unwarranted.

E. Section 144.011.1(11) Does Not Alter the Result

The Commission concluded that the Director's regulation, 12 CSR 10-110.220(G) which states that hotels "must pay tax on the purchase of reusable items including furniture, curtains, linens, towels, pillows, mirrors, radios and televisions for room accommodation" is consistent with the statutes and therefore must be enforced. The

Commission reached this conclusion based on its view that the legislature could have included an exemption for “hotel furnishings like those at issue in this case” in section 144.011.1(11), but since it did not, there is no “direct statutory conflict with 12 CSR 10-110.220(G).” This conclusion misapplies the law, and misinterprets section 144.011.1(11), which provides an exemption from sales tax for “items of a nonresuable nature which are furnished to the guests in the guests’ rooms” where the items are purchased by a hotel or similar establishment and the “items are included in the charge made for such accommodations.”

While section 144.011.1(11) provides an exemption for certain nonreusable items purchased by hotels, it is silent as to the tax treatment of reusable items. Despite this silence, the Commission concluded that the Director’s regulation, which provides that all reusable items provided to customers by hotels are subject to tax regardless of whether the reusable items were held for resale, is valid and should be enforced. But section 144.011 has the clear purpose of identifying transactions that are not taxable—not those that are subject to tax. The Commission’s construction is simply not supported by the words of the statute.

Moreover, this Court has already rejected the approach taken by the Commission in this case. Section 144.011.1(9) likewise excludes from the definition of “retail sale” or “sale at retail” the transfer of “reusable containers” for which a deposit is required and refunded upon return. Upon passage of that provision, the Director argued that it impliedly revoked the resale exemption for bottles under the use tax law. This Court rejected the Director’s position in *Smith Beverage Co. of Columbia v. Reiss*, 568 S.W.2d

61, 67-8 (Mo. banc 1978). Like section 144.011.1(9), section 144.011.1(11) does not address the applicability of the resale exclusion to reusable items purchased by hotels, and does not support the conclusion that reusable items purchase for resale are subject to tax.

CONCLUSION

The conclusion that the Room Furnishings are resold to the hotel guests is consistent with the hotels' treatment of other transactions with their customers. For example, the hotels charged a separate fee for rollaway beds, and collected tax on that charge, recognizing that the rental of a rollaway bed is a taxable sale. Tr. 183. There is no material difference between the hotels' rental of the rollaway bed and its rental of the beds provided with the rooms to hotel customers. In both instances, a charge for the use of the bed is collected from the customers, and tax is paid on the charge. In both instances, the use of the bed is temporary and the bed must remain within the hotel during its use. The only distinction between the two transactions is that the charge for the rollaway is separately stated. But this distinction is immaterial since customers nonetheless pay consideration for the use of the beds in the rooms. Indeed, if the hotels restructured their fees, and imposed separate charges for the use of beds, TVs and other furnishings, as they do with the rollaway beds, would there be any question that the payment for the use of the furnishings was a rental charge? *See Six Flags II*, 179 S.W.3d 266, 269 (Mo. banc 2005). There is no reasonable basis for treating the beds provided in the rooms differently from the rollaway beds for sales tax purposes. The hotels purchase

both types of beds for resale (in subsequent rental transactions), they collect tax on the rental charges, and therefore, they owe no tax on the purchase of these items.

For all of the foregoing reasons, this Court should reverse the decision of the Commission and remand with instructions to allow the resale exclusion for all of DI Supply's sales of Room Furnishings to the Missouri Drury Hotels and included in the assessments issued by the Director, except as conceded by DI Supply at trial.

In the alternative, this Court should reverse the decision of the Commission and remand with instructions to abate the assessments on DI Supply's sales of: 1) the Missouri Drury Hotels' essential furnishings, including beds, televisions, chairs, clocks, desks, lamps, microwaves, pictures, refrigerators, tables, towels, and wall mirrors; and 2) all nondurable items that are expensed by the Missouri Drury Hotels for accounting purposes and replaced frequently including towels, bed linens, washcloths, pillows, shower curtains, bath mats, and pens.

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CERTIFICATE OF SERVICE AND COMPLIANCE

I hereby certify that the foregoing was electronically mailed to Emily A. Dodge, Assistant Attorney General, Missouri Attorney General's Office, Supreme Court Building at emily.dodge@ago.mo.gov on September 3, 2019.

I also hereby certify that the foregoing brief complies with Rule 55.03 and with the limitations in Rule 84.06(b) in that it contains 8445 words.

/s/ Carole L. Iles