
IN THE SUPREME COURT OF MISSOURI

DIRECTOR OF REVENUE,

Appellant,

v.

DREYER ELECTRIC COMPANY,

Respondent.

From the Administrative Hearing Commission
The Honorable Renee T. Slusher

APPELLANT'S REPLY BRIEF

ERIC S. SCHMITT
Attorney General

JULIA E. RIVES
Assistant Attorney General
Missouri Bar No. 69249

CHRISTOPHER R. WRAY
Assistant Attorney General
Missouri Bar No. 66341

P.O. Box 899
Jefferson City, MO 65102
Phone: (573) 751-8824
Fax: (573) 751-0774
Julia.Rives@ago.mo.gov
ATTORNEYS FOR APPELLANT

TABLE OF CONTENTS

TABLE OF CONTENTS.....	2
TABLE OF AUTHORITIES	3
REPLY ARGUMENT.....	5
CONCLUSION.....	18
CERTIFICATE OF COMPLIANCE.....	19

TABLE OF AUTHORITIES

Cases

Bartlett Int’l, Inc. v. Dir. of Revenue,

487 S.W.3d 470 (Mo. banc 2016) 6

Concord Pub. House, Inc. v. Dir. of Revenue,

916 S.W.2d 186 (Mo. 1996) 6, 9, 11, 12

DST Systems, Inc. v. Director of Revenue,

43 S.W.3d 799 (Mo. banc 2001) 6, 9, 10, 12, 14, 15, 16

Emerson Elec. Co., v. Dir. of Revenue,

204 S.W.3d 642 (Mo. banc 2006) 6, 8, 12

Floyd Charcoal Co., Inc., v. Dir. of Revenue,

599 S.W.2d 173 (Mo. banc 1980) 5, 6, 7, 8, 9, 11

IBM Corp. v. Dir. of Revenue,

491 S.W.3d 535 (Mo. banc 2016) 10, 14, 15, 16, 17

Reichert v. Bd. of Educ. of City of St. Louis,

217 S.W.3d 301 (Mo. 2007)..... 13

Southwestern Bell Tel. Co. v. Dir. of Revenue,

78 S.W.3d 763 (Mo. banc 2002) 14, 15, 16

Southwestern Bell Tel. Co. v. Dir. of Revenue,

182 S.W.3d 226 (Mo. banc 2005)	5, 6, 9, 10, 14, 15, 16
<i>Southwire Co. v. Chilivis,</i>	
228 S.E.2d 295 (Ga. Ct. App. 1976)	7, 8
<i>Templemire v. W&M Welding, Inc.,</i>	
433 S.W.3d 371 (Mo. banc 2014)	16
<i>Theroff v. Dollar Tree Stores, Inc.,</i>	
Case Number 97235, 2020 WL 203121 (Mo. banc 2020)	17
<i>Utilicorp United, Inc. v. Dir. of Revenue,</i>	
75 S.W.3d 725 (Mo. banc 2001)	6, 9, 13
<i>Utility Serv. Co., Inc. v. Dep’t of Labor & Indus. Relations,</i>	
331 S.W.3d 654 (Mo. 2011)	13
<i>20th & Main Redevelopment P’ship v. Kelley,</i>	
774 S.W.2d 139 (Mo. banc 1989)	13

Statutes and Regulations

§ 144.030 RSMo.....	5, 7, 14, 16, 17
12 C.S.R. 10-111.010	6, 7, 8, 9, 11

REPLY ARGUMENT

Respondent claims that Appellant's argument overrules forty years of Supreme Court precedent. (Resp. Br. at 5-6). But this Court has never decided whether electrical equipment or the parts and materials used to supply power to a machine is exempt under section 144.030. In fact, it is Respondent that pushes this Court's precedent beyond its typical boundaries.

I. The integrated plant doctrine is the required test and it requires that all three prongs be met before equipment is exempt under the manufacturing exemption.

The question presented by this case is whether different parts of a building's electrical system are exempt from sales tax under the manufacturing exemption as "replacement equipment or parts" that are "used directly" in manufacturing. The test for when equipment is used directly in manufacturing is the integrated plant doctrine. *Floyd Charcoal Co., Inc., v. Dir. of Revenue*, 599 S.W.2d 173, 176-178 (Mo. banc 1980); see *Southwestern Bell Telephone Co.*, 182 S.W.3d 226, 232 (Mo. banc 2005) ("*Bell II*"). Under this doctrine, a reviewing Court considers whether the disputed item meets three prongs:

- (1) Is the disputed item necessary to production?
- (2) How close, physically and causally, is the disputed item to the finished product?

- (3) Does the disputed item operate harmoniously with the admittedly exempt machinery to make an integrated and synchronized system?

Floyd, 559 S.W.2d at 177.

This Court has repeatedly held that *Floyd*'s three-prong integral plant doctrine is derived from the statute's "used directly in manufacturing" language, and must be applied accordingly. *Concord Pub. House, Inc. v. Dir. of Revenue, State of Mo.*, 916 S.W.2d 186, 192-193 (Mo. banc 1996); *Sw. Bell*, 182 S.W.3d at 233-234; *Emerson Elec. Co., v. Dir. of Revenue*, 204 S.W.3d 642, 644 (Mo. banc 2006); *Utilicorp United, Inc. v. Dir. of Revenue*, 75 S.W.3d 725, 727-729 (Mo. banc 2001); *DST Systems, Inc. v. Director of Revenue*, 43 S.W.3d 799 (Mo. banc 2001). This doctrine is subject to the statutory requirement that all tax exemptions must be "strictly construed against the taxpayer." *Bartlett Int'l, Inc. v. Dir. of Revenue*, 487 S.W.3d 470, 472 (Mo. banc 2016); *Emerson*, 204 S.W.3d at 646-647.

The Code of State Regulations explains that the language "used directly in manufacturing" exempts purchases of articles that are "substantially used in, essential to, and comprising an integral part of the manufacturing...process." 12 C.S.R. 10-111.010(1). The rule lists the three requirements of the integrated-plant doctrine and then states:

Under the integrated plant theory, adopted by Missouri, it is not sufficient to meet only one of these requirements. *For example, items used in material storage or handling before the manufacturing process begins may be essential to the process, but generally are not an integral part of the manufacturing process and are therefore not used directly in manufacturing.*

12 C.S.R. 10-111.010(2)(J) (emphasis added).

There is no controlling case in Missouri that has determined that electrical equipment similar to the equipment used here is exempt under the integrated plant doctrine. Cases from at least four other states, however, strongly suggest the exemption does not apply because building infrastructure is not itself a *direct* part of the manufacturing process. This “direct” part language is exactly the same language used in section 144.030, and it is also reflected in the requirement that items be an “integral part of the manufacturing process” in order to be “used directly in manufacturing.” 12 C.S.R. 10-111.010(2)(J).

Respondent ignores most of these cases and their logic, addressing only one of them. *Southwire Co. v. Chilivis*, 228 S.E.2d 295, 296 (Ga. Ct. App. 1976) (holding that electrical equipment like rectifiers, electrical switches, and electrical metering and monitoring equipment were only “indirectly used in the manufacturing process” carried out by an “intervening agency”). Respondent says *Floyd* rejected Georgia’s reading of the manufacturing exemption because Georgia’s cases relied on the rule that tax exemptions must be strictly

construed. 599 S.W.2d at 176 (Mo. 1980). But this Court has also held that tax exemptions must be strictly construed. More importantly, however, Respondent ignores the logic of *Southwire* and similar cases from other states. Building infrastructure is classically *not* a direct part of the manufacturing process. Items like electrical equipment and climate control are more like infrastructure than the assembly line itself.

This Court has held that equipment used as a prelude to manufacturing is not used directly in manufacturing. For example, in *Emerson* the Court held that design and development equipment was not used directly in manufacturing. 204 S.W.3d at 646-647. In *Floyd*, the Court held that items used on the line to allow access for repairs were not exempt. 599 S.W.2d at 173 (purchased stairways and ramps used by manufacturer of charcoal briquettes were not exempt from sales tax as directly used in manufacturing process, in absence of showing they were an integral part of processing system).

Similarly, the rules interpreting this statute provides that items used solely to perform repairs on the manufacturing equipment are not used directly under the integrated plant doctrine. See 12 C.S.R. 10-111.010(4)(M) (“A manufacturing company uses pneumatic powered tools directly on its assembly line. It also has hand tools used to repair or adjust the machines throughout the plant. The pneumatic powered tools are exempt as machinery and

equipment directly used in manufacturing. The hand tools do not qualify as machinery and equipment directly used in manufacturing and are taxable.”).

Finally, in *Utilicorp*, this Court held that items that are used to transport the finished product away from the manufacturing line are not used directly in manufacturing under the integrated plant doctrine. 75 S.W.3d at 727-729 (holding equipment used in the transmission and distribution of electricity was not entitled to manufacturing exemption for the electric company because it was not “used directly” in manufacturing); *see also* 12 C.S.R. 10-111.010(4)(Q). In *Bell II*, this Court held that some of the equipment used in a vertically integrated phone line system met the three prongs of the integrated plant doctrine but other equipment did not. *Sw. Bell*, 182 S.W.3d at 234 (pay phones were not directly used in the production process of transmitting and recreating a person’s voice via telephone lines).

All of these cases stand for the proposition that the phrase “used directly in manufacturing” means that the item is an integral part of the manufacturing process itself, not merely a prelude or a follow-up. *See DST Systems*, 43 S.W.3d at 803 (analyzing how the computers and other equipment were an integral part of the production of the ultimate product, the causal connection between the computers and the final product, and the necessity of the computers to producing the final product); *Concord Pub. House*, 916 S.W.2d at 192-193 (reiterating that *Floyd Charcoal* rejected a strict interpretation of

the phrase “directly used” to exempt only items that physically alter raw materials to a finished product); *See Sw. Bell*, 182 S.W.3d at 231.

II. The items in the present case do not meet all three prongs of the integrated plant doctrine.

The majority of the disputed items are more like the equipment that this Court has held was not used directly in manufacturing because the equipment is either not used in the sawmill’s manufacturing process (the lights, heater, electrical outlets) or it is not necessary to run the manufacturing line (the circuit breakers, the overload relay, and the wires that are not used to power or control the equipment but to shut the equipment down in case of malfunction). None of this equipment meets the three prongs of the integrated plant doctrine. It is not necessary to run the manufacturing equipment, it is not an integral part of the equipment, and it is not causally connected to the output of the final product. Respondent does not explain how these items meet the three prongs of the integrated plant doctrine. An item must meet all three prongs of the integrated plant doctrine in order to be exempt.; *Sw. Bell*, 182 S.W.3d at 234 (*abrogated on other grounds by IBM Corp. v. Dir. of Revenue*, 491 S.W.3d 535 (Mo. 2016)); *see DST Systems*, 43 S.W.3d at 802-803.¹

¹ *DST* noted that the exempted items included the batteries and backup generators that assured an uninterrupted power supply to the computer system. *DST Systems*, 43 S.W.3d at 802. The Court did not specifically analyze how these items were used directly in manufacturing under all three prongs of

Because the lights, heat, and outlets do not form a part of the integrated manufacturing system but are instead used to provide light, heat, and electrical energy to the building's outlets, the items do not satisfy a single prong of the integrated plant doctrine. Therefore, these items are not used directly in manufacturing and the AHC erred in finding that these items were tax exempt.

The other category of items at issue are the items that deliver power to the manufacturing equipment: the starters and the electrical wires that deliver power from the starters to the equipment. The record and the AHC's findings support that the items meet the first and third prongs of the integrated plant doctrine. However, these items are causally one step removed from the production line and form a secondary system that is designed to "support" and "deliver power" to the exempt equipment. (Tr. 13-14, 22-24). While the direct-use "requirement is not limited to those items of machinery, equipment, and parts that produce a direct physical change in the composition of the raw materials...*the integrated and synchronized system begins when raw materials enter the production process and ends when the product is finished.*" 12 C.S.R. 10-111.010(2)(J) (emphasis added); see *Concord Pub. House*, 916 S.W.2d at 191-193 (reiterating that *Floyd Charcoal* has rejected a strict interpretation of the

the integrated plant doctrine even though it did analyze how other items were used directly. *Id.* at 803.

phrase “directly used” to exempt only items that physically alter raw materials to a finished product.). Because these items form a part of the process that is prior to the beginning of the production process, they are outside of the integrated and synchronized system.

Under the integrated plant doctrine, equipment from two different systems may be exempt so long as the equipment is used directly to manufacture a product that will result in a final sale on which sales tax is to be collected. *Concord Pub. House, Inc. v. Dir. of Revenue, State of Mo.*, 916 S.W.2d 186, 192-193 (Mo. 1996). Here, unlike the computers in *Concord* and *DST Systems* that were used directly to manufacture the final product, the disputed items do not act in a similar way to cause a change to the graded timber when the materials enter the production process. The items merely acted as a conduit between the source of electrical power and the admittedly exempt manufacturing machinery. The items are similarly situated to the development and design equipment at issue in *Emerson*, which this Court considered were a prelude to manufacturing. *Emerson*, 204 S.W.3d at 646-647.

These items fall outside of what has historically been included under the integrated plant doctrine. Just as the transmission and distribution of electricity to the consumer is not part of manufacturing the electricity itself, so the transmission and distribution of electricity from the electrical grid to the

consumer's equipment is not an integrated part of manufacturing the final product. *Utilicorp*, 75 S.W.3d at 727-729.

Respondent asks this Court to affirm the AHC's decision that all of the disputed items met the three prongs of the integrated plant doctrine. This would produce an absurd and illogical result. *Reichert v. Bd. of Educ. of City of St. Louis*, 217 S.W.3d 301, 305 (Mo. 2007). If this Court finds that the equipment is exempt under the integrated plant doctrine, then the doctrine will swallow the exemption as defined by the statute. All equipment used in a manufacturer's facility will be effectively exempt, whether it is necessary to production or not. This is contrary to the legislature's intent to exempt only certain equipment and is inconsistent with the principle of strictly construing tax exemptions against the taxpayer. See *Utility Serv. Co., Inc. v. Dep't of Labor & Indus. Relations*, 331 S.W.3d 654, 658 (Mo. 2011); *20th & Main Redevelopment P'ship v. Kelley*, 774 S.W.2d 139, 141 (Mo. banc 1989) ("Ascertaining and implementing the policy of the General Assembly requires the court to harmonize all provisions of the statute.")

For the foregoing reason, this Court should find that the disputed items do not qualify for the tax exemption and should reverse the judgment of the AHC.

III. The issues in *IBM* and the subsequent amendment to § 144.030 have no bearing on the question on appeal in this case.

In *IBM*, this Court was asked to determine whether software used by credit card companies to assimilate data constituted manufacturing. *IBM Corp. v. Dir. of Revenue*, 491 S.W.3d 535, 541 (Mo. 2016). This Court held that such a practice was not manufacturing and went on to state that: “To the extent cases such as *Bell I* and *Bell II* suggest that an expansive interpretation of the word ‘manufacturing’ is authorized by the ‘manufacturing’ exemption, and to the extent that they hold that the electronic transfer of voices is itself manufacturing as that term is used in the exemption, they are no longer to be followed.” *Id.*

The legislature’s subsequent amendment of § 144.030 overturned *IBM* to the extent that it applied to telecommunication services only.

[T]he term “manufacturing” shall include the production, or production and transmission, of telecommunications services...and accordingly abrogates the Missouri supreme court’s interpretation of those exemptions in *IBM* [] to the extent inconsistent with this section and [*Bell I* and *Bell II*].

§ 144.030 (2018). The amended statute went on to state that “the construction and application of this subdivision as expressed by the Missouri supreme court in [*DST, Bell I, and Bell II*] is hereby affirmed.” *Id.* Respondent avers that this expresses an intent to read the integrated plant doctrine as broadly as possible. (Def. Br. at 11-12). This is not the required result for two reasons.

First, *Bell II* specifically stated that it must apply a limited approach to the integrated plant doctrine and only exempted the equipment that met all three prongs. *See Sw. Bell*, 182 S.W.3d at 234. (“In applying the “integrated plant” doctrine, all three prongs should be examined before determining whether an item qualifies for the manufacturing exemption. If an item is not necessary to production, it cannot be exempt. If it is not close physically or causally to the end product, it cannot be exempt. If it does not operate with admittedly exempt items in an integrated and synchronized system, it cannot be exempt.”). This approach clarified the approach taken by the Court in *DST Systems*, which analyzed how the computers met all three prongs of the integrated plant doctrine, but did not analyze how all of the equipment met all of the prongs of the integrated plant doctrine. 43 S.W.3d at 803. This approach taken by the Court in *Bell II* is superior because it provided greater clarity for what is necessary for equipment to be exempted under the integrated plant doctrine.

Second, *IBM* did not discuss the integrated plant doctrine because it was not determining whether the software, hardware, and servers at issue were “used directly” in manufacturing but whether *IBM* was engaged in manufacturing. *IBM*, 491 S.W.3d at 540-541.² Similarly, the statutory

² *Bell I* also did not address whether or not equipment was used directly under the integrated plant doctrine because the issue in that case was whether or not

amendment specifically reversed only *IBM's* holding as to whether manufacturing includes the production and transmission of telecommunications services. § 144.030 (2018). The legislature did not amend the statute to expand the application of the exemption to equipment used only indirectly in manufacturing, nor did the amendment change the requirement of the integrated plant doctrine as the test for when equipment is “used directly” in manufacturing. In fact, the legislature reaffirmed the use of this test as used by the Court in *DST*, *Bell I*, and *Bell II*. *Bell I* did not discuss the integrated plant theory, leaving *DST* and *Bell II*. *DST* and *Bell II* both state that the integrated plant doctrine is the correct test and both apply it to the equipment at issue in those cases, however, *Bell II* does so more thoroughly, analyzing how each item met each prong of the integrated plant doctrine. Under the doctrine of stare decisis, to the extent *Bell II* stands in conflict with *DST*, the latter case controls. *Templemire v. W&M Welding, Inc.*, 433 S.W.3d 371, 386-387 (Mo. banc 2014) (J. Fischer dissenting in concurrence with J. Wilson).

Finally, the issues raised in Respondent’s brief regarding whether *IBM* has been entirely abrogated or whether the 2018 amendment to § 144.030 is

the transmission of voices over phone lines was or was not manufacturing. *Southwestern Bell Tel. Co. v. Dir. of Revenue*, 78 S.W.3d 763, 767-768 (Mo. banc 2002).

retroactive are not issues that are necessary to the resolution of the immediate appeal.³ Here, the issue is whether electrical equipment used in a sawmill met the three prongs of the integrated plant doctrine. Both the technology and the manufacturing process used in this case are as old as the manufacturing exception itself. This Court did not mention or discuss the integrated plant doctrine in *IBM*. Therefore, this Court does not need to reach any holding on the Commission's decision regarding whether or not *IBM* was overruled entirely by the legislative amendment to § 144.030 or whether the amendment was intended to be retroactive in order to resolve the question on appeal in this case. See *Theroff v. Dollar Tree Stores, Inc.*, Case Number 97235, 2020 WL 203121 at *6 (Mo. banc Jan. 14, 2020) (*Breckenridge, concurring*) (“[A]s this Court has held countless times, an opinion is limited by the issues before the Court and any holdings beyond those necessary to decide the issues are *dicta*.”) (citations omitted). This Court should not be tempted by Respondent's invitation to interpret the amendment as requiring the Court to expand the integrated plant doctrine beyond what is required by the plain language of the statute and by this Court's precedent.

³ Appellant is not conceding either issue.

CONCLUSION

For the foregoing reasons, this Court should reverse the decision of the Administrative Hearing Commission with respect to the refund of use taxes on the purchase of electrical equipment.

Respectfully submitted,

ERIC S. SCHMITT
Attorney General

/s/ Julia E. Rives
JULIA E. RIVES
Assistant Attorney General
Missouri Bar No. 69249

P.O. Box 899
Jefferson City, MO 65102
Phone: (573) 751-3321
Fax: (573) 751-5391
Julia.Rives@ago.mo.gov

ATTORNEYS FOR RESPONDENT
STATE OF MISSOURI

CERTIFICATE OF COMPLIANCE

The attached brief complies with the limitations contained in Missouri Supreme Court Rule 84.06 and contains 3,102 words, excluding the cover, certification and appendix, as determined by Microsoft Word 2016 software; and that pursuant to Rule 103.08 and the brief was served upon all other parties through the electronic filing system.

/s/ Julia E. Rives

JULIA E. RIVES

Assistant Attorney General

Missouri Bar No. 69249

P.O. Box 899

Jefferson City, MO 65102

Phone: (573) 751-3321

Fax: (573) 751-5391

Julia.Rives@ago.mo.gov

ATTORNEY FOR RESPONDENT
STATE OF MISSOURI