

IN THE SUPREME COURT OF MISSOURI

S.C. No: 98601

SEBA, LLC,
Appellant,

v.

MISSOURI DIRECTOR OF REVENUE,
Respondent.

Appeal from the Administrative Hearing Commission,
The Honorable Renee T. Slusher, Commissioner
Case No.: 16-3073

SEBA, LLC'S SUBSTITUTE REPLY BRIEF

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ARGUMENT

JURISDICTION

In its Substitute Respondent's Brief, the DOR acknowledges the instant case falls within the Court's exclusive jurisdiction under Article V, Section 3 of the Missouri Constitution. As the DOR concedes, the Court has not previously construed the meaning of "**negligence**" in Section 144.250.3. (Res.Br.2). Section 144.250.3 does not define the term "**negligence**" as used therein, and there presently exist no cases from the instant Court, interpreting that word as utilized in the statute. *Hermel, Inc. v. St. Tax Comsn.*, 564 S.W.2d 888,897 (Mo.banc.1978). Since there exists no pre-existing precedent to apply, the case presents an issue of first impression. *Id.* In determining whether the AHC erred in upholding a 5% penalty against SEBA, the Court must determine the meaning of "**negligence**" in Section 144.250.3, and thus, the instant appeal requires the construction of the revenue laws of this state. *Mo.Con.Art.V §3;Eliau v. DOR*, 402 S.W.3d 566,567 n.3 (Mo.banc.2013); *Housing Authority Of Poplar Bluff v. Eastwood*, 736 S.W.2d 46,47 (Mo.banc.1987).

Respondent DOR also admits the instant case presents an additional issue of first impression. SEBA contends the auditor's findings and methodology for estimating missing retail sales under Section 144.250.4, which the AHC adopted, were erroneous, and unsupported by competent and substantial evidence. The DOR concedes it knows of no opinion, addressing DOR estimates or estimate methodology under Section 144.250.4. (Res.Br.24). And, as the DOR acknowledges, Section 144.250 does not identify any factors which the DOR must use in estimating a taxpayer's gross receipts. (Res.Br.2-3).

Contrary to the DOR's suggestion, SEBA is not asking the Court to read into Section 144.250.4 any exceptions or limitations. Nor is SEBA asking the Court to rewrite Section 144.250.4. (Res.Br.3).

As is clear from its plain language, Section 144.250.4 does not delineate the method by which an auditor is to estimate a taxpayer's retail sales, for the purpose of calculating the applicable sales tax thereunder. **RSMo §144.250.4. *Dick Proctor Imports v. DOR*, 746 S.W.2d 571,575 (Mo.banc.1998)**, relied on by the AHC, does not discuss the nature of the method an auditor must use in estimating a taxpayer's retail sales. Rather, ***Dick Proctor*** merely holds an auditor's calculation and methodology must be based on competent and substantial evidence, not on speculation. ***Id.*** SEBA asks that the Court construe Section 144.250.4, and articulate the methodology to be used in estimating a taxpayer's retail sales, and in particular, what information or documentation is a reliable basis upon which such an estimate can be made. Since no decision of the instant Court provides guidance on this issue, the construction of Section 144.250.4 implicates the Court's exclusive jurisdiction under Article V, Section 3 of the Missouri Constitution. ***Hermel*, 564 S.W.2d at 897; *Alumax Foils v. City Of St. Louis*, 939 S.W.2d 907,910 (Mo.banc.1997).**

I.

**REPLY TO RESPONDENT’S ARGUMENT THAT
COMPETENT AND SUBSTANTIAL EVIDENCE
ESTABLISHED SEBA UNDERREPORTED ITS SALES,
RESULTING IN LIABILITY FOR UNPAID SALES TAX.**

The Court will not affirm a decision of the AHC if it is arbitrary, capricious, unreasonable, or unlawful. *K.C. Chiefs Football Club, Inc. v. DOR*, 602 S.W.3d 812,817-818 (Mo.banc.2020); *Myron Green Corp. v. DOR*, 567 S.W.3d 161,164 (Mo.banc.2019). This Court reviews the AHC’s legal decisions on a *de novo* basis. The Court is not bound by the AHC’s interpretation and application of the law. *K.C. Chiefs*, 602 S.W.3d at 818. In determining whether the agency’s findings are supported by competent and substantial evidence, the Court must look to the whole record, not merely the evidence which supports the agency’s decision, as the DOR suggests. *Lagud v. K.C. Bd. Of Police Cmsrs.*, 136 S.W.3d 786,791 (Mo.banc.2004). Nor is the Court required to view the evidence in the light most favorable to the AHC’s decision. *Id.*

It is the Director’s burden to show a tax liability. *Six Flags Theme Parks, Inc. v. DOR*, 102 S.W.3d 526,529 (Mo.banc.2003). Laws of the state imposing a tax are to be strictly construed against the taxing authority, and in favor of the taxpayer. *Id.*; *Utilicorp United, Inc. v. DOR*, 75 S.W.3d 725,731 (Mo.banc.2001).

When reviewing the AHC’s Decision, the Court must decide whether its findings were supported by competent and substantial evidence. *Myron Green*, 567 S.W.3d at 164. In adopting the auditor’s findings, the AHC acted unreasonably and arbitrarily, since those

findings were premised on speculation, not competent and substantial evidence. **RSMo** §621.193; *Visionstream v. DOR*, 465 S.W.3d 45,47-48 (Mo.banc.2015). To avoid being arbitrary or unreasonable, the AHC's decision had to be made utilizing something other than speculation, guesswork, or surmise. *Mprove v. KLG Telecom*, 135 S.W.3d 481,489 (Mo.App.W.D.2004).

The finding of an administrative agency is arbitrary and unreasonable, where it is not based on substantial evidence. *Edmonds v. McNeal*, 596 S.W.2d 403,407 (Mo.banc.1980). To meet basic standard of due process, and avoid being arbitrary, unreasonable, or capricious, an agency's decision must be made using something other than surmise, conjecture, or gut feeling. *MO Nat. Ed. Assoc. v. MO St. Bd. Of Ed.*, 34 S.W.3d 266,281 (Mo.App.W.D.2000). An agency cannot act in a subjective manner, without guidelines or criteria. *Id.* When an agency's finding is based on speculation and conjecture, it cannot stand. *Baldwin v. Des Granges*, 199 S.W.2d 353,358 (Mo.1947). That is the situation herein.

The DOR seeks, unsuccessfully, to distinguish *State ex rel DeWeese v. Morris*, 221 S.W.2d 206,209 (Mo.1949), when addressing the propriety of the auditor's methodology, and her estimate of SEBA's taxable retail sales. It asserts *DeWeese* is irrelevant, since the auditor therein did not use any direct information regarding the taxpayer's business operations, choosing instead to base his conclusions on the records of prior and subsequent owners of the business. *DeWeese* is not analogous the DOR argues, because the auditor therein had no information about how much business the taxpayer did, while Hoffman

calculated SEBA's taxable retail income based on its financial records and cash register receipts, an approach the AHC found to be reasonable. (Res.Br.24-25).

What the DOR fails to acknowledge, is that, like the auditor in *DeWeese*, Hoffman chose not to use the actual information Brad Artega provided to her regarding SEBA's business operations, in calculating SEBA's taxable retail income. This fact places the instant case within the ambit of *DeWeese*. *Id.* During the audit, Artega, Eddie's owner, provided documentation of Eddie's sales to the auditor, in compliance with the auditor's request. Additionally, Artega provided the auditor with the records SEBA's accountant used in preparing its sale tax returns. (Tr.31,41,68-69). This information was consistent with the figures set forth in SEBA's bank statements. (Tr.,Ex.A,17).

At hearing, Artega provided unimpeached testimony regarding the nature of Eddie's business as an un-automated single-man donut shop, the amount of Eddie's wholesale versus retail sales during the audit period, and the amount of Eddie's average retail cash sale. No objection was made to Artega's testimony, which was based on his personal knowledge as owner of Eddie's. (Tr.7-11,13,17-21,32-35). Even though the auditor had direct information regarding Eddie's business operations, its wholesale and retail sales, and its average retail cash sale, the auditor did not rely on this information in making her findings, but chose to engage in speculation, conjecture, and assumptions which were unsubstantiated by the record.

Instead of estimating Eddie's taxable sales, based on the financial information it provided, the auditor chose to base her findings on conjecture and admitted speculation. The DOR argues it should be given "latitude" in determining which re-construction method

to utilize when the taxpayer fails to maintain adequate records. (Res.Br.29). Such latitude, however, does not authorize an auditor to speculate regarding a taxpayer's sales or give an auditor a license to calculate those sales based on conjecture. Findings based on speculation and conjecture are without evidentiary support, and must be set aside. *Baldwin*, 199 S.W.2d at 358.

In support of its argument the Director should be given latitude in determining which method to apply, Respondent relies on *Diesel Country Truck Stop v. Commissioner Of I.R.S.*, T.C. Memo 2000-317 (2000). (Res.Br.29-30). *Diesel Country* cannot support either the auditor's methodology or her calculation of SEBA's taxable sales. First, the memorandum decision in *Diesel Country* is not precedential authority. Moreover, *Diesel Country* involved application of federal tax statutes, and addressed the propriety of the IRS' ruling that a California corporate taxpayer underreported its diesel fuel sales. In that *Diesel Country* did not involve application of Missouri sales tax statutes to a Missouri corporate taxpayer, it is irrelevant. *Id.*

While Section 144.210.2 permits the DOR to make assessments based on any information within its possession, or which shall come into its possession, that statute does not authorize the auditor to make arbitrary assessments, or assessments based on speculation. The statute contemplates a rational methodology will be applied to develop a reasonable approximation of the taxpayer's liability. *DeWeese*, 221 S.W.2d at 209-210.

While a taxpayer is required to keep records of its sales, Section 144.320 does not prescribe or set forth any specific form of recordkeeping which is required. An auditor's dissatisfaction with a taxpayer's recordkeeping method, or business documents, is not a

license for the auditor to disregard the records kept by the taxpayer, and provided during the audit. An auditor is not free to essentially dismiss the documentation provided by the taxpayer, and engage in speculation, when determining the businesses' taxable sales. *DeWeese* teaches that findings based on speculation or conjecture are unsupported by competent and substantial evidence. *DeWeese*, 221 S.W.2d at 209-210.

Citing *State ex rel Sure-Way Transportation v. Division Of Transportation*, 836 S.W.2d 23,26 (Mo.App.W.D.1992), Respondent argues the auditor's estimate of SEBA's taxable sales and methodology were based on competent and substantial evidence, in particular, Hoffman's examination of SEBA's own financial records and receipts. (Res.Br.25). However, the auditor did not base her estimate of Eddie's taxable sales on the financial records and receipts Artega provided. Rather, the auditor chose to substitute speculation, conjecture, and unsubstantiated assumption, for the information contained in those business records. This fact distinguishes the instant case from *Sure-Way Transportation. Id.*

In addition to failing to draw her findings from the documentation SEBA provided during the audit, the auditor, whose findings the AHC adopted, chose to ignore the undisputed evidence regarding the nature of Eddie's business. It is undisputed Eddie's is a small donut shop, with one paid employee, Eddie Strickland. Strickland is responsible for making all the donuts sold at Eddie's. Additionally, Strickland performs all of the business's daily tasks, including acting as counterperson, answering the telephone, waiting on all walk-in customers, and cleaning the store at the end of the day. Eddie's is not an automated shop. Strickland makes all the donuts by hand. (Tr.10-11,15-16,34-35,53-54).

The AHC adopted the auditor's conclusion that Eddie's sold 349.6 dozen donuts on a retail basis in July 2015, a figure representing 11.4 dozen donuts in retail sales each day that month. Eddie's wholesale donut sales per day in July 2015 were 34 dozen donuts. Based on the auditor's findings, Strickland was required to make, by hand, over 45 dozen donuts per day during July 2015. However, the auditor admitted she saw **no** evidence Strickland made 45 dozen donuts per day. Moreover, the auditor conceded she did not base her 11.4 dozen retail figure on any record SEBA provided. To the contrary, the 11.4 dozen retail figure was based on speculation. (Tr.34,87-92).

Citing *Campbell v. Guetersloh*, 287 F.2d 878,880 (5th Cir.1961); and *Davis v. U.S.*, 226 F.3d 331,336 (6th Cir.1995), the DOR contends the existence of unreported income may be demonstrated by any practicable proof, which is available in the circumstances of the particular situation. (Res.Br.29). Neither *Campbell* nor *Davis* involve application of Missouri sales tax statutes to a Missouri corporate taxpayer, or address the documents, information, or methodology which can be used to calculate that businesses' taxable sales. Rather, *Campbell* and *Davis*, like *Diesel Country*, involve application of federal tax statutes. *Campbell*, 287 F.2d at 880; *Davis*, 226 F.3d at 334. Since *Campbell* and *Davis* address the propriety of methods used by the Commissioner of Internal Revenue in calculating a taxpayer's federal income, rather than application of Missouri sales tax statutes, those cases are distinguishable, and do not support the auditor's methodology, which the AHC adopted in Decision. *Id.*

Significantly, the auditor admitted she did not base the 11.4 dozen retail figure on any record SEBA provided, but chose instead, to base that figure on speculation. In its

Brief, the DOR conveniently overlooks the significant role speculation and conjecture played in the auditor's findings. The auditor's findings, which the AHC adopted, were based on speculation. As such, those findings are unsupported by competent and substantial evidence, and must be set aside. *Shrock v. Walt Auto Sales*, 358 S.W.2d 812,815 (Mo.1962).

In finding Eddie's retail sales for July 2015 totalled \$12,535.93, the starting point for the auditor's calculations was Eddie's July 2015 cash register receipts, which Artega provided. The auditor calculated the average retail cash sale figure of \$8.06, by taking the 490 cash register receipts, adding up the amounts on those receipts, and dividing the total by 490, the number of receipts the auditor received. (Tr.,Ex.A,17). The auditor admitted she did not know whether the 490 receipts represented cash or credit card sales. (Tr.99-100). Hoffman did not take the 490 receipts, and separate the cash sales from the credit card sales, to determine the total amount of cash sales for each day during July 2015, and for the month as a whole. (Tr.71-72,96-97). Consequently, the auditor's average retail cash sale figure of \$8.06 erroneously included amounts for credit card sales.

The DOR emphasizes the AHC's conclusions that it could not find the auditor's method of calculating the average retail cash sale was not based on competent and substantial evidence because she used the very records SEBA provided, and that the auditor's calculations were based on a reasonable probability, given the information with which she had to work. (Res.Br.32;L.F.117). However, these findings were erroneous, since the auditor did not calculate SEBA's average retail cash sale, based on the actual records SEBA provided, the 490 receipts. Rather, the auditor's calculations were based on

speculation, conjecture, and unfounded assumptions regarding those receipts. Such speculation and unfounded conjecture does not constitute substantial evidence. *Shrock*, 358 S.W.2d at 815; *DeWeese*, 221 S.W.2d at 209-210.

The DOR suggests SEBA failed to provide an alternative method by which to calculate its average retail cash sale. This suggestion is without merit. SEBA contended a simple alternative method existed: taking the receipts for cash sales out of the 490 receipts for July 2015, totaling up the receipts for cash sales, and dividing that figure by the number of cash sale receipts. (Tr.99-100). The DOR fails to acknowledge the existence and soundness of this alternative methodology for determining SEBA's average retail cash sale.

Respondent contends the auditor's calculation of the average retail sale price was an estimate, which may or may not have matched the average retail sale amount for July 2015, but that was because SEBA failed to "provide more than two-thirds of its receipts for July 2015 to the auditor." Relatedly, Respondent argues the auditor's calculation of the average retail cash sale was based on competent and substantial evidence, namely, "objective mathematical calculations from the receipts" SEBA provided. (Res.Br.31).

In making this argument, however, Respondent fails to acknowledge the auditor's average retail cash sale figure was premised on an assumption unsupported by the record. Specifically, the unfounded assumption there should have been 1,555 receipts for the month of July 2015. This assumption does not constitute substantial evidence to support the auditor's findings, findings the AHC adopted. *Baldwin*, 199 S.W.2d at 358. Contrary to the DOR's contention, the auditor's calculation of the average retail cash sale was not based solely on mathematical calculations from the receipts SEBA provided for July 2015.

Rather, the auditor's calculations were based on assumptions and speculations regarding those receipts, one of those assumptions being there should have been 1,555 rather than 490 receipts for that month. Since the auditor's finding the average retail cash sale was \$8.06 was based on speculation and inferences which could not reasonably be drawn from the evidence, rather than mathematical calculations based on the receipts provided, it was erroneous. *Mprove*, 135 S.W.3d at 489; *Mo. Natl. Ed. Assoc.*, 34 S.W.3d at 281.

The DOR contends an agency's decision is not arbitrary where it is made using some kind of objective data. (Res.Br.35). However, in calculating the average retail cash sale for July 2015, the auditor did not simply use the "objective data" provided to her-the 490 receipts. Rather, the auditor reached her conclusions by engaging in conjecture, speculation and assumptions, and "fact" manipulation, rather than making mathematical calculations utilizing the receipts provided. Moreover, the DOR overlooks the fact the auditor could have easily determined which of the 490 receipts for July 2015 represented cash, as opposed to credit card sales, if she had simply asked Brad Artega. As the auditor conceded, she chose not to ask this simple question. (Tr.100).

Engaging in speculation, based on the fact the transaction numbers on the receipts for July 2015 were not sequential, the auditor concluded there should have been at least 1,555 cash register receipts for that month. (Tr.Ex.A,17;L.F.116-118). Even though SEBA's bank statements were a close match to Eddie's July 2015 sales figures, due to her *assumption* there were missing receipts for July 2015, Hoffman determined not all cash was being deposited in SEBA's bank account. The auditor multiplied her \$8.06 average

retail sale figure by 1,555, resulting in \$12,535.93 in estimated retail sales for July 2015. (Tr.Ex.A,16-20).

In its Decision, the AHC adopted assumptions made by the auditor, which were unsupported by competent and substantial evidence. Significantly, the auditor admitted she did not consult any DOR regulations, guidelines, caselaw or other authorities to determine whether these assumptions were valid, and consistent with audit principles. (Tr.85-86). Crucially, Hoffman conceded when she performed the SEBA audit, she had absolutely **no** experience in determining the amount of missing cash sales. (Tr.85-86,100-102). It is important to remember the SEBA audit was either the first or second audit Hoffman performed. Hoffman was still undergoing training in her profession when she undertook that audit. The auditor could not recall whether she asked any specific questions of her supervisor while estimating Eddie's average retail cash sale. (Tr.83-86,100-102). Nor did the auditor discuss with her supervisor whether \$8.06 was an appropriate figure to use in determining Eddie's average retail sale for July 2015, and on which to calculate Eddie's retail sales for that month. (Tr.,83-85,101-102).

Rather than base her findings on objective data-the actual records SEBA provided-the auditor chose to engage in speculation, based on the *possibility* receipts might be missing for July 2015. (Tr.100-101). Despite the fact Hoffman found no material differences when comparing the gross deposits, as documented in SEBA's bank statements, to the gross sales reported on SEBA's sale tax returns, she decided not to utilize the objective data, the records SEBA provided. Rather, the auditor conducted an estimated cash markup determination. (Tr.Ex.A,16-20). In adopting the auditor's methodology and

findings, which were premised on unfounded speculation, the AHC erred. Its findings, which were based on unsupported assumptions and conjecture, were without support in the record. *Shrock*, 358 S.W.2d at 815; *DeWeese*, 221 S.W.2d at 209-210; *RSMo* §621.193.

In its Brief, the DOR overlooks crucial concessions the auditor made at hearing. First, the auditor admitted she could not determine whether her average retail cash sale figure of \$8.06 for July 2015 or her \$12,535.93 figure for Eddie's retail cash sales for that month was accurate, since both estimates were based on a possibility. (Tr.100-101). Second, Hoffman conceded the SEBA audit was the first or second sales tax audit she performed, and she was still in training at the time she undertook the audit. (Tr.83-85,100-102).

Relying on *Dodson v. Ferrara*, 491 S.W.3d 542,567 (Mo.banc.2016), the DOR argues some uncertainty, even speculation, is inherent in an estimate where available documents and information are incomplete. That does not mean an estimate is not supported by substantial evidence. (Res.Br.38). At issue is not a "minor uncertainty" in the auditor's calculations. To the contrary, Hoffman's findings were based on speculation, a fact the auditor herself admitted. In adopting the auditor's findings, which were based upon possibilities, conjecture and speculation, rather than the financial documents SEBA provided, the AHC erred. *Mprove*, 135 S.W.3d at 489. *Dodson* did not involve a sales tax audit, wherein an auditor estimated a taxpayer's retail sales. Rather, *Dodson* addressed the constitutionality of the statutory cap on damages. *Id.* Thus, *Dodson* is distinguishable, and lends no support to either the auditor's findings or the AHC's Decision.

In its Respondent's Brief, the DOR asserts SEBA chose not to have a method by which it documented its sales. (Res.Br.37). It takes issue with the fact SEBA did not have a cash register, which generated Z-tapes,¹ and for not having a credit card machine which recorded individual credit sales.² As Artega admitted, he purchased a used cash register for Eddie's, which did not use a Z-tape. (Tr.28,54-55). Significantly, no provision of the Sales Tax Act, including Section 144.320, requires a business to utilize a cash register which produces a Z-tape, or a credit card machine which documents sales individually, rather than providing batch totals for the day's credit sales. Section 144.320 obligates a taxpayer to keep sufficient records to establish the amount of its gross income. **RSMo** §144.320. However, neither Section 144.320, nor any other provision of the Sales Tax Act, sets forth the precise type of cash register or credit card machinery a taxpayer must use, or sets forth the precise type of documentation a taxpayer must retain. Thus, SEBA cannot be faulted for using a cash register which did not generate Z-tapes.

Finally, the auditor's finding Eddie's average retail cash sale was \$8.06, the price of a dozen donuts at retail, was inconsistent with the nature of Eddie's business and common sense. It was unreasonable for Hoffman to conclude each retail customer of Eddie's during July 2015 purchased at least a dozen donuts. The record contains absolutely

¹ Z-tapes are tapes printed from a cash register, which summarize the day's sales. (*U.S. v. Koudanis*, 207 F.Supp.3d 115,121 (D.Mass.2016)).

² Eddie's credit card machine printed a receipt, setting forth the total amount of credit sales for each day. (Tr.27-28,47,54-55).

no evidence to support the auditor's conclusion in this regard. Hoffman's conclusion was contrary to Artega's undisputed and un-objected to hearing testimony that the vast majority of Eddie's walk-in retail customers did not purchase a dozen donuts at a time, and it was rare during the week to sell dozens of donuts to a single customer. (Tr.20-21). In rejecting this evidence, which came in at hearing without objection, without making a specific finding it was not credible or unworthy of belief, the AHC erred. Probative evidence received without objection in a contested case must be considered in an administrative hearing of the nature the Commission held below. *B.R. v. M.D.S.S.*, 466 S.W.3d 657,663 (Mo.App.E.D.2015); *Concord Publishing House v. DOR*, 916 S.W.2d 186,195 (Mo.banc.1996); **RSMo** §536.070(8).

Compounding this error, the Commission adopted Hoffman's findings, even though those findings were unreasonable, based on speculation, and contrary to the nature of Eddie's business. In adopting these findings, as well as other findings Hoffman made, which were based on nothing more than speculation and conjecture, the AHC erred as a matter of law. *Mprove*, 135 S.W.3d at 489; *Edmonds*, 596 S.W.2d at 407; *Baldwin*, 199 S.W.2d at 358. Since the AHC failed to recognize the auditor's \$8.06 average retail sale estimate, as well as the auditor's methodology which the Commission adopted, were premised on nothing more than erroneous assumptions and speculation, which were without support in the record, the Commission erred, and its findings must be set aside. *Id.*

II.

REPLY TO THE DOR'S ARGUMENT SEBA FAILED TO MEET ITS BURDEN OF ESTABLISHING ITS SALES TO ST. PATRICK'S CENTER AND ST. JOHN THE BAPTIST CATHOLIC CHURCH WERE EXEMPT.

In making her findings regarding SEBA's exempt sales, the auditor failed to use the information SEBA provided to her, and failed to undertake simple inquiries, which would have demonstrated whether her findings were correct or the product of speculation. At issue is whether SEBA's sales to St. Patrick's Center and St. John The Baptist Catholic Church ("St. John") were exempt under Section 144.210. Hoffman could have easily determined whether St. Patrick's and St. John were members of the St. Louis Archdiocese, for purposes of determining whether Eddie's sales to those entities were exempt, by consulting the official Catholic Directory ("Directory"). As the auditor conceded, she did not consult the Directory, despite the fact the 10-16-08 letter from the Department's Taxation Bureau to the Archdiocese demonstrated the Directory was in the Department's possession. (Tr.106). The DOR acknowledges this fact in its Brief. (Res.Br.40-41).

As the auditor conceded, she failed to undertaken simple inquiries, such as consulting the Directory, which would have provided a correct answer, and chose to substitute speculation and conjecture for the information which could be obtained from those inquiries. In adopting the auditor's findings, including those regarding Eddie's sales to St. Patrick's and St. John, the AHC erred. *Mprove*, 135 S.W.3d at 489.

The DOR contends the AHC properly concluded St. Patrick's Center and St. John were not exempt entities, and SEBA's sales to those churches were not exempt from sales tax, under Section 144.210. (Res.Br.39-45). What the DOR fails to acknowledge is that the 10-16-03 letter confirmed organizations and agencies listed in the Directory under the Archdiocese Of St. Louis were agencies and instrumentalities of the Archdiocese permitted to use the 7-11-02 exemption letter from the Taxation Bureau. The 7-11-02 exemption letter approved the Archdiocese's application for sale/use tax exempt status under Section 144.030.2(19). The letter stated purchases by the Archdiocese were not subject to sales or use tax, if conducted within the organization's exempt charitable, religious and educational functions and activities. (Tr.Ex.13,Pt.1).

The 7-11-02 exemption letter was contained in SEBA's Exhibit 13, admitted into evidence at hearing before the AHC. The second letter contained in that Exhibit was a 10-16-08 letter from the Taxation Bureau to the Archdiocese ("10-16-08 letter"). (Tr.Ex.13,Pt.1). The 10-16-08 letter confirmed organizations listed in the Directory, under the Archdiocese Of St. Louis, were agencies and instrumentalities of the Archdiocese, and those organization were permitted to use the 7-11-02 exemption letter. Moreover, the 10-16-08 letter went on to explicitly state the St. Louis Archdiocese was required to furnish the Department with current copies of the Directory, to ensure the Department had updated records of the agencies and instrumentalities which were in use of the 7-11-02 exemption letter. (Tr.Ex.13,Pt.1).

The only *reasonable* inference which can be drawn from the 10-16-08 and 7-11-02 letters was that the DOR had possession of the most recent copy of the Directory, and thus,

had access to the Directory. Consequently, the Directory was part of the DOR's own records. It is axiomatic agencies may officially notice their own records. See *Millridge Bank v. St. Banking Bd.*, 509 S.W.2d 763,766-767 (Mo.App.W.D.1974); and *M.S.H.P. v. Robinson*, 648 S.W.2d 644,645 (Mo.App.S.D.1983).

In its Brief, the DOR claims there is no evidence showing whether the Archdiocese ever provided a copy of the Directory to the DOR. (Res.Br.40). However, the DOR's argument ignores the explicit terms of the 10-16-08 letter, which *mandated* the Archdiocese furnish the DOR with current copies of the Directory. *Welch v. Eastwind Care Center*, 890 S.W.2d 395,397 (Mo.App.W.D.1995). The DOR asks the Court to ignore both the explicit terms of the 10-16-08 and 7-11-02 letters, as well as the only reasonable inferences which can be drawn from the language of those letters.

Additionally, the DOR contends a court should not use judicial notice to go outside the record, unless the facts are matters of common knowledge, or are capable of certain verification. (Res.Br.44-45). Whether St. John and St. Patrick's Center were exempt entities and part of the St. Louis Archdiocese was easily capable of verification. All the auditor had to do was to consult the Directory, presumably in the DOR's possession, to determine if those entities were part of the Archdiocese. The DOR seeks to distract the Court from the undisputed fact the auditor chose not to consult the Directory, even though it was in the DOR's possession, and even though it would definitely show if the two entities in question were part of the St. Louis Archdiocese. (Tr.106).

Exhibit 13, and the 10-16-18 letter which was a part of that Exhibit, were admitted into evidence at hearing without objection. At hearing, the DOR offered no evidence to

refute that letter, or the other letters in Exhibit 13. Despite the fact the AHC made no finding that either the 10-16-08 letter demonstrating the most recent version of the Directory was in the DOR's possession, or the auditor's concession she failed to consult the Directory in rendering her findings regarding Eddie's exempt sales, was not credible or was unworthy of belief, the AHC chose to disregard this crucial, undisputed evidence. It erred in doing so. **B.R.**, 466 S.W.3d at 663.

The DOR contends *Sanzone v. Mercy Health*, 326 F.Supp.3d 795 (E.D.Mo.2018), and *Overall v. Ascension*, 23 F.Supp.3d 816 (E.D.Mi.2014), do not establish the AHC was required to take judicial notice of the Directory. (Res.Br.42-45). In seeking to distinguish *Sanzone*, the DOR overlooks the significance of the court's ruling therein. Namely, the probative effect of the Directory in demonstrating entities and organizations listed in the Directory are part of the United States Catholic Church. As the District Court observed in *Sanzone*, courts viewed an entity or organization's listing in the Directory as a public declaration by the Catholic Church that the entity or organization was associated with the Church. *Sanzone*, 326 F.Supp.3d at 806-807. In fact, the IRS considered any entity or organization listed in the Directory to be associated with the U.S. Catholic Church. *Id.*

In emphasizing *Sanzone's* procedural posture-*Sanzone* was disposed of on a motion to dismiss for lack of subject matter jurisdiction-the DOR seeks to distract the Court from the relevant ruling in that decision, and its application to the instant facts: the listing of St. Patrick's Center and St. John's in the Directory under the St. Louis Archdiocese constituted competent and substantial evidence those entities were associated with the Catholic

Church. *Id.* In focusing on the procedural aspects of *Sanzone*, the DOR seeks to minimize the import of the Court's ruling therein.

While the DOR acknowledges *Overall's* holding that a court *can* take judicial notice of the Directory, it seeks to distinguish *Overall* by arguing there are procedural prerequisites to taking judicial notice under Rule 201 of the Federal Rules Of Evidence, as the District Court did in *Overall*. (Res.Br.44). However, this case does not involve the taking of judicial notice under FRE 702. Rather, SEBA contends the AHC could take judicial notice of the Directory under Section 536.070(6). Section 536.070(6) does not contain the same procedural prerequisites to taking judicial notice as those in Rule 201 of the Federal Rules Of Evidence. In relying on the Federal Rules, the DOR seeks to impose additional hurdles on SEBA, which are not reflected in the express language of Section 536.070(6).

Relying on *American Prairie Construction Co. v. Hoich*, 560 F.3d 780,797 (8th Cir.2009), the DOR argues caution should be taken to avoid admitting evidence through the use of judicial notice in contravention of the relevancy, foundation, and hearsay rules. (Res.Br.44). Given the probative nature of the Directory, no such danger exists in the instant case. *Sanzone*, 326 F.Supp.3d at 806-807; *Overall*, 23 F.Supp.3d at 831. *Overall* holds the Official Catholic Directory is a public document, which courts can judicial notice of. *Overall*, 23 F.Supp.3d at 831. Again citing *Hoich*, the DOR posits that on fact questions, a court should not use the doctrine of judicial notice to go outside the record, unless the facts are matters of common knowledge or capable of certain verification. (Res.Br.44). Whether St. John's and St. Patrick's Center were listed in the Directory was

indeed capable of “certain verification.” In determining whether SEBA’s sales to these entities were exempt, all the auditor had to do was to consult the Directory. However, as the auditor admitted, she chose not to do so. (Tr.106). The Commission erred in failing to take judicial notice of the Directory under Section 536.070(6). Compounding this error, the AHC failed to find St. Patrick’s Center and St. John’s, being listed in the Directory, were entities and organizations to who the 7-11-02 exemption letter applied. *Overall*, 23 F.Supp.3d at 831;*Sanzone*, 326 F.Supp.3d at 806-807.

III.

REPLY TO RESPONDENT DOR’S ARGUMENT THAT THE COURT SHOULD AFFIRM THE IMPOSITION OF A 5% PENALTY PURSUANT TO SECTION 144.250.3.

As the DOR acknowledges, Missouri sales tax statutes, Section 144.010 et seq., do not define the word “**negligence**” used therein. (Res.Br.46). It contends the Court should consider statutes involving related subject matter, if those statutes provide necessary definitions or shed light on the meaning of the statute being construed. Relying on *Balloons Over The Rainbow, Inc. v. DOR*, 427 F.3d 815,825-826 (Mo.banc.2014), the DOR argues when the legislature uses a word in a statute which has other judicial or legislative meaning attached to it, the legislature is presumed to have acted with knowledge of that judicial or legislative action. (Res.Br.46).

Given these contentions, it would be reasonable to expect the DOR to argue the Court should define “**negligence**” for purposes of Section 144.250.3, by looking at how Missouri courts have defined “**negligence**” for purposes of Sections 144.250.1 and

144.220, related sales tax provisions, the approach SEBA recommended in its Substitute Appellant's Brief. However, the DOR asserts the Court should consider the definition of negligence in 26 USC §6662, when construing the meaning of "**negligence**" in Section 144.250.3. The DOR suggests the definition of "**negligence**" in federal income tax statutes is pertinent, because Section 144.320 imposed on SEBA the legal duty to keep books and records, as required for income tax purposes under Title 26 of the United States Code. (Res.Br.46).

Relatedly, the DOR posits the Court should follow its prior decision in *Hiett v. DOR*, 899 S.W.2d 870 (Mo.banc.1995), wherein the Court adopted the definition of "**negligence**" in 26 USC §6662, in determining whether taxpayers were negligent in deducting certain amounts from their Missouri income and failing to pay Missouri income tax on that amount when due. (Res.Br.47). Both *Hiett* and the federal statute on which it relied, 26 USC §6662 involved income taxes. Neither *Hiett* nor 26 USC §6662 address Missouri sales taxes, and the meaning of "**negligence**" in that context. And, while the DOR dismisses *Lora v. DOR*, and *Lynn v DOR*, those decisions address the meaning of "**negligence**" within the context of Missouri sales tax statutes.

While the DOR argues the Court should adopt the definition of negligence in 26 USC §6662, in determining the meaning of that term in Section 144.250.3 (Res.Br.46-48), the express language of 26 USC §6662 precludes its application herein. That section states negligence includes any failure to make a reasonable attempt to comply with the provisions of "*this title.*" 26 USC §6662(c) [Emphasis added]. Since the issue is whether SEBA negligently failed to comply with Missouri sales tax statutes such that a penalty under

Section 144.250.3 was warranted, the definition of negligence in 26 USC §6662(c) has no bearing on the propriety of the penalty assessed by the auditor, and upheld by the AHC. The Court is not ruling on the propriety of a penalty under the federal income tax statutes. Accordingly, it should not use the definition of negligence in 26 USC §6662 in determining whether the assessment of a penalty was appropriate. Relatedly, the decisions relied upon by the DOR, including *Parrish v. Commissioner Of I.R.S.*, 169 F.3d 1098,1102 (8th Cir.1999), which addressed the burden of proof under federal tax statutes, are not dispositive of SEBA's burden under Section 144.250.3.

In its Respondent's Brief, the DOR argues the Court should not consider cases interpreting or applying the term "**negligent**" in Section 144.220, which sets forth the statute of limitations for sales tax proceedings. Likewise, the DOR posits the Court should not consider cases under Section 144.250.2, which applies when the full amount of sales tax is not paid when due, unless it is shown such failure is due to reasonable cause, and not the result of willful neglect, evasion, or fraudulent intent. Sections 144.220.1 and 144.250.2, unlike 26 USC §6662(c), are provisions of the Missouri sales tax statute. Since the instant case arises under the sales tax statute, and a penalty was assessed against SEBA pursuant to Section 144.250.3 of that statute, the definitions of "**negligent**" and "**neglect**" contained in the sales tax statute, are more probative on the meaning of "**negligence**" in Section 144.250.3. *Balloons Over The Rainbow*, 427 F.3d at 825-826.

The DOR asserts Joseph Otten "did not defend SEBA's inadequate record keeping" and Otten counseled his clients to keep Z-tapes. (Res.Br.54). The fact Eddie's did not use a cash register with a Z-tape cannot serve as a basis for the imposition of a penalty under

Section 144.250.3. No provision of the Missouri Sales Tax Act requires a business to utilize a cash register having a Z-tape. Additionally, the DOR posits a penalty was warranted, since SEBA allegedly failed to provide the auditor with all of the cash register receipts for July 2015. (Res.Br.54). A penalty cannot be imposed on SEBA based on the auditor's *assumptions* that cash register receipts were missing and there should have been 1,555 receipts for July 2015, since those assumptions were nothing more than rank speculation. The auditor's unfounded assumptions, which the AHC erroneously adopted, cannot support the assessment of a penalty under Section 144.250.3. To be affirmed, the AHC's assessment of a penalty must be supported by competent and substantial evidence. *B.R.*, 466 S.W.3d at 663; *Mprove*, 135 S.W.3d at 489. The AHC was not free to substitute the auditor's unfounded speculation and assumptions for evidence of this nature. *Id.*

Finally, the DOR argues SEBA's reliance on professional advice did not preclude the assessment of a penalty against it. The DOR asserts Brad Artega, owner of Eddie's, never identified any advice Otten may have given him. (Res.Br.53-54). The DOR interprets "**advice**" too narrowly.

Joseph Otten, SEBA's accountant and bookkeeper, did provide advice to SEBA, in regard to payment of Eddie's sales taxes. *U.S. v. Boyle*, 105 S.Ct. 687,692-693 (1985). It is undisputed Otten had prepared Eddie's sales tax returns since that business began operations in 2007. Otten prepared all of Eddie's sales tax returns during the audit period. The preparation of sales tax returns for SEBA by Otten was the rendering of professional advice, since those returns reflected Otten's professional judgment as to the amount of sales taxes owed for Eddie's operations. Since Brad Artega is a lay person, and not an

accountant, he acted reasonably in relying on Otten's professional judgment and advice.

Id. At no time while preparing Eddie's sales tax returns did Joseph Otten ever request any additional information, other than the information Artega provided to him. (Tr.25-27,29-31,44-47,57-63). The record contains no evidence that Otten ever advised Artega the information provided to him was inadequate for the preparation of Eddie's sales tax returns, or that Otten took issue with Artega's financial recordkeeping, as the DOR implies in its Brief. It is undisputed both Artega and Otten reviewed the sales tax returns, prior to filing the same, to check those returns for accuracy.³ In preparing Eddie's sales tax returns, Otten used his best professional abilities as an accountant. (Tr.25-27,29-31,44-47,57-63).

In determining the amount of sales tax SEBA owed, and preparing its sales tax returns, Ottens was providing SEBA professional advice, advice on which it reasonably relied. *Id.* Thus, the AHC erred in finding SEBA was negligent in reporting its taxable sales within the meaning of Section 144.250.3, and its imposition of a penalty must be set aside. *Id.;Lora v. DOR*, 618 S.W.2d 630,634 (Mo.banc.1981).

³ The auditor assessed a penalty because she believed SEBA failed to double-check its records when reporting its sales to the Department. (Tr.108-109). If the Department can assess a penalty for this reason, then any taxpayer could be subject to a penalty for nothing more than a mathematical error. The language of Section 144.250.3 does not support such a result. **RSMo** §144.250.3.

CONCLUSION

The Decision of the AHC is neither authorized by law, nor supported by competent and substantial evidence. SEBA asks the Court to set that Decision aside.

Respectfully submitted,

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CERTIFICATE OF SERVICE

A copy of the foregoing document was filed with the Missouri Electronic filing system this 1st day of September, 2020, which will send a copy to: Thomas Arthur Houdek, attorney for Respondent, at 301 West High Street, Room 670, P.O. Box 475, Jefferson City, Missouri 65105; and Emily Dodge, attorney for Respondent, at P.O. Box 899, Jefferson City, Missouri 65102.

/s/ Mary Anne Lindsey_____

CERTIFICATE OF COMPLIANCE

This Substitute Appellant's Brief complies with Rule 84.06(b) and contains 6,688 words. To the best of my knowledge and belief, the copy of the Brief forwarded to the Clerk of the Court, via electronic mail, has been scanned for viruses, and is virus-free.

/s/ Mary Anne Lindsey

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