SC91010

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IN THE SUPREME COURT OF MISSOURI

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E & B GRANITE, INC.,

Respondent (Petitioner below),

vs.

DIRECTOR OF REVENUE,

Appellant (Respondent below).

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From the Administrative Hearing Commission of Missouri,
The Honorable Karen A. Winn, Commissioner

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# APPELLANT'S BRIEF

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## JURISDICTIONAL STATEMENT

The issues before the Court in this matter involve the construction of § 144.054.2, RSMo (2009 Cum. Supp.),[1/] a revenue law of the State of Missouri. Therefore, this Court has exclusive jurisdiction over this matter pursuant to Article V, § 3 of the Missouri Constitution.

[1/] All references to the Missouri Revised Statutes are to the 2009 Cumulative Supplement unless otherwise specified.

## STATEMENT OF FACTS

The relevant facts are few and undisputed. E & B Granite, Inc. ("E & B") is both a construction contractor and retailer of granite products. (LF 44). It sells and installs granite countertops, fireplace hearths, and windowsills. (LF 44). E & B purchases raw granite slabs for ultimate sale at retail to customers as granite countertops or other items, or for its own use as a construction contractor making real property improvements. (LF 49-55). In both instances, the raw granite slabs are manufactured or made into granite countertops or other items prior to their sale to customers or their installation as real property improvements. (LF 49-55).

In 2009, E & B paid state and local sales and use taxes under protest on the purchase price of granite slabs that were used by E & B in making real property improvements as a construction contractor.[2/] (LF 45). By agreement between E & B and its customers, title to the finished granite items did not pass until E & B permanently and completely installed the

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[2/] E & B had originally paid all state and local sales and use taxes under protest. Prior to the AHC's decision, E & B abandoned its claim of exemption for its retail sales and its claim of exemption from local sales tax for its purchases because § 144.054.2 does not provide an exemption for retail sales or for local sales tax.

granite items as an improvement to the customers' real property. (LF 45). Therefore, no sale at retail of tangible personal property occurred when E & B made improvements to real property. *See, e.g., Marsh v. Spradling*, 537 S.W.2d 402, 407 (Mo. 1976).

E & B claimed an exemption from state sales tax and state and local use taxes pursuant to § 144.054.2, arguing that all the granite slabs it purchased constituted "materials used or consumed in the manufacturing . . . of any product." (LF 46). The Director of Revenue disallowed the exemption, and E & B appealed the decision to the Administrative Hearing Commission ("AHC"). (LF 46). The question before the AHC was whether E & B's purchases of raw granite slabs for its own use in making real property improvements under a construction contract were subject to state sales tax and state and local use taxes under Missouri law.

The AHC acknowledged in its decision that tax exemptions are strictly construed against the taxpayer, and the taxpayer has the burden to prove entitlement to a tax exemption. Decision, p. 5 (citing *Cook Tractor Co., Inc. v. Dir. of Revenue*, 187 S.W.3d 870, 872 (Mo. banc 2006). Nevertheless, the AHC granted the tax exemption in this case, holding that "an installed countertop is a product." Decision, p. 9. The AHC also did not attempt to define what constitutes "materials used or consumed" under § 144.054, but

determined that the legislature "provided this exemption, resulting in a situation in which no tax is paid." Decision, p. 10. Recognizing its dramatic departure from the law, the AHC added that "[t]he wisdom of any such exemption is for the legislature, not this Commission, to decide." Decision, p. 10.

## POINTS RELIED ON

I. **The Administrative Hearing Commission Erred in Awarding Sales and Use Tax Refunds to E & B Granite, Inc., Because the Making of a Real Property Improvement is Not the Manufacturing of any "Product" Under § 144.054.2, In That a Real Property Improvement Such as an Installed Countertop is Not a "Product."**

*Blevins Asphalt Const. Co. v. Dir. of Revenue*, 938 S.W.2d 899 (Mo. banc 1997)

*International Business Machines Corp. v. Dir. of Revenue*, 958 S.W.2d 554 (Mo. banc 1997)

*Southwestern Bell Tel. Co. v. Dir. of Revenue*, 78 S.W.3d 763 (Mo. banc 2002)

II. **The Administrative Hearing Commission Erred in Awarding Sales and Use Tax Refunds to E & B Granite, Inc., Because the Tax Exemption in § 144.054.2 Does Not Apply to Raw Products, In That a Countertop That is Cut, Polished, and Permanently Attached to Real Property by a Construction Contractor is Not Within the Meaning of "Materials Used or Consumed in the Manufacturing" of "Any Product."**

*Concord Pub. House, Inc. v. Dir. of Revenue*, 916 S.W.2d 186 (Mo. banc 1996)

*ICC Management, Inc. v. Dir. of Revenue*, 290 S.W.3d 699 (Mo. banc 2009)

*Standard Operations, Inc. v. Montague*, 758 S.W.2d 442 (Mo. banc 1988)

## SUMMARY OF THE ARGUMENT

A long line of cases from this Court hold that the purchase of raw construction materials by contractors for the purpose of making real property improvements is subject to sales and use tax. *See, e.g., Blevins Asphalt Const. Co. v. Dir. of Revenue*, 938 S.W.2d 899, 901 (Mo. banc 1997); *Bratton Corp. v. Dir. of Revenue*, 783 S.W.2d 891, 892 (Mo. banc 1990); *Becker Elec. Co., Inc. v. Dir. of Revenue*, 749 S.W.2d 403, 405 (Mo. banc 1988); *Overland Steel, Inc. v. Dir. of Revenue*, 647 S.W. 2d 535, 538 (Mo. banc 1983); *J.E. Williams Const. Co. v. Spradling*, 555 S.W.2d 16, 24 (Mo. banc 1977); and *City of St. Louis v. Smith*, 114 S.W.2d 1017, 1019-20 (Mo. 1937).

With the passage of § 144.054, did the legislature intend to change decades of established precedent so that construction contractors no longer pay taxes on their purchase of raw construction materials? No. But that is exactly what the AHC decided. The AHC's decision, however, is not consistent with controlling case law, the plain language of the statute, and the statutory structure. Moreover, such an interpretation produces absurd consequences.

A real property improvement, like real property, is not a "product" under § 144.054.2. Instead, the term "product" has been limited to tangible personal property and services that are subject to tax. Therefore, the

purchase of raw construction materials for a real property improvement is not exempt from sales or use taxes. *Blevins Asphalt Const. Co. v. Dir. of Revenue*, 938 S.W.2d 899, 901 (Mo. banc 1997). Indeed, while an item may be a "product" if sold separately, if the item is instead attached permanently as an improvement to real property it is not a "product." Accordingly, E & B's purchase of granite solely for installation as a real property improvement is not exempt from sales and use taxes as a "product."

Furthermore, the term "materials" in § 144.054.2 is part of a larger list of things that, when read together and consistent with the maxim *ejusdem generis*, demonstrates the meaning of "materials." *See Standard Operations, Inc. v. Montague*, 758 S.W.2d 442, 444 (Mo. banc 1988). In this context, the term "materials" means those things which facilitate the manufacturing of the ultimate product and not the raw product itself. Thus, the list includes things like gas, coal, water, or machinery – all used to produce the ultimate product. § 144.054.2.

Had the legislature intended to include the raw product in the exemption it could have included the same language it used in the exemption in § 144.030.1(2) – "materials . . . which when used in manufacturing . . . become a component part or ingredient of the new personal property resulting from such manufacturing." It did not include this language and did

not intend the meaning to broadly sweep in the raw product as tax-exempt "materials."

The consequences of the AHC's decision, if permitted to stand, would be disastrous. Construction contractors would be treated differently depending on whether they did anything to make the items they install. Worse still, some or all construction contractors (and therefore their customers) would be free from any taxes on their purchases used to make improvements to real property. There is no suggestion that the legislature intended such a result, and to interpret § 144.054.2 in this way violates the strict or narrow construction that must be made of a tax exemption. *See Branson Properties USA, L.P. v. Dir. of Revenue*, 110 S.W.3d 824, 825 (Mo. banc 2003).

## ARGUMENT

*Standard of Review*

The only issues in this case are legal issues, and they involve the interpretation of a revenue law – § 144.054. This Court reviews the AHC's interpretation of revenue laws *de novo*. *Brinker Mo., Inc. v. Dir. of Revenue*, --- S.W.3d ---, 2010 WL 3430437, *2 (Mo. banc, Aug. 31, 2010) ("Statutory interpretation is an issue of law that this Court reviews *de novo*."); *see also Finnegan v. Old Republic Title Co. of St. Louis, Inc.,* 246 S.W.3d 928, 930 (Mo. banc 2008). But § 144.054 is not just any revenue law; instead, it is a sales and use tax exemption subject to strict construction:

> Tax exemptions are strictly construed against the taxpayer. An exemption is allowed only upon clear and unequivocal proof, and doubts are resolved against the party claiming it. Exemptions are interpreted to give effect to the General Assembly's intent, using the plain and ordinary meaning of the words.

*Branson Properties USA, L.P. v. Dir. of Revenue*, 110 S.W.3d 824, 825 (Mo. banc 2003). In other words, "it is the burden of the taxpayer claiming the

exemption to show that it fits the statutory language exactly." *Cook Tractor Co. v. Dir. of Revenue*, 187 S.W.3d 870, 872 (Mo. banc 2006).

The taxpayer in this case – E & B – cannot satisfy the burden to show that it fits the statutory language at all, much less exactly. Accordingly, the AHC's decision to refund taxes under the exemption in § 144.054.2 should be reversed and judgment entered in favor of the Director of Revenue.

## I. The Administrative Hearing Commission Erred in Awarding Sales and Use Tax Refunds to E & B Granite, Inc., Because the Making of a Real Property Improvement is Not the Manufacturing of any "Product" Under § 144.054.2, In That a Real Property Improvement Such as an Installed Countertop is Not a "Product."

The exemption from sales and use taxes in § 144.054.2 applies only to a "product." Case law in Missouri has long established what constitutes a "product" for purposes of sales and use taxes – and it does not include real property or real property improvements. *See, e.g., Southwestern Bell Tel. Co. v. Dir. of Revenue*, 78 S.W.3d 763, 766-67 (Mo. banc 2002) (reviewing the development of "product"). Yet, the AHC departed from decades of controlling authority to hold that "an installed countertop is a product."

Decision, p. 10. This decision is not supported by the law, and certainly not consistent with a strict construction of the tax exemption in § 144.054.2.

Section 144.054 does not define "product" and the dictionary provides only limited assistance with broad definitions of the term. *See* Webster's Third New International Dictionary 1810 (1993) (defining product to include: "something produced by physical labor or intellectual effort: the result of work or thought"; "a result of the operation of involuntary causes or an ensuing set of conditions"; and "the amount, total, or quantity produced: the output of an industry or firm"). This Court, however, has extensively considered the term "product" in the context of sales and use tax exemptions. One such decision – *International Business Machines Corp. v. Dir. of Revenue*, 958 S.W.2d 554, 557 (Mo. banc 1997) – is relied upon by the AHC in its decision, albeit incorrectly.

The AHC stated in its decision that this Court in *International Business Machines*, "defined a 'product' as 'an output with a market value.'" Decision, p. 8. From this fragment of *International Business Machines*, the AHC took its departure from the controlling law and decided that real property improvements such as "installed countertops are a product because they are an output with a market value." Decision, p. 9.

The fragment quoted by the AHC from *International Business Machines*, however, omits an important qualification in the case. In its entirety, this Court actually held that: "Because a product is an output with a market value, *it can be either tangible personal property or a service*." *International Business Machines*, 958 S.W.2d at 557 (emphasis added). Thus, a "product," for purposes of sales and use taxes, is either tangible personal property or a service. A real property improvement is not a "product" subject to sales and use taxes. This basic point has been confirmed repeatedly by this Court.

In *Blevins Asphalt Const. Co. v. Dir. of Revenue*, 938 S.W.2d 899, 901 (Mo. banc 1997), for example, this Court considered whether asphalt was subject to sales and use tax. The key distinction was when title passed and whether the asphalt was installed on real property as an improvement or sold as a "product" when title passed. "If title had passed before the asphalt was installed on real property, [it] would have created new personal property . . . . However, because title passed after the asphalt was installed, [it] created an improvement to real property which *cannot be 'new personal property . . . .*'" *Id.* at 901 (emphasis added); *see also, e.g., Bratton Corp. v. Dir. of Revenue*, 783 S.W.2d 891 (Mo. banc 1990) (noting that materials purchased for

improvement of real property are subject to tax); *Overland Steel, Inc. v. Dir. of Revenue*, 647 S.W.2d 535 (Mo. banc 1983) (same).

Like *Blevins*, E & B installs countertops before title passes. The AHC, in fact, acknowledged that title passes after a countertop is installed by E & B. Decision, p. 4. Thus, a countertop cannot be personal property or a product because it is an improvement to real property. As a real property improvement, an installed countertop is not a "product" exempt from taxes under § 144.054.2. The decision of the AHC should therefore be reversed and judgment entered in favor of the Director of Revenue.

## II. The Administrative Hearing Commission Erred in Awarding Sales and Use Tax Refunds to E & B Granite, Inc., Because the Tax Exemption in § 144.054.2, Does Not Apply to Raw Products, In That a Countertop That is Cut, Polished, and Permanently Attached to Real Property by a Construction Contractor is Not Within the Meaning of "Materials Used or Consumed in the Manufacturing" of "Any Product."

Even if the AHC were correct and the long-standing law establishing what constitutes a "product" were reversed, the tax exemption claim of E & B must still fail. Section 144.054.2 provides that the following are exempted from sales and use tax:

> [E]lectrical energy and gas, whether natural, artificial, or propane, water, coal, and energy sources, chemicals, machinery, equipment, and materials used or consumed in the manufacturing, processing, compounding, mining, or producing of any product.

E & B argued below, and the AHC erroneously agreed, that the items it installs in homes – granite countertops, etc. – fit within this tax exemption. This is not the case, and is certainly not a narrow or strict construction of the tax exemption. The plain language of the statute, the statutory structure, and the potential consequences do not support the interpretation advanced by E & B and adopted by the AHC.

### A. The Plain Language of § 144.054.2 Limits the Tax Exemption to Electrical Energy, Gas, Propane, Water, and Similar "Materials" "Used or Consumed" in the Manufacturing Process and Does Not Apply to the Raw Product That is Being Manufactured.

As with any statutory provision, "the primary rule of statutory interpretation is to give effect to legislative intent as reflected in the plain language of the statute." *Akins v. Dir. of Revenue*, 303 S.W.3d 563, 565 (Mo. banc 2010) (citing *State ex rel. White Family Partnership v. Roldan*, 271

S.W.3d 569, 572 (Mo. banc 2008)). "In the absence of statutory definitions, the plain and ordinary meaning of a term may be derived from a dictionary. . . . and by considering the context of the entire statute in which it appears." *State ex rel. Burns v. Whittington*, 219 S.W.3d 224, 225 (Mo. banc 2007) (citing *American Healthcare Management, Inc. v. Dir. of Revenue*, 984 S.W.2d 496, 498 (Mo. banc 1999) and *Butler v. Mitchell-Hugeback, Inc.*, 895 S.W.2d 15, 19 (Mo. banc 1995)).

In this case, the AHC purported to interpret the "plain language of § 144.054," but it failed to do so. Decision, p. 10. Key terms requiring interpretation are: "materials used or consumed." § 144.054.2. While these terms describe what is subject to the exemption, they are not defined in the statute. As such, we must turn to the dictionary and cannons of statutory construction for assistance as to their meaning in the context of this statute.

### 1. The Meaning of "Materials," Properly Construed, Does Not Include the Raw Product Being Manufactured.

The AHC appears to simply assume that the term "materials" in § 144.054.2 includes the raw product which is ultimately installed. This is certainly one possible interpretation, but it is not the only interpretation of the term, and it is in fact inconsistent with the required narrow construction

of the statute or the list of terms of which it is a part.

The dictionary provides the following potentially applicable definitions of the noun "materials":

> **Material** *n* – **1a**(1): the basic matter from which the whole or the greater part of something physical is made (2) the finished stuff of which something physical is made **b**(1): the whole or a notable part of the elements or constituents or substance of something physical or not physical **2a**: apparatus necessary for doing or making something

Webster's Third New International Dictionary 1392 (1993). The definitions of material(s) include either the raw product from which something is made or an apparatus necessary to make something. As such, the dictionary definitions provide some guidance concerning this term, but not a conclusive answer. "Dictionary definitions are not, however, the final source of guidance in statutory interpretation." *State v. Payne*, 250 S.W.3d 815, 820 (Mo. App. W.D. 2008). This is particularly true when the definitions provide only moderate guidance given the broad terms and numerous meanings that could be applied. *Id.*

The meaning of statutory terms is also dependent on the context in

which they are placed. "The maxim *ejusdem generis* ('of the same kind') is also of assistance here. By that precept of construction, specific enumeration is useful in determining the scope and extent of more general words." *Standard Operations, Inc. v. Montague*, 758 S.W.2d 442, 444 (Mo. banc 1988); *see also Pollard v. Board of Police Com'rs*, 665 S.W.2d 333, 341 (Mo. banc 1984) (noting that the rule of *ejusdem generis* is an aid to statutory construction problems such that when general words follow a specific enumeration of things the general words are limited by the specific) (citing *United States v. Turkette,* 452 U.S. 576, 581 (1981) and 2A Sands, *Sutherland Statutory Construction* § 47.17 (4th ed. 1973)).

In this case, the meaning of the general term "materials" is aided by the maxim "*ejusdem generis*" since it is part of (and at the end of) a larger list of more specific terms. The other more specific terms in the list are: "electrical energy and gas, whether natural, artificial, or propane, water, coal, and energy sources, chemicals, machinery, [and] equipment." § 144.054.2. The question then is whether these more specific terms are consistent with a definition of "materials" meaning raw product or a definition of "materials" meaning an apparatus used to make something. It is the latter. The terms in the list in § 144.054.2 are all things which are used to do something to or with the raw product and not the raw product itself. Thus, the definition of

"materials" that is consistent with this list, the canons of statutory construction, and the dictionary is one which means "materials" that are an apparatus used to make something else.

Here, the granite slabs are not being used as an apparatus or to facilitate the manufacturing of something else. The granite slabs are the item itself, albeit in raw form, being manufactured. It is not this raw form that is the subject of the exemption in § 144.054.2, particularly if the exemption is to be strictly construed in accordance with controlling law.

### 2. The Definitions of "Used or Consumed" Also Support the Intended Meaning of "Materials."

This interpretation of "materials" is also consistent with the dictionary definitions of the two verbs connected to the term "materials" in § 144.054.2 – "used or consumed":

> **Consume** *vt* – **1:** to destroy or do away with completely; cause to waste away utterly **2a:** to spend wastefully **b:** to use up **c:** to utilize in the satisfaction of wants or the process of production
>
> **Use** *vt* – **1** *archaic* **2:** to put into action or service **3:** to carry out a purpose or action by means of **4:** to expend or consume by putting to use

Webster's Third New International Dictionary 490, 2523-24 (1993). These definitions contemplate, in part, the consumption or use of something that will be done away with completely. For example, electricity – which is included in the list of "materials" – is used or consumed in the manufacturing process and certainly would be considered completely done away with in the process. As is water, coal, or similar "materials" listed in § 144.054.2.

The terms "machinery" or "equipment," also contained in § 144.054, would not be completely done away with, but they would be utilized in the process of production or would carry out a purpose or action as set forth in the dictionary definitions. Considered in the context of the surrounding list and terms, the plain meaning of the term "materials" – especially given the strict or narrow construction required of a tax exemption – does not apply to the raw product ultimately produced and installed in real property. Instead, the statute was intended to extend only to those materials that facilitate the manufacturing of the raw product.

### B. The Statutory Structure Also Supports the Interpretation that Tax-Exempt "Materials" Under § 144.054.2 Do Not Include the Raw Products.

In addition to the plain and ordinary meaning of a term, as derived from either the statutory definition or the dictionary, courts look to the "context of the entire statute in which it appears" to determine its meaning. *See State ex rel. Burns v. Whittington*, 219 S.W.3d 224, 225 (Mo. banc 2007). In determining the intent and meaning of statutory language, "the words must be considered in context and sections of the statutes *in pari materia*, as well as cognate sections, must be considered in order to arrive at the true meaning and scope of the words." *South Metro. Fire Protection Dist. v. City of Lee's Summit*, 278 S.W.3d 659, 666 (Mo. banc 2009).

Section 144.054 expressly provides for "additional sales tax exemptions." Thus, it is in addition to those exemptions found in § 144.030. One such exemption is found in § 144.030.2(2), and specifically provides for "materials . . . which when used in manufacturing . . . become a component part or ingredient of the new personal property resulting from such manufacturing." This perfectly describes the situation in this case – the granite slabs when used in the manufacturing process become a component part or ingredient of the new countertop resulting from the manufacturing.

Yet, § 144.054.2 says nothing about the raw product or materials becoming a component part. And why? Because the additional exemption in § 144.054.2 was not intended to apply to the raw product, but instead to those things such as electricity, coal, or other "materials" that are being used or consumed to finish the raw product.

If the legislature had intended that the raw product be included in the tax exemption in § 144.054.2, it could have included the same language in the exemptions found in § 144.030.2(2). It did not. And to broadly extend the interpretation of the additional exemption in § 144.054.2 to include language that the legislature could have included is improper. Indeed, to extend the interpretation in the way the AHC has done would be a dramatic departure from the long-standing law concerning contractors (without any evidence that the legislature intended such a result).

A long line of cases from this Court hold that the purchase of raw construction materials by contractors for the purpose of making real property improvements is subject to sales and use tax. *See, e.g., Blevins Asphalt Const. Co. v. Dir. of Revenue*, 938 S.W.2d 899, 901 (Mo. banc 1997); *Bratton Corp. v. Dir. of Revenue*, 783 S.W.2d 891, 892 (Mo. banc 1990); *Becker Elec. Co., Inc. v. Dir. of Revenue*, 749 S.W.2d 403, 405 (Mo. banc 1988); *Overland Steel, Inc. v. Dir. of Revenue*, 647 S.W. 2d 535, 538 (Mo. banc 1983); *J.E.*

*Williams Const. Co. v. Spradling*, 555 S.W.2d 16, 24 (Mo. banc 1977); and *City of St. Louis v. Smith*, 114 S.W.2d 1017, 1019-20 (Mo. 1937). While these cases do not involve § 144.054.2, the reasoning of these cases is equally applicable to a claim of exemption under § 144.054.2.

In *Blevins*, for example, this Court held that an asphalt construction contractor that manufactured its own asphalt was liable for sales tax on its purchases of paving materials. The purchases did not qualify for the exemption from sales and use tax under § 144.030.2(2), which exempts the purchase of "[m]aterials . . . which when used in manufacturing . . . become a component part or ingredient of the new personal property resulting from such manufacturing . . . and which new personal property is intended to be sold ultimately for final use or consumption." *Blevins*, 938 S.W.2d at 901.

Much like E & B, Blevins engaged in business in two different ways. *Id.* at 900. First, the company purchased paving materials to manufacture asphalt, which was sold to its customers without installation. *Id.* Such materials would qualify for the exemption under § 144.030.2(2) as an ingredient or component part of new personal property that is intended to be sold ultimately for final use and consumption. *Id.* Second, the company purchased paving materials for its manufacture of asphalt, which in turn was used to fulfill its own installation contracts. *Id.* These purchases were not

exempt because title to the asphalt passed only after the asphalt was installed onto real property. *Id.* at 901.

The Department of Revenue's regulations concerning contractors like E & B, 12 CSR 10-112.010, embody the holding in *Blevins* and refer to such companies as described in *Blevins* as "dual operators." The regulation further explains the treatment of a dual operator as follows: "Dual Operator – When a dual operator purchases materials that are specifically identified for use in a contracting job, it should pay tax on the purchase of the materials." 12 CSR 10-112.010 (3) (B).

E & B conducts its business as a dual operator and purchases granite slabs to make improvements to real property. The activities of E & B are factually indistinguishable from the activities at issue in *Blevins.* Nothing in the language of § 144.054.2 suggests that the legislature intended to overrule the dual operator concept developed by this Court in *Blevins* and elaborated upon in the Department of Revenue's regulations. Thus, the statutory structure supports the plain language, and the exemption in § 144.054.2 should not apply to E & B's purchase of raw product.

### C. The Potential Consequences of the AHC's Interpretation – Tax Free Purchases for Construction Contractors and Their Customers – Was Not Intended by § 144.054.2.

Finally, courts also look at the potential consequences of the proposed interpretation to determine the appropriate interpretation of a statute. Thus, for example, if the proposed interpretation or plain language produces an absurd or illogical result, the court will not adopt that interpretation or meaning. *See Akins*, 303 S.W.3d at 565 ("A court will look beyond the plain meaning of the statute only when the language is ambiguous or would lead to an absurd or illogical result.") (citing *Spradlin v. City of Fulton*, 982 S.W.2d 255, 258 (Mo. banc 1998)). Here, the absurd result is identified by the AHC itself: "The legislature has provided this exemption, resulting in a situation in which no tax is paid." Decision, p. 10.

The purpose of a manufacturing exemption like § 144.054 is to "encourage the production of items ultimately subject to sales tax and to encourage the location and expansion of industry in Missouri." *Concord Pub. House, Inc. v. Dir. of Revenue*, 916 S.W.2d 186, 190 (Mo. banc 1996). Expanding the manufacturing exemption provided by § 144.054.2 to cover the making of real property improvements by a construction contractor would not further the purpose of manufacturing exemptions. Indeed, expansion of the

manufacturing exemption to cover the activities of E & B would undermine a fundamental purpose of the Missouri sales tax system – to tax property once and only once.

This Court described this fundamental purpose in *Westwood Country Club v. Dir. of Revenue*:

> The purpose of Missouri's sales tax system is to tax property once and not at various stages in the stream of commerce. Westwood, as a private club not open to the public, does not engage in sales at retail and, thus, does not charge members and guests sales tax on meals and beverages served to them. Westwood must, however, pay sales tax on its purchase of food and beverages.

*Westwood Country Club v. Dir. of Revenue*, 6 S.W.3d 885, 888 (Mo. banc 1999). This principle was recently restated by this Court in the case of *ICC Management, Inc. v. Dir. of Revenue*, 290 S.W.3d 699 (Mo. banc 2009).

In *ICC Management*, the Court held the resale exclusion only applies where the item purchased for resale is later sold in a taxable sale at retail. *Id.* at 700. ICC Management, Inc. ("ICC"), was a private jail facility in Missouri that housed inmates pursuant to various contracts with certain

local political subdivisions in Missouri. *Id.* The issue was whether ICC's supply of the food and other consumables to the inmates was subject to tax or exempted under the governmental sales exemption. *Id.* at 702. This Court referred back to *Westwood Country Club* in denying the exclusion to ICC:

> Indeed, if ICC were correct in its argument that its purchases of consumables are not subject to tax because they will be served to inmates, but that its sales are not subject to tax because of the governmental tax exemption, then no tax would be imposed on the purchase, use or sale of these consumables at all. *The purpose of the exemption is not to provide a special benefit to ICC that is not enjoyed by other taxpayers*.

*Id.* at 703 (emphasis added). While *ICC Management* specifically dealt with the resale exclusion, the above fundamental principles described by this Court apply to this case and to the activities of E & B.

The leading commentator on state taxation echoes the above principles identified by this Court in stating that the primary question to ask in resolving the manufacturer/real property contractor issue is:

> [W]hether the subsequent transfer of the property will be the subject of a sales or use tax. If it will be, there is no justification for imposing a tax on the manufacturer/real property contractor's purchase of the property, regardless of the "nature of the transaction." On the other hand, if the subsequent transfer will not be subject to tax because the manufacturer/real property contractor is deemed to be selling real property, then the manufacturer/real property contractor should pay a tax on its purchase of tangible personal property.

Jerome R. Hellerstein and Walter Hellerstein, *State Taxation*, ¶ 15.08[5] (3rd ed. 2000).

Permitting the exemption under § 144.054.2 for both E & B's manufacturing activities and E & B's construction contractor activities does not ensure that taxation is only imposed on one stage of the stream of commerce; instead, it prevents taxation altogether. The AHC freely concedes this point. Title to the granite countertops installed by E & B does not pass until installation. As a construction contractor, E & B is making an improvement to real property that is not subject to sales tax. *See, e.g., Marsh*

*v. Spradling*, 537 S.W.2d 402, 407 (Mo. 1976) (holding that transfer of title was consummated when the cabinets were affixed to the real estate; consequently, contractor was not liable for sales tax because there was no transfer of tangible personal property subject to sales tax). As a result, the purchase of the granite slabs used by E & B as a construction contractor would escape taxation altogether.

Likewise, expanding the exemption to cover real property improvements would not serve the purposes of the manufacturing exemptions in encouraging "the production of items ultimately subject to sales tax." *Concord Pub. House*, 916 S.W.2d at 190. Instead, it would lessen items that are subject to taxation. Section 144.054.2 was only intended to exempt things used for manufacturing; it was not intended to prevent the taxation of purchases by contractors making real property improvements. If the legislature had so intended, it would have used specific language referring to installation or the making of real property improvements.

Expansion of the exemption to cover E & B's activities would give E & B a special benefit not enjoyed by other construction contractors solely because E & B is a construction contractor that happens to measure, cut, and polish its own countertops, which it then uses in making real property improvements. While all other construction contractors would have to pay

state and local sales or use tax on their purchases of finished products used in making real property improvements, E & B would not have to pay state sales tax or state and local use tax on its purchases.[3/]

In *ICC Management*, this Court indicated that exemptions are not designed to give special benefits to specific taxpayers within a class of similarly-situated taxpayers. *See ICC Management,* 290 S.W.3d at 703. Nothing in the language of § 144.054.2, an exemption for manufacturing, suggests that its purpose was to benefit vertically-integrated construction contractors over all other construction contractors. Such special treatment is not supported by the statute or the taxation policy of Missouri. As such, E & B cannot show that it fits the statutory exemption exactly, and its claims should therefore be rejected. *Cook Tractor*, 187 S.W.3d at 872.

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[3/] Or more troubling still would be the potential for all construction contractors to claim tax exempt status on all of their purchases of raw products. For example, a carpenter could argue that the cutting and installation of lumber to build a house would be exempt from taxes.

## CONCLUSION

For the foregoing reasons, the Administrative Hearing Commission's decision should be reversed and judgment entered in favor of the Director of Revenue.

Respectfully submitted,

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## Certification of Service and of Compliance with Rule 84.06(b)-(c)

The undersigned hereby certifies that on this ___ day of October 2010, one true and correct copy of the foregoing brief, and one disk containing the foregoing brief, were mailed, postage prepaid, to:

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The undersigned further certifies that the foregoing brief complies with the limitations contained in Rule No. 84.06(b) and that the brief contains _____ words.

The undersigned further certifies that the labeled disk, simultaneously filed with the hard copies of the brief, has been scanned for viruses and is virus-free.

_____
Jeremiah J. Morgan
Deputy Solicitor General

## APPELLANT'S APPENDIX

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