No. SC99998

IN THE SUPREME COURT OF MISSOURI

WALMART STARCO LLC,

Respondent,

v.

DIRECTOR OF REVENUE

Appellant.

Appeal from the Administrative Hearing Commission

BRIEF AS *AMICUS CURIAE* OF THE COUNCIL ON STATE TAXATION IN SUPPORT OF RESPONDENT

THOMPSON COBURN LLP
Janette M. Lohman, #31755
Matthew J. Landwehr, #51945
Kristen E. Sanocki, #67375
One US Bank Plaza
St. Louis, Missouri 63101
(314) 552-6000
(314) 552-7000 (fax)

Attorneys for Amicus Curiae
Council On State Taxation

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

Cases

Statutes and Regulations

Rules

I. STATEMENT OF INTEREST OF AMICUS CURIAE

The Council On State Taxation ("COST") is a nonprofit trade association based in Washington, D.C. COST was organized in 1969 as an advisory committee to the Council of State Chambers of Commerce. Today, COST has an independent membership of over 500 of the largest multistate corporations engaged in interstate and international business. COST represents companies doing business in every state across the country. COST members employ a substantial number of Missourians, own extensive property in Missouri, and conduct substantial business in Missouri.

COST's objective is to preserve and promote equitable and non-discriminatory state and local taxation of multijurisdictional business entities. In furtherance of this objective, COST has participated as *amicus curiae* in many significant federal and state tax cases since its formation, including state and local tax issues in Missouri. *See Acme Royalty Co. v. Dir. of Revenue* (consolidated with *Gore Enter. Holdings, Inc. v. Dir. of Revenue*), 96 S.W.3d 72 (Mo. banc 2002).

COST's longstanding policy is to seek fair, efficient, and customer-focused tax administration.[1] Affirming the Administrative Hearing Commission's ("AHC") decision by this Court will result in both fair and efficient administration of the

[1] COST has a specific policy position on fair, efficient, and customer-focused tax administration. *See* COST, *Fair, Efficient, and Customer-Focused Tax Administration*, https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/fair-efficient-and-customer-focused-tax-administration---revised-april-2023---final.pdf (last visited Sept. 14, 2023).

Missouri tax system. The issue before this Court is the application of sales/use tax exemptions to business transactions. Sales/use taxes principally are intended to tax end-user consumption and exempt intermediate business inputs. Specifically, imposing sales/use taxes on business inputs is not only contrary to sound tax policy but also causes significant distortion, raises product costs, and places in-state businesses at a competitive disadvantage.[2]

COST appreciates that it is up to the General Assembly, and not this Court, to minimize sales/use taxes on business inputs, which account for approximately 39 percent of Missouri's sales tax revenue.[3] However, as noted in the AHC decision: "Avoiding repeated taxation in streams of commerce represents a fundamental purpose of Missouri's tax system." AHC Decision at 8 (citing *Westwood Country Club v. Dir. of Revenue*, 6 S.W.3d 885, 888 (Mo. banc 1999)) (L.F. at 00732).[4] To underscore this purpose and avoid the repeated taxation of commerce, this Court

---

[2] COST has a specific policy position on the sales taxation of business inputs. *See* COST, *Sales Taxation of Business Inputs*, https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/sales-taxation-of-business-inputs.pdf (last visited Sept. 14, 2023).

[3] *See* Ernst & Young LLP, State Tax Research Institute ("STRI") & COST, *The Impact of Imposing Sales Tax on Business Inputs* (May 2019), https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/1903-3073001_cost-ey-sales-tax-on-business-inputs-study_final-5-16.pdf (last visited Sept. 14, 2023). On average the taxation of business inputs accounts for 42 percent of all states' sales/use tax revenue. *Id.*

[4] References to the Legal File are as "L.F."

should affirm the AHC's determination that Walmart Starco LLC's ("Starco") purchases of electronic scanners, credit card readers, computers, and servers ("IT Equipment") qualified for the State's resale exemption under RSMo §§ 144.018.1 and 144.615(6), or alternatively, the State's manufacturing component part exemption under RSMo § 144.030.2(2). COST, in filing this *amicus brief* in support of Starco, wholeheartedly agrees with and supports the AHC's decision to minimize repeated sales/use taxes on business inputs.

II. STATEMENT OF THE FACTS AND STATEMENT OF JURISDICTION

COST adopts the Statement of the Facts presented by the Respondent Starco. *See* Respondent's Brief at 9-13.

Pursuant to Missouri Supreme Court Rule 84.05(f)(2), COST certifies that consent to file this brief was sought from all parties, and that counsel for Respondent and counsel for Appellant consented.

III. SUMMARY OF ARGUMENT

This case presents two significant issues for the Court to consider. First, where should sales/use taxes be imposed? This Court should affirm the AHC's holding that Starco's purchase of IT Equipment at a warehouse in Missouri for the purpose of reselling it – and where such equipment is actually resold, used in other states, and subject to tax in those other states – is not the correct location to impose Missouri's sales/use tax. Second, this case presents an issue raised but not addressed by the

AHC as to the application of the manufacturing exemption if the State's resale exemption does not apply because there was too much processing of the equipment to constitute an exempt sale for resale. By default, if the resale exemption does not apply, then the State's manufacturing component part exemption should apply. This Court should summarily reject the Director of Revenue's position that neither exemption applies.

IV. ARGUMENT

A. Sales/Use Tax Imposition Should Apply at the Consumption Location.

Sales/use taxes are principally designed to tax end-use consumption, and not the reselling of a product before it has been delivered to the location of the product's ultimate use. The production (*i.e.,* manufacturing) or warehousing location should not control where a product is sourced for the imposition of sales/use taxes – instead, a state's tax imposition (sourcing) should reflect the location where the purchaser/consumer will use the product. Fair and efficient tax policy dictates that the sourcing rules should focus on the location of where the products are used by the purchaser.[5]

[5] *See* COST, *Sourcing Sales and Use Taxes Should be Uniform and Approximate Where Products are Used*, https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/sourcing-sales-and-use-taxes---final.pdf (last visited Sept. 14, 2023).

Starco purchased the IT Equipment for the purpose of reselling it, and in fact did resell it, to other legal entities.[6] Regardless of whether the State's resale exemption applies or the State's manufacturing component part exemption applies, it is not contested that Starco sold the IT Equipment to other legal entities (with no additional dispute over whether the sales were arms-length transactions).

[6] Prior to February 1, 2013, Starco was a single member limited liability company that was treated as a disregarded entity. RSMo § 347.187.2 states unequivocally, that "**(S)olely for the purposes of** …**chapter 144, RSMo** [the sales and use tax statutes]…, **a limited liability company** and its members **shall be classified and treated on a basis consistent with the limited liability company's classification for federal income tax purposes**." RSMo § 347.187.2 (bracketed information and emphasis added). If this statute is read literally and consistently with this Court's precedent, all of the Director of Revenue's assessments for the periods occurring prior to February 1, 2013 should be dismissed because the Director clearly, knowingly, and erroneously issued assessments against a deemed non-existent entity. That is, prior to February 1, 2013, Starco was required by § 347.187.2 to be treated as a disregarded entity, or division of its parent, Wal-Mart Stores East, LP, **for sales and use tax purposes**. Under this statute, Wal-Mart Stores East, LP was the only relevant taxpayer for sales and use tax purposes up until February 1, 2013. Based on the Director's substantive arguments, the Director was well aware of § 347.187.2 and yet, the Director knowingly made erroneous assessments against a deemed non-existent entity. To be consistent with the statute and this Court's precedent, the Court must dismiss the pre-February 1, 2013 assessments. *See* ***Com. Barge Line Co. v. Dir. of Revenue***, 431 S.W.3d 479, 485 (Mo. banc 2014), in which sales tax returns erroneously filed by a disregarded limited liability company were insufficient to start the running of the statute of limitations with respect to its single member, the only recognized taxpayer. Here, assessments improperly filed against Starco, a non-existent taxpayer, should be dismissed. After February 1, 2013, given Starco's change in status from a disregarded entity to a "C" corporation for federal income tax purposes (and Missouri sales and use tax purposes), this issue should be moot.

The Director of Revenue's imposition of use tax at Starco's Pineville, Missouri warehouse reflects unsound tax policy because such imposition in no way "approximates" the location where the products are used by Starco's end-user purchasers.[7] More importantly, the position is not supported by either the State's resale exemption or its manufacturing component part exemption statutes. The AHC properly rejected the Director of Revenue's claim that *Custom Hardware Engineering & Consulting, Inc. v. Director of Revenue*, 358 S.W.3d 54 (Mo. banc 2012) controls the tax dispute in this case. Starco's facts are very different and distinguishable. Unlike *Custom Hardware*, Starco resold the disputed IT Equipment and paid use tax in the appropriate states where the equipment was delivered and used. Thus, the AHC correctly held that Starco's purchases of its IT Equipment

[7] In an optimally designed sales tax, because much of the IT Equipment is point-of-sale ("POS") equipment used to make retail sales, such equipment should be exempt from all sales/use taxation as a business input. However, Missouri is not alone in taxing such equipment – none of the 45 states with state sales taxes have a robust exemption for POS equipment or furnishings used to make retail sales. *See* K. Frieden, F. Nicely & P. Nair, *The Best and Worst of State Sales Tax Systems*, Dec. 2022, https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/270677_cost_salestaxbk_2022_final.pdf (last visited Sept. 14, 2023). The lack of an exemption for POS equipment, however, does not validate the Director of Revenue's denial of a resale exemption or manufacturing exemption. This merely creates another potential layer of tax pyramiding by imposing the sales/use tax both where the product was initially stored, and subsequently, at its location of use.

qualified for the State's resale exemption. AHC Decision at 8 (L.F. at 00732); RSMo § 144.018.1.

Starco was not, as the Department of Revenue suggests, trying to "game" Missouri's or any other states' sales/use tax systems by avoiding the payment of any sales/use tax on the IT Equipment. Consistent with the statute and basic tax principles, Starco correctly paid tax based on the products' ultimate use location—where the IT Equipment was delivered.[8] The AHC recognized the risk of "double taxation" would certainly come true with the other states where Starco or its purchasers had already remitted use tax because those states' statute of limitations to claim a refund for tax remitted has likely expired.[9] AHC Decision at 9 (L.F. at 00733). The likelihood of double taxation results from the Director of Revenue's assessment of use tax based on his conclusion that storage and processing of the equipment constituted use. The position completely ignores the fact that tax

[8] "The Store/Clubs that purchased IT Equipment from Walmart Starco would then accrue use tax and remit that tax to the jurisdiction where the IT Equipment was delivered and used based on the cost plus the fixed-percentage markup paid by the WMT Group companies." AHC Decision (Finding of Fact No. 25) at 5 (L.F. 00729).

[9] States, albeit in a non-uniform manner, to avoid United States Constitutional issues with fair apportionment, provide a credit for most sales/use taxes legally paid to other states. *See Oklahoma Tax Comm'n v. Jefferson Lines, Inc*., 514 U.S. 175, 194 (1995). However, because Starco properly relied on Missouri providing a resale exemption for its IT Equipment sold to others, filing refund claims to obtain credit for the tax paid that the Department of Revenue assessed in this case would likely be denied based on it not being timely filed within the applicable statutory periods.

imposition should (and does) occur at the location where the property is used (*i.e.*, where the product is ultimately consumed).

B. The "Heads I Win – Tails You Lose" Concept Should Not Apply.

This Court affirming the AHC's decision on grounds of either allowing Starco to claim the State's resale exemption or manufacturing component part exemption avoids the unjust result of a coinflip that has a one-sided result. While Starco conducted limited testing and reimaging of some of its IT Equipment (which it resold) at its warehouse in the State, it is unfathomable that the Director of Revenue is arguing that reimaging and testing is sufficient to deny that the equipment is held for resale, while simultaneously asserting that Starco failed to qualify for the State's manufacturing component part exemption. The Director of Revenue cannot have it both ways.

The resale exemption and manufacturing exemption work in concert to limit what would otherwise greatly increase the amount of transaction taxes imposed on business inputs. These exemptions, especially the resale exemption, are what differentiate labeling a transaction tax as a sales/use tax versus a gross receipts tax. States with gross receipts taxes, which are generally disfavored because of their negative features, compensate for the pyramiding of taxes by utilizing a much lower

tax rate.[10] Missouri's present state tax rate of 4.225 percent exceeds the tax rate of any other state's tax categorized as a gross receipts tax.[11]

Accordingly, while the Director of Revenue states "repackaging" does not constitute "manufacturing," citing cases that are not on point with Starco's fact pattern of testing and reimaging some of the IT Equipment (*e.g., AAA Laundry & Linen Supply Co. v. Dir. of Revenue*, 425 S.W.3d 126 (Mo. banc 2014) and *House of Lloyd, Inc. v. Dir. of Revenue*, 884 S.W.2d 271 (Mo. banc 1994)), how is Starco's testing and reimaging of its IT Equipment not a manufacturing process (by further processing such equipment for purposes of modifying those products to enable them to be resold) if it does not qualify for the State's resale exemption? To decide the contrary would controversially make the State's sales/use tax structure, albeit with a high tax rate, more akin to a gross receipts tax structure.

Finally, the Director of Revenue is changing his policy with respect to what can qualify for the manufacturing component part exemption. The Director has issued extensive regulations, found in 12 CSR 10-110.200, that interpret RSMo §

---

[10] *See* Richard D. Pomp, STRI, *Resisting the Siren Song of Gross Receipts Taxes: From the Middle Ages to Maryland's Tax on Digital Advertising*, July 2022, https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-studies-articles-reports/md-tax-study.pdf (detailing the problems with gross receipts taxes) (last visited Sept. 14, 2023).

[11] For example, Ohio Commercial Activities Tax, a gross receipts tax, has a tax rate of 0.26 percent. *See* O.R.C. § 5751.03.

144.030.2(2) and that were valid at the time of the assessments. The regulations discuss in great detail what can qualify for the manufacturing component part exemption. This regulatory language is very broad. We believe that under these regulations, a computer that is purchased and combined with new software and tested or configured, qualifies as a component part of the finished product – *i.e.*, a generic computer that, after addition of the software or configuration, can now be used in concert with a customer's national and international integrated operating systems.

> Under 12 CSR 10-110.200(3)(A), the Director states that:
>
> Materials, **manufactured goods** [*i.e.,* ***computer hardware***], machinery, and parts ***that become a component part or ingredient of new personal property to be sold ultimately for final use or consumption are not subject to tax***. Purchases of ingredients or ***component parts are exempt from tax if they are intended to and do become a part of the finished product***. The exemption does not apply to materials that are totally consumed and are not intended to and do not become a part of the final product. In order to qualify for this exemption, the material in question must be intended to remain in the finished product in at least trace amounts for a specific purpose.

12 CSR 10-110.200(3)(A) (bracketed information and emphasis added). The hardware that the Starco purchased was clearly a component part of the "new computer" (*i.e.,* tangible personal property with a new and different use and value) that was produced or manufactured by Starco, by changing out the software included with the hardware.

The Director now complains that Starco was not a "manufacturer",[12] but there is no legal requirement that a taxpayer be a "manufacturer" to qualify for the component part exemption. The regulation only requires that the *activity* creating the new product qualifies as either "**manufacturing**, **processing**, **compounding**, **mining**, **producing** or **fabricating** of **products intended to be sold ultimately for final use or consumption**." 12 CSR 10-110.200(1) (emphasis added).

> For example, in 12 CSR 10-110.200(4)(B):
>
> > A restaurant purchases apple wood to use in the smoking of foods. The restaurant burns the wood in a closed chamber called a smoker in which it places the food. The burning wood releases compounds, and small but measurable quantities of the compounds enter and permeate the food. ***Because a part of the wood, in the form of smoke particles, blends with and remains as part of the finished product***, the apple wood may be purchased tax exempt as an ingredient or component part.

12 CSR 10-110.200(4)(B) (emphasis added). If the Director would permit a restaurant to purchase apple wood to be used for smoking foods on an exempt basis under the component part exemption (*i.e.*, because smoky flavor is traceable in the final food that the restaurant serves to its customers), why would off-the-shelf computer hardware, that must be fitted with new software or reconfigured by the taxpayer in order to be usable, not qualify for the component part exemption, if the

[12] *See* Respondent's Response to Petitioner's Motion for Summary Decision at 23 (L.F. 00543).

finished product ultimately is sold in a taxable transaction?[13] We believe uploading the customer-specific software in the purchased hardware would, at a minimum constitute either manufacturing, producing, or processing under the Director's regulations. Bottom line – if wood purchased to be burned so that smoky flavoring is incorporated into food sold to a restaurant's customers can qualify for the component part exemption, it is hard to believe that computer hardware purchased for combination with customer-specific software would not also qualify for the component part exemption.

Accordingly, based on his own regulations, the Director should have conceded that the computer hardware purchased by the taxpayer clearly qualified for the component part exemption, and vacated the existing assessments. It appears that by issuing the disputed final decisions against the taxpayer, the Director has also violated RSMo § 32.053 by condoning the assessments. RSMo § 32.053 states that:

> Any final decision of the department of revenue which is a result of a change in policy or interpretation by the department effecting [*sic*] a particular class of person subject to such decision shall only be applied prospectively.

---

[13] *See also* ***Al-Tom Inv., Inc. v. Dir. of Revenue***, 774 S.W.2d 131, 135 (Mo. banc 1989), in which the Court held that cooking oil that a fast-food restaurant incorporated into fried chicken qualified for the component part exemption. In that case, the Director was arguing that only 50% of the cooking oil was incorporated into the chicken and that, accordingly, only 50% of the oil was exempt, but the Court held that 100% of the cost of the cooking oil qualified for the component part exemption if any part of the grease made it into the chicken.

By disallowing the component part exemption on the basis that the taxpayer was not a manufacturer, the Director was clearly changing his policy as to what activities can qualify for the component part exemption. Accordingly, RSMo § 32.053 gives this Court a clear legal basis to vacate all the assessments against the taxpayer without ever reaching the merits of either the resale exemption issue or the component part exemption issue. The burnt wood/component part example cited above illustrates how inappropriate the Director's actions were in issuing and upholding the assessments. The assessments in their entirety should be dismissed.

V. CONCLUSION

For the foregoing reasons, COST respectfully asks this Court to affirm the AHC decision as Starco qualifies for the State's resale exemption (or, alternatively, the State's manufacturing component part exemption). Upholding the AHC decision under either approach reaffirms that Missouri applies its sales/use tax in a manner that avoids duplicative taxation and taxes a product where it is ultimately used/consumed by a purchaser/consumer.

Respectfully Submitted,

THOMPSON COBURN LLP

By: */s/ Matthew J. Landwehr*
Janette M. Lohman, #31755
Matthew J. Landwehr, #51945
Kristen E. Sanocki, #67375
One US Bank Plaza
St. Louis, Missouri 63101
314-552-6000
314-552-7000 (facsimile)
jlohman@thompsoncoburn.com
mlandwehr@thompsoncoburn.com
ksanocki@thompsoncoburn.com

Attorneys for Amicus Curiae
Council On State Taxation

CERTIFICATE OF COMPLIANCE

I hereby certify that pursuant to Rule 84.06(c), the foregoing Brief as *Amicus Curiae* of the Council On State Taxation in Support of Respondent complies with the limitations contained in Rule 84.06(b), was prepared using Microsoft Word in 14-point Times New Roman font, contains 3,234 words as determined by Microsoft Word, and was electronically served on all counsel of record through Case.net.

/s/ Matthew J. Landwehr

CERTIFICATE OF SERVICE

I hereby certify that on September 14, 2023, the foregoing Brief as *Amicus Curiae* of the Council On State Taxation in Support of Respondent was filed electronically through Case.net and, therefore, served on all counsel of record.

/s/ Matthew J. Landwehr