

Before the
Administrative Hearing Commission
State of Missouri



WATKINS MOTOR LINES, INC.,)	
)	
Petitioner,)	
)	
vs.)	No. 10-1418 RI
)	
DIRECTOR OF REVENUE,)	
)	
Respondent)	
)	

DECISION

We grant the motion for summary decision of Watkins Motor Lines, Inc. (“WML”) and deny the motion for summary decision of the Director of Revenue (“the Director”).

Procedure

On July 27, 2010, WML filed a complaint appealing the Director’s final decision dated June 28, 2010 regarding income tax liability for 2006—specifically, appealing the Director’s denial of WML’s request for a refund of income tax based on its first amended return as described in the findings of fact below. On August 26, 2010, the Director filed an answer. On April 28, 2011, WML filed another complaint, to which we gave our case number 11-0788 RI. In that case, WML appealed the Director’s denial of a refund of income tax based on its second amended return as described in the findings of fact below. On July 14, 2011, we consolidated the two cases under case number 10-1418 RI. On September 2, 2011, WML filed its motion for

summary decision, accompanied by proposed findings of fact and a brief. On November 21, 2011, the Director filed a response to WML's motion for summary decision as well as its own motion for summary decision, accompanied by proposed findings of fact, conclusions of law, and a brief. On December 19, 2011, WML filed a response to the Director's motion for summary decision, and on December 29, 2011, the Director filed a reply to WML's response to the Director's motion for summary decision. Our Regulation 1 CSR 15-3.446(6)¹ provides that we may decide this case without a hearing if a party establishes facts that no party disputes and entitle the movant to a favorable decision.

Commissioner Marvin O. Teer, Jr., having read the full record including all the evidence, renders the decision.²

Findings of fact

1. At all relevant times, WML was a Florida corporation whose domicile and primary place of business was in Lakeland, Florida.
2. At all relevant times until the sale of its assets as referred to below, WML was a truckline that operated a commercial less-than-load freight trucking business as a common carrier in interstate commerce. Those operations included operations in Missouri.
3. At all relevant times until the sale of its assets as referred to below, WML's Missouri trucking business included carrying freight both on an intrastate (between two Missouri locations) and an interstate (crossing state lines) basis.
4. At all relevant times until the sale of its assets as referred to below, WML leased trucking terminals from a sister corporation, Freight Terminals, Inc. ("Freight Terminals"). WML owned certain personal property in those terminals, such as furniture and fixtures. These

¹ References to "CSR" are to the Missouri State Code of Regulations, as current with amendments included in the Missouri Register through the most recent update.

² Section 536.080.2; *Angelos v. State Bd. of Regis'n for the Healing Arts*, 90 S.W.3d 189, 192-93 (Mo. App., S.D. 2002). Statutory references are to RSMo 2000 unless otherwise indicated.

terminals were located in St. Louis, Kansas City, and Springfield, Missouri, as well as other locations outside Missouri.

5. At all relevant times until the sale of its assets as referred to below, WML also owned certain intangible assets, specifically proprietary software, customer lists, and goodwill.
6. In September 2006, WML and Freight Terminals sold substantially all of their assets to FedEx Corporation (“FedEx”). That sale conveyed, among other things, WML’s personal property, both in Missouri and elsewhere, as well as intangible assets, which consisted of proprietary software, customer lists, and goodwill (the “intangible assets”).
7. At all relevant times, FedEx’s domicile was Delaware, and its principal place of business was Tennessee.³
8. For 2006, WML’s federal net income included the following amounts:

Income from interstate transportation services	\$8,714,858
Income derived from purely Missouri intrastate transportation services	\$20,009
Gain from sale of fixed assets located in Missouri to FedEx	\$264,932
Gain from sale of software to FedEx	\$13,310,944
Gain from sale of goodwill to FedEx	\$112,193,300
Gain from sale of customer list(s) to FedEx	\$77,000,000 ⁴

9. In its second amended return for 2006, WML elected to be taxed for Missouri income tax purposes pursuant to the provisions of § 143.451.4. It did not elect to use the apportionment method set out in § 143.451.4(1) and (2).⁵

³ FedEx Corporation’s Annual Report (Form 10-K) filed with the Securities and Exchange Commission July 15, 2013. We take official notice of the contents of FedEx’s 10-K report. Section 536.070(6) allows us to take official notice “of all matters of which the courts take judicial notice.” Courts may take judicial notice of the contents of a corporation’s publicly filed annual report. *In re BP p.l.c. Securities Litigation*, 843 F.Supp.2d 712, 781 n.33 (S.D. Tex. 2012); *OrbusNeich Med. Co. v. Boston Scientific Corp.*, 694 F.Supp.2d 106, 111 (D. Mass. 2010).

⁴ “Watkins-FedEx Sale Net Gain Reconciliation,” Ex. 3 to the Director’s motion for summary decision, proposed findings of fact and conclusions of law, and brief. The information shown here does not represent the entire transaction between the companies as stated therein.

⁵ See “WML’s 2006 Missouri income tax returns” below for a discussion of the three returns WML filed for its 2006 Missouri income tax. The second amended return was the final return it filed, and forms the basis for the parties’ positions and our decision.

10. In 2006, 4.0570 percent of WML's interstate transportation miles resulted from interstate transportation operations in Missouri.
11. 4.0570 percent of \$8,714,858 is \$353,562. WML reported that amount to the Director as income derived from interstate transportation miles apportioned to Missouri on its second amended 2006 Missouri corporate income tax return.

WML's 2006 Missouri income tax returns

12. WML's original 2006 Missouri income tax return, filed October 17, 2007 (the "original return"), showed a "Missouri taxable income- all sources" of \$180,756,584. This figure included the entire amount of WML's income from interstate freight operations and the proceeds of the asset sale to FedEx. WML then multiplied that figure by .0457 to compute a Missouri taxable income after apportionment of \$7,333,295.
13. WML stated erroneously in its original return that it was using the apportionment method set out in § 143.451.3.
14. On April 8, 2009, the Director issued a final decision determining that WML had overpaid \$57,606.
15. On May 12, 2009, WML filed an amended 2006 Missouri income tax return (the "first amended return"). In that return, WML again reported the same figure (\$180,756,584) for "Missouri Taxable Income- all sources," but multiplied that figure by .03220 to compute a Missouri taxable income after apportionment of \$5,820,162. Based on this return, WML sought an additional refund of \$96,558.
16. On June 28, 2010, the Director issued a final decision disallowing WML's refund request based on the first amended return.
17. On August 12, 2010, WML filed another amended 2006 Missouri income tax return (the "second amended return"). In that return, WML multiplied only the income it received

from interstate transportation services by .0457 to compute income derived from interstate transportation miles of \$353,562, resulting in a Missouri taxable income after apportionment of \$638,502. Based on this return, WML sought an additional refund of \$419,425.

18. On April 8, 2011, the Director issued a final decision denying WML's request for refund based on its second amended return.

Freight Terminals' amended 2006 income tax return

19. Freight Terminals filed an amended 2006 Missouri income tax return in which it elected to be taxed according to the provisions of the Multistate Tax Compact.⁶
20. In that return, Freight Terminals reported its gain from the sale of substantially all of its assets as "nonbusiness income" under the Multistate Tax Compact.
21. The Director issued a notice of adjustment, disallowing the report of the sale as nonbusiness income.
22. After Freight Terminals protested the notice of adjustment, the Director accepted Freight Terminals' assertion that the gain from the sale of assets was nonbusiness income.

Conclusions of Law

We have jurisdiction over appeals from the Director's final decisions.⁷ Our duty in a tax case is not to review the Director's decision, but to find the facts and to determine, by the application of existing law to those facts, the taxpayer's lawful tax liability for the period or transaction at issue.⁸ In making our determination, we must strictly construe taxing statutes

⁶ Section 32.200.

⁷ Section 621.050.1.

⁸ *J.C. Nichols Co. v. Director of Revenue*, 796 S.W.2d 16, 20-21 (Mo. banc 1990).

against the Director and in favor of the taxpayer.⁹ If the right to tax is not conferred by plain language, it is not extended by implication.¹⁰ However, the taxpayer has the burden of proof.¹¹

I. Issue and rule we adopt

The issue in this case is whether the income from the sale of WML’s software, customer lists, and goodwill is income from a Missouri source. The parties have stated alternative versions of the issue, which we discuss below. Also, we adopt the Supreme Court’s latest statement defining “source of income,” found in *Jay Wolfe Imports Missouri, Inc. v. Director of Revenue*, where the Court held that the source of income was where the income was produced.¹²

II. Applicable statutes and regulations

Section 143.431.1¹³ defines “Missouri taxable income” and shows how it is calculated, as follows:

The Missouri taxable income of a corporation taxable under sections 143.011 to 143.996 shall be so much of its federal taxable income for the taxable year, with the modifications specified in subsections 2 to 4 of this section, as is derived from sources within Missouri as provided in section 143.451. . . .

Section 143.441.1(2)¹⁴ describes a type of corporation such as WML:

Every railroad corporation or receiver in charge of the property thereof which operates over rails owned or leased by it and every corporation operating any buslines, trucklines, airlines, or other forms of transportation operating over fixed routes owned, leased, or used by it extending from this state to another state or states[.]

WML elected to be taxed under § 143.451.4, which provides in relevant part:

A corporation described in subdivision (2) of subsection 1 of section 143.441 shall include in its Missouri taxable income all

⁹Section 136.300.1.

¹⁰*Delta Air Lines, Inc. v. Director of Revenue*, 908 S.W.2d 353, 355 (Mo. banc 1995); *United Air Lines, Inc. v. State Tax Comm’n*, 377 S.W.2d 444, 449 (Mo. banc 1964).

¹¹Sections 136.300.1 and 621.050.2.

¹²282 S.W.3d 839, 841 (Mo. banc 2009), citing *Bass Pro Shops, Inc. v. Director of Revenue*, 746 S.W.2d 97, 98 (Mo. banc 1988).

¹³RSMo Supp. 2012.

¹⁴RSMo Supp. 2012.

income arising from all sources in this state and all income from each transportation service wholly within this state, from each service where the only lines of such corporation used are those in this state, and such proportion of revenue from each service where the facilities of such corporation in this state and in another state or states are used, as the mileage used over the lines of such corporation in the state shall bear to the total mileage used over the lines of such corporation.

Section 143.451.4 then sets out an optional apportionment method, which reads as follows:

The taxpayer *may* elect to compute the portion of income from all sources within this state in the following manner:

- (1) The income from all sources shall be determined as provided;
- (2) The amount of investment of such corporation on December thirty-first of each year in this state in fixed transportation facilities, real estate and improvements, plus the value on December thirty-first of each year of any fixed transportation facilities, real estate and improvements in this state leased from any other railroad shall be divided by the sum of the total amount of investment of such corporation on December thirty-first of each year in fixed transportation facilities, real estate and improvements, plus the value on December thirty-first of each year, of any fixed transportation facilities, real estate and improvements leased from any other railroad. Where any fixed transportation facilities, real estate or improvements are leased by more than one railroad, such portion of the value shall be used by each railroad as the rental paid by each shall bear to the rental paid by all lessees. The income shall be multiplied by the fraction thus obtained to determine the proportion to be used to arrive at the amount of Missouri taxable income.

(Emphasis added.) WML elected not to apply this apportionment formula.

Finally, 12 CSR 10-2.200(1) gives trucking companies such as WML a choice for allocating and apportioning Missouri taxable income between § 143.451.4 and § 32.200,

(Missouri's version of the Multistate Tax Compact), as follows:

Where a trucking company has income from sources both within and without Missouri, the amount of business income from sources within Missouri shall be determined pursuant to [the Multistate

Tax Compact and the rules set out in this regulation], *unless the taxpayer elects to apportion pursuant to section 143.451.4, RSMo.*

(Emphasis added.) WML elected to apportion pursuant to § 143.451.4.

III. Understanding and interpreting § 143.451.4

A. Distinguishing § 143.451.4 from § 143.451.2

As seen below, we attempt to apply the source of income rule by analyzing a number of the Supreme Court cases where the rule was applied. However, all of those cases actually apply § 143.451.2 (or its predecessors, § 143.040 RSMo 1949 or § 11343 RSMo 1939), not § 143.451.4. The source of income rule applies to all of these statutes, so the comparison is germane to our analysis, but because the cases we analyze regarding source of income are governed by § 143.451.2 or its predecessors, we think it worthwhile to set out the important ways in which the two subsections are different.

The first distinction concerns the coverage of the two subsections. Subsection 2 can be described as the default law for corporations electing to be taxed under § 143.451, while subsection 4 governs taxation only of “railroads...buslines, trucklines, airlines, or other forms of transportation operating over fixed routes...extending from this state to another state or states.” This distinction explains why the overwhelming number of this Commission’s decisions, and the opinions of our appellate courts, apply subsection 2, not subsection 4.

The second distinction is that § 143.451.2 provides the following regarding income included as Missouri taxable income:

A corporation described in subdivision (1) of subsection 1 of section 143.441 shall include in its Missouri taxable income all income from sources within this state, *including that from the transaction of business in this state and that from the transaction*

of business partly done in this state and partly done in another state or states.

(Emphasis added.) There is no corresponding “partly in Missouri/partly outside Missouri” language in subsection 4.

The third distinction grows from the second, and pertains to how income from such a “partly in/partly out” transaction is to be allocated, for which § 143.451.2(1) provides:

Where income results from a transaction *partially in this state and partially in another state or states*, and income and deductions of the portion in the state cannot be segregated, then such portions of income and deductions *shall* be allocated in this state and the other state or states as will distribute to this state a portion based upon the portion of the transaction in this state and the portion in such other state or states.

(Emphasis added.) Since subsection 4 has no “partly in/partly out” language, there is no requirement that income from such a transaction must be allocated.

The fourth distinction follows from the third, and pertains to the application of the nominally optional apportionment formulas contained in the two subsections. For subsection 2, the above-stated requirement that the taxpayer *shall* allocate income from “partly in/partly out” (i.e., multistate) transactions presents the problem faced by businesses operating across state lines since state corporate income taxes were first imposed in the early 20th century—the essential impossibility of determining, geographically, the source of income from a transaction that crosses state lines. To address this situation, § 143.451.2(2)(b)’s facially “optional” apportionment method, as a practical matter, becomes, effectively, mandatory; it must be employed by virtually every taxpayer electing to be taxed under subsection 2 in order to satisfy the requirement that income and deductions from partly in/partly out transactions be allocated

appropriately.¹⁵ By contrast, the apportionment formula of subsection 4(1)-(2) is entirely optional, as shown by WML’s decision not to use it.

B. The components of Missouri taxable income as set out in § 143.451.4

Section 143.451.4 provides that a transportation corporation such as WML shall include the following four components in its Missouri taxable income:

- all income arising from all sources in this state
- and all income from each transportation service wholly within this state,
- from each service where the only lines of such corporation used are those in this state,
- and such proportion of revenue from each service where the facilities of such corporation in this state and in another state or states are used, as the mileage used over the lines of such corporation in the state shall bear to the total mileage used over the lines of such corporation.

Applying this language to the facts, we easily conclude that WML’s income from the sale of its intangible property was neither “income from a transportation service wholly within this state” nor “[income] from any service where the only lines of WML used were those in this state.”¹⁶ Nor, applying the Supreme Court’s holding in *Delta Air Lines v. Director of Revenue*, was such income “revenue from each service where the facilities of [WML] in this state and in another state or states are used.” We base this conclusion on the *Delta Air Lines* holding that the word “service” in § 143.451.4 means “a regularly scheduled trip over a public transportation route.”¹⁷ Applying the Court’s ruling to the fourth component of Missouri taxable income in § 143.451.4, we see that the fourth component is “*such proportion of revenue from each*

¹⁵ The near-universal application of the apportionment formula of § 143.451.2(2)(b) to corporations not electing to be taxed under the Multistate Tax Compact has led to statements such as: “Under Missouri law, a corporation has three options in computing its income tax: (1) the single-factor ‘source of income’ method, *sec. 143.451.2(2)(b)*, (2) the three-factor ‘unitary business’ method in the Multistate Tax Compact, *sec. 32.200, art. IV*, or (3) any other method of allocation agreed to by the taxpayer and the Director that apportions income to this state according to the method shown in the corporation’s books or records, *sec. 143.461.2*.” *Maxland Dev. Corp. v. Director of Revenue*, 960 S.W.2d 503, 505 (Mo. banc 1998) (emphasis added).

¹⁶ WML groups these two components together under “income from intrastate transportation services,” as we set out above under finding of fact number 7.

¹⁷ 908 S.W.2d at 356. The Court was addressing the Director’s argument that “service” actually meant “Delta’s entire system of airline transportation and was not limited to an individual flight or trip that uses a Missouri facility.” *Id.* at 355.

service...as the mileage used over the lines of such corporation in the state shall bear to the total mileage used over the lines of such corporation.” (Emphasis added.) It is the “proportion of revenue” that the fourth component describes, not the ratio of Missouri miles to total miles. The fourth component, by its terms, relates only to income from transportation services, and in this case, corresponds to the \$638,502 WML reported on its second amended return as Missouri income from interstate transportation services.

Finally, we note that the four components are preceded by: “A corporation described in subdivision (2) of subsection 1 of section 143.441 *shall include in its Missouri taxable income*...” (Emphasis added). The word “and” preceding “such proportion of revenue from each service” signals that what follows is one element of the components to be included in Missouri taxable income. And, being a list, we apply the statutory maxim of *noscitur a sociis*—a word (or here, a phrase) is known by the company it keeps.¹⁸ The first three items on the list are undoubtedly sources of income, so the fourth is a source of income as well—not, as the Director asserts, a ratio by which a taxpayer’s Missouri taxable income is to be calculated.¹⁹

The income at issue (the gain from the sale of WML’s software, customer lists, and goodwill) does not fit into any of the second, third, or fourth components of taxable income set out in § 143.451.4. It is neither income from a transportation service wholly within Missouri, from any service where WML’s only lines used are those in Missouri, nor from revenue earned from interstate transportation. Therefore, if that income is Missouri taxable income, it must fit into the first component-- it must arise from a source in this state.²⁰

¹⁸ *Aquila Foreign Qualifications Corp. v. Director of Revenue*, 362 S.W.3d 1, 5 (Mo. banc 2012).

¹⁹ We set out and discuss the Director’s argument regarding the meaning of the fourth component under “The Director’s arguments” below.

²⁰ We are aware that the first component, “income arising from all sources in this state,” probably includes income described by the other three components. The reason for this seeming anomaly can be traced through an examination of § 143.451.4’s predecessors (sections 10115 RSMo 1929, 11343 RSMo 1939, 143.040.2 RSMo 1949 and 1959), a task we will not undertake here.

IV. Determining the source of income

A. Prior cases where source of income was determined

As we state above under “Understanding and interpreting § 143.451.4,” the issue in this case is whether the income from the sale of WML’s software, customer lists, and goodwill constitutes income from a Missouri source. In *Jay Wolfe Imports Missouri*, the Supreme Court held:

The “source of income” analysis has been Missouri's “longstanding construction” of its corporate taxation scheme. “*The source of income has been defined as the place where the income was produced.*” Under the source of income concept, income produced outside Missouri is not subject to Missouri taxation. The “source of income” inquiry permits a corporation to apportion its taxable income only where it can show it had income from outside Missouri.^[21]

Our Supreme Court has determined, in a number of cases, whether the income in question was produced in (or out of) Missouri, or was from a Missouri (or non-Missouri) source. Below, we set out several of the Court’s prior holdings on the issue, in an attempt to determine the boundaries of the doctrine.

In *F. Burkhart Mfg. Co. v. Coale*,²² the taxpayer had plants and sales operations both inside and outside of Missouri. The out-of-Missouri operations did not serve Missouri customers and *vice versa*. The Supreme Court held that the income from the out-of-Missouri operations was not income from a Missouri source because the only Missouri connection was that the company owning the out-of-state plants was a Missouri corporation and the general business was directed by the executive officers of the company, who were located in Missouri.

In *In re Kansas City Star Co.*,²³ the taxpayer operated branch offices and news bureaus in other states, and hired correspondents who lived and worked worldwide. The Supreme Court

²¹ 282 S.W.3d 839, 841 (Mo. banc 2009) (emphasis added and internal citations omitted).

²² 139 S.W.2d 502 (Mo. 1940).

²³ 142 S.W.2d 1029 (Mo. banc 1940).

held that its income was produced from sources partly in and partly out of Missouri because the taxpayer's "far-flung" activities all contributed to its income.²⁴

In *Medicine Shoppe Int'l, Inc. v. Director of Revenue (Medicine Shoppe I)*, the taxpayer loaned money to its franchisees to help the franchisees start or expand their businesses, and charged origination fees and interest on those loans. The Supreme Court held the interest and fees charged constituted income derived partly from activities in Missouri.²⁵

In *Union Elec. Co. v. Coale*,²⁶ *Petition of Union Elec. Co. of Missouri*,²⁷ and *Medicine Shoppe Int'l, Inc. v. Director of Revenue (Medicine Shoppe II)*,²⁸ the taxpayers received passive dividend or interest income from foreign corporations. The Supreme Court held the income to have been produced entirely outside Missouri because the interest was paid there.²⁹

In *A.P. Green Fire Brick Co. v. State Tax Comm'n*³⁰ and *Brown Group, Inc. v. Administrative Hearing Comm'n*,³¹ the taxpayers received royalty income from their licensing of trademarks, trade names, manufacturing processes, or designs or patterns to licensees outside the United States. The Supreme Court held the income to have been produced where the trademarks, trade names, and manufacturing processes were used, which occurred entirely outside Missouri.³²

In *Langley v. Administrative Hearing Comm'n*,³³ the taxpayer, a Missouri corporation, sold beer bottles to a brewery located in St. Louis that the taxpayer bought from an out-of-state

²⁴ 142 S.W.2d at 1038.

²⁵ 75 S.W.3d 731, 735 (Mo. banc 2002).

²⁶ 146 S.W.2d 631 (Mo. 1940).

²⁷ 161 S.W.2d 968 (Mo. banc 1942).

²⁸ 156 S.W.3d 333 (Mo. banc 2005).

²⁹ *Union Elec. Co. v. Coale*, 146 S.W.2d at 635; *Petition of Union Elec. Co. of Missouri*, 161 S.W.2d at 971-72; *Medicine Shoppe II*, 156 S.W.3d at 338.

³⁰ 277 S.W.2d 544 (Mo. 1955).

³¹ 649 S.W.2d 874 (Mo. banc 1983).

³² *A.P. Green Fire Brick*, 277 S.W.2d at 547; *Brown Group*, 649 S.W.2d at 880.

³³ 649 S.W.2d 216 (Mo. banc 1983).

manufacturer. The Supreme Court held that income from the sales was produced within Missouri. The income was produced by the sales, not by the origin of what was sold.³⁴

In *Bank Bldg. & Equip. Corp. of America v. Director of Revenue*,³⁵ the taxpayer, whose principal place of business was in Missouri, designed and constructed buildings for financial institutions and health care facilities in Missouri and nearby states. The construction was overseen by an on-site superintendent, but overall management of design and construction was done in the taxpayer's St. Louis headquarters. The taxpayer segmented its income into consulting, design, and construction components. For buildings constructed outside Missouri, it claimed that construction income was "income not from a Missouri source." The Supreme Court disagreed and held that the income from designing and constructing such buildings was allocable to Missouri because the "overall effort" produced the income.³⁶

In *Bass Pro Shops, Inc. v. Director of Revenue*,³⁷ the taxpayer's income in question derived from mail order sales, including those made to customers out of state. The Supreme Court held that the income from those activities was produced entirely in Missouri because, even though the taxpayer advertised out of state and used toll-free telephone numbers to facilitate such orders, there were no out-of-state operations involved in the sales.³⁸

In *J.C. Nichols Co. v. Director of Revenue*,³⁹ the taxpayer managed Kansas real estate from its Missouri offices. The Supreme Court held that the income earned thereby was produced partly in Missouri because the taxpayer's management structure was located in Missouri, and

³⁴ 649 S.W.2d at 217-18.

³⁵ 687 S.W.2d 168 (Mo. banc 1985).

³⁶ *Id.* at 171.

³⁷ 746 S.W.2d 97 (Mo banc 1988).

³⁸ *Id.* at 98.

³⁹ 796 S.W.2d 16, 18 (Mo. banc 1990).

that management was one of the efficient causes contributing directly to the production of the income in question.⁴⁰

In *Maxland Dev. Corp. v. Director of Revenue*,⁴¹ the taxpayer managed rental real estate located outside Missouri. Where the management was exercised from the taxpayer's Missouri headquarters, the income was classified as partly in-state and partly out-of-state, but where the Missouri headquarters did not retain direct control of the properties' management, the source of income was outside Missouri.⁴²

Finally, in *Jay Wolfe Imports Missouri*, the taxpayer was an automobile dealer that sold vehicles to out-of-state customers who came to the dealership in Missouri to take possession of the vehicles. The Supreme Court held that the income from those sales was from a Missouri source because the transactions were completed there; therefore, the income was produced entirely in Missouri.⁴³

B. The problem with those cases as applied to this one

Unfortunately, the above-cited cases, while potentially useful for setting boundaries regarding the scope of when income came from a Missouri source, do not help us in this case. For one thing, the fact situations of these cases are not only quite different from the one presented here, but there is a level of complexity here that the prior cases lacked. In most of the above-cited cases, the income derived from product sales, as opposed to here, where the income in question arises from the gain from a sale of WML's intangible property. Also, in the other cases, the facts were clear-cut, and the resulting decisions were, comparatively, uncomplicated—for instance, income from trademark licenses was produced where the trademarks were used, and income from managing out-of-state realty from a Missouri office was partly produced in

⁴⁰ 796 S.W.2d at 17-18.

⁴¹ 960 S.W.2d 503 (Mo. banc 1998).

⁴² *Id.* at 506-07.

⁴³ 282 S.W.3d at 840-42.

Missouri. Finally, in every case cited above, the taxpayer was a Missouri corporation doing some business out of state, whereas here, the taxpayer is a foreign corporation that did business in Missouri.

*C. The income was produced **where** one or more of the parties
did something to produce it*

But there is a pattern to the Court's rulings that is not only consistent from case to case, but fulfills the plain language of the statute. Specifically, we see in each case that the Court discerned where the income was produced, and in most cases it was produced where some or all of the parties did something to produce it.

In cases where both parties were either inside (*Langley*) or outside (*F. Burkhart*) Missouri when they took the steps necessary to consummate the transaction, those facts—location plus consummation—were decisive. Similarly, in *Jay Wolfe*, the out-of-state buyers came to the dealer in Missouri to complete the transaction and take possession of the vehicles.

Where the taxpayer's income came from out-of-state investments that the taxpayer held passively (*Union Electric* cases, *Medicine Shoppe II*), the source of income was the place the income was generated, i.e., where the efforts of the out-of-state corporation whose stocks or bonds generated the dividends or interest received by the taxpayers.

Where the taxpayer's income came from licensing its intellectual property (*A.P. Green Fire Brick, Brown Group*) to non-United States licensees, the income was produced by the licensees' manufacturing or other business efforts, which occurred outside the United States.

Where the taxpayer's income derived from its management of out-of-state realty (*J.C. Nichols, Maxland*), the source of income depended on where that management was exercised. If it was exercised from within Missouri, then the income derived partly from a Missouri source and partly from a non-Missouri source, but if the management was exercised outside Missouri, the resulting income was held to be not from a Missouri source.

Where the taxpayer's income came from sales of newspapers and newspaper advertising, both of which occurred inside and outside Missouri, and the taxpayer also had sales and newsgathering offices outside Missouri (*Kansas City Star*), the income derived partly from a Missouri source and partly from a non-Missouri source.

In summary, the common rule of these cases is that the income was produced where, as the Court could best determine, the effort was made by the parties to give effect to the transaction.

*D. Applying the rule as stated,
the income was produced outside Missouri*

The seller of the intangible property (WML) was both domiciled and headquartered in Florida. The buyer of such property (FedEx) was domiciled in Delaware and headquartered in Tennessee. As we set out below, one of WML's arguments, based on *Petition of Union Elec.*, is that the source of income was where the sale occurred. While we reject that specific argument because it is based on dicta from *Petition of Union Elec.* and has no support in Missouri law, we use the undisputed evidentiary basis for WML's assertion—that neither buyer nor seller was domiciled or headquartered in Missouri—for our conclusion that the income from the sale of WML's intangible assets was *produced* outside Missouri.

We find support for this conclusion in the *Langley* and *F. Burkhart* cases we cite above. In *Langley*, the presence of buyer and seller in Missouri justified a conclusion that the income was produced in Missouri, even though the items sold came from out of state.⁴⁴ And conversely, in *F. Burkhart Mfg. Co.*, the out-of-state presence of the buyer and seller, as well as the things sold, dictated a conclusion that Missouri was not the source of income from such sale.⁴⁵

⁴⁴ 649 S.W.2d at 217-18.

⁴⁵ 139 S.W.2d at 502-04.

We infer that the sale occurred outside Missouri from our findings that the parties had neither domicile nor headquarters in Missouri. Such an inference need not be justified beyond all doubt and is not precluded by a mere possibility that the contrary may be true.⁴⁶ In this case, there is such a “mere possibility” that, while the sale took place between a Florida company and a Tennessee company, the income was somehow produced in Missouri. But as *Jones* instructs, that mere possibility does not negate a sound inference to the contrary.

We therefore conclude that the income was produced where the sale was made, and the sale was made outside Missouri.

V. The Director’s arguments

A. *The Director’s primary argument- the formula stated in § 143.451.4 is an apportionment formula to be applied to all of WML’s net income*

The Director’s primary argument is that the mileage apportionment formula set out in § 143.451.4 applies to *all* of WML’s net income. The genesis for this argument is found in the first two sentences of *Delta Air Lines, Inc. v. Director of Revenue*:

Section 143.451.4, RSMo 1994, provides an apportionment formula for corporations that operate interstate transportation services. *That apportionment formula uses mileage as the basis for determining the percentage of the corporation's income that must be attributed to Missouri for Missouri income tax purposes.*^[47]

If this statement, cited more than once by the Director in his arguments, is taken at face value, his position prevails. However, as WML points out, the actual issue in *Delta Air Lines* had a far narrower scope, specifically whether miles from overflights that do not land in Missouri can be used in the apportionment ratio of § 143.451.4.

We consider the Director’s position to be expressly refuted by the words of § 143.451.4 itself and their interpretation by the Supreme Court in *Delta Air Lines*. These authorities, as we

⁴⁶ *Jones v. Director of Revenue*, 189 S.W.3d 187, 190-91 (Mo. App., W.D. 2006).

⁴⁷ 908 S.W.2d 353, 354 (Mo. banc 1995) (emphasis added).

set out above under “Understanding and interpreting § 143.451.4,” make it clear that the apportionment formula in § 143.451.4 does not apply to all of WML’s net income, but only to WML’s interstate transportation income. This fact, in turn, recasts the Court’s declaration at the start of *Delta Air Lines* into *dicta*.

However, the Director maintains that not only does the Court’s statement at the beginning of *Delta Air Lines* dictate the correct way to apply § 143.451.4, but that the Department of Revenue has “consistently applied § 143.451.4 [in that manner] for almost 40 years.” In support, the Director cites to his Schedule MO-MS which, he says, “provides for the application of the mileage percentage to the total Missouri taxable income from all sources to determine the Missouri taxable income from Missouri sources.”⁴⁸ The Director is correct in one assertion: his Schedule MO-MS does, indeed, call for a taxpayer governed by § 143.451.4 to apply the percentage of “Missouri miles” over “total miles” to its total net income. However, the Director cites to no authority to support his claim that the Department’s form has any force of law, and we find none. Also, as WML points out, the Director produced no evidence in support of his assertion that the Department had applied § 143.451.4 in the manner asserted in this case for any length of time, much less for 40 years. Finally, the Director offers no legal basis for his assertion that the Department’s application of a statute to have any force of law, however long it may have done so. While the Director’s interpretation of his own regulation is entitled to deference,⁴⁹ we see no ground for extending that deference to his forms.

B. The Director’s other arguments

Second, the Director, in support of his interpretation of § 143.451.4, asserts that “mileage-based formulas are a constitutional method of determining a state’s proportionate share

⁴⁸ Director’s motion for summary decision, proposed findings of fact and conclusions of law, and brief, p. 15.

⁴⁹ See *Tadrus v. Missouri Bd. of Pharmacy*, 849 S.W.2d 222, 228 (Mo. App., W.D. 1993).

of a transportation company's taxable income.”⁵⁰ That may be so, but even if it is true (and we express no opinion on the matter), it is simply irrelevant here because no such formula exists in § 143.451.4, except for the optional formula of § 143.451.4(1) and (2), an option that WML did not elect.

The Director's third argument is that “[WML]’s interpretation and application of § 143.451.4 excludes income which is taxable by Missouri.” In support of this argument, the Director first recounts the original and first amended returns WML filed before filing the second amended return, and provides a summary for how WML calculated its income tax on each such return. However, we see no reason for including this information for the two superseded returns, and the Director provides none.

But then the Director makes this statement: “[WML] asserts that the mileage factor set forth in § 143.451.4 can be divided into valuation segments, with the apportionment percentage applied to a single segment.” This statement is in error. WML did not assert that the *mileage factor* could be divided into valuation segments, but that the factors *comprising Missouri taxable income* under § 143.451.4 were divided into such segments, which WML and this order refer to as “components.” In a sense, the Director's error here is a variation of his first error—he assumes, contrary to the plain language of the statute, that the ratio set out in the fourth component of § 143.451.4 is to be applied to all of WML's net income. Based on that error, the Director states: “[WML] has completely excluded the \$190,700,750 in gain from the assets, which [WML] has deemed to be intangible assets.”⁵¹ We agree that WML did just that—but by our application of Missouri law to the issue, it may do so if that gain is not income from a Missouri source. Whether or not WML may exclude that gain is the subject of this case. From

⁵⁰ Director's motion for summary decision, proposed findings of fact and conclusions of law, and brief, p. 15.

⁵¹ Director's motion for summary decision, proposed findings of fact and conclusions of law, and brief, p. 17.

there, the Director makes a number of other arguments, which appear well-reasoned and articulately presented. However, given that they are based on the above-stated erroneous assertion, we see little utility in addressing them point by point.

The Director’s final argument is that WML’s calculation would result in an unconstitutional double taxation because it counts Missouri miles twice. The Director’s argument, as we understand it, is that WML included its intrastate income in its calculation of Missouri taxable income (the second and third components of the four components comprising Missouri taxable income under § 143.451.4), then included it again in its calculation of its interstate income under the fourth such component. However, we believe the Director erred in his analysis by applying WML’s intrastate mileage to the fourth component because, as we state above, the fourth component is a component of WML’s interstate income, not the formula used to compute that income.

VI. WML’s arguments

A. The source of income was where the sale occurred

WML offers a rule that, on its face, appears to apply. WML cited *Petition of Union Elec.* as follows:

It is said that the locus of the source of income is determined as follows: In this case of income derived from labor, it is the place where the labor is performed; in the case of income derived from use of capital, it is the place where the capital is employed; *and in the case of profits from the sale or exchange of capital assets, it is the place where the sale occurs.*^[52]

(Emphasis added). *Black’s Law Dictionary* defines “capital asset” as “a long-term asset used in the production of a business or used to produce goods or services, such as equipment, land, or an industrial plant,”⁵³ while the Internal Revenue Code defines the term more broadly, as “property

⁵² 161 S.W.2d at 970.

⁵³ *Black’s Law Dictionary* (9th ed.) 134.

held by the taxpayer (whether or not connected with his trade or business),” except (broadly speaking) inventory, property subject to depreciation, accounts or notes receivable acquired in the ordinary course of business, supplies, and a few other relatively narrow categories.⁵⁴ Specifically, goodwill is a capital asset for income tax purposes,⁵⁵ and proceeds from its sale are reported as capital gains.⁵⁶ Customer lists are treated the same way.⁵⁷ Given that § 143.091 provides that “Any term used in [Chapter 143 has] the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required by the provisions of [Chapter 143],” we can, easily, embrace the federal income tax definition of “capital asset.”

However, while the rule definitely applies, we have doubts as to whether it is a statement of Missouri law, because neither the issue nor the holding of *Petition of Union Elec. Co.* had anything to do with taxing the gain from the sale or exchange of capital assets. Instead, as we noted above, the holding of the case was that dividend income from foreign corporations was not income from a Missouri source, and therefore was not subject to Missouri income tax.

Also, the provenance of the capital asset language from *Petition of Union Elec.* makes the rule yet shakier. The citation reads as follows in its entirety:

Income consists of an increase in the economic wealth of the taxpayer. The sources from which it is derived are said to be three: (A) labor; (B) the use of capital, in which term we include for convenience land; and (C) profits derived from the sale or exchange of capital assets. These latter represent an accretion in the value of the assets while they are in the hands of the taxpayer. *Eisner v. Macomber*, 252 U.S. 189, 40 S.Ct. 189, 64 L.Ed. 521, 9 A.L.R. 1570; *Holmes, Federal Taxes*, 6th Ed., pp. 396 to 398. It is said that the locus of the source of income is determined as follows: In this case of income derived from labor, it is the place where the labor is performed; in the case of income derived from use of capital, it is the place where the capital is employed; and in

⁵⁴ 26 U.S.C. § 1221(a).

⁵⁵ *Dixie Fin. Co. v. United States*, 474 F.2d 501, 506 n.5 (5th Cir. 1973).

⁵⁶ *Dakan v. United States*, 492 F.2d 1192, 1199 (Ct. Cl. 1974).

⁵⁷ *Commissioner of Internal Revenue v. Killian*, 314 F.2d 852, 854 (5th Cir. 1963).

the case of profits from the sale or exchange of capital assets, it is the place where the sale occurs. *In re Kansas City Star Co.*, 346 Mo. 658, 142 S.W.2d 1029; *Holmes, Federal Taxes* (6th Ed.) pp. 396 to 398, *supra*.^{58]}

After citing the edited portion of the opinion, WML asserts: “Under [the test of *Petition of Union Elec. Co.* stated above], the income from the sale of WML’s capital assets located outside Missouri to a purchaser located outside Missouri is not income from Missouri sources.” Our first issue with this assertion is based on our observation above that the assets in question are not “located outside Missouri” as we discuss below under “WML’s argument that *mobilia sequuntur personam* applies.”

Our more fundamental issue with WML’s argument is whether the cited language is even a statement of Missouri law. Just as the Director mistook *dicta* for a statement of law in *Delta Air Lines*, so too does WML mistake *dicta* for law here.⁵⁹ Specifically, neither the issue nor the holding of *Petition of Union Elec. Co.* had anything to do with taxing the gain from the sale or exchange of capital assets. Instead, as we noted above, the holding of the case was that dividend income from foreign corporations was not income from a Missouri source, and therefore was not subject to Missouri income tax.

As part of preparing this decision, we sought the derivation of the “capital asset” portion of the rule WML cites. We first looked to see whether the language regarding sale of capital assets came from the *Kansas City Star* case, but it did not. Instead, we ascertained that it came from Holmes’ *Federal Taxes* treatise. Holmes’ precise language regarding the source of income from the sale of capital assets reads: “[i]f the income is from the sale of capital assets, the place where the sale is made is likewise decisive.” The only authority Holmes cites for this statement is a Treasury Department ruling that, according to Holmes, presents the “simple rule that the

⁵⁸ 161 S.W.2d at 970.

⁵⁹ “Dicta” is defined as “[a statement]...not essential to the court’s decision of the issue before it.” *Calvert v. Plenge*, 351 S.W.3d 851, 857 (Mo. App., E.D. 2011).

source of gains from the sale of property is located in the place where the sale is made.”

However, Holmes also notes another Treasury Department ruling that “the place where title passes is regarded as decisive.”⁶⁰ In short, not only is the statement in Holmes’ treatise not a statement of Missouri law, but the authority from whence it came provides another rule of equal dignity from the same source.

*B. The source of income was where the intangible assets were located
(mobilia sequuntur personam)*

Alternatively, WML states the issue as “whether income from the sale of [its] freight trucking assets *located outside Missouri* is includible in [its] taxable income.” (Emphasis added.) Consistent with that position, WML asserts in its response to the Director’s motion for summary decision, proposed findings of fact, conclusions of law, and brief that its intangible assets were “located” in Florida – its corporate headquarters – under the concept of *mobilia sequuntur personam*, citing *McDougal v. McDougal*⁶¹ and *State of California ex rel. Houser v. St. Louis Union Trust Co.*⁶² The United States Supreme Court defined *mobilia sequuntur personam* as follows: “[T]he maxim *mobilia sequuntur personam*...means only that it is the identity or association of intangibles with the person of their owner at his domicile which gives jurisdiction to tax.”⁶³ Or as applied here, capital gains from the sale of intangible property can be taxed only by the seller’s state of domicile.

We see two problems with WML’s argument. First, *Petition of Union Elec. Co.* spoke to this issue as follows:

⁶⁰ George E. Holmes, *Federal Taxes* (6th ed.) p. 396-97 n.18.

⁶¹ 279 S.W.2d 731, 739 (Mo. App., Spr. 1955) .

⁶² 260 S.W.2d 821, 826 (Mo. App., St.L.D. 1953).

⁶³ *Curry v. McCanless*, 307 U.S. 357, 367 (1939).

It is... true that for many purposes the situs of personal property is considered to be at the domicile of its owner. *This...proposition, however, is purely fictitious* and is now limited in its application to a few cases, principally those regarding the devolution of estates of decedents and bankrupts.... In the field of income taxation in particular it is important to penetrate beyond legal fictions and academic jurisprudence to the economic realities of the cases.[⁶⁴]

Further, the United States Supreme Court, in another case involving state corporate income tax, said:

Although a fictionalized situs for intangible property sometimes has been invoked to avoid multiple taxation of ownership, there is nothing talismanic about the concepts of “business situs” or “commercial domicile” that automatically renders those concepts applicable when taxation of income from intangibles is at issue. The Court has observed that the maxim *mobilia sequuntur personam*, upon which these fictions of situs are based, “states a rule without disclosing the reasons for it.” The Court also has recognized that “the reason for a single place of taxation no longer obtains” when the taxpayer's activities with respect to the intangible property involve relations with more than one jurisdiction.[⁶⁵]

Everything the courts said in those two cases applies to this case.

The concept that intangible property has no obvious or generally accepted location for tax purposes is hardly surprising, considering that “intangibles themselves have no real situs.”⁶⁶ They are “but relationships between persons, natural or corporate, which the law recognizes by attaching to them certain sanctions enforceable in courts.”⁶⁷ Thus, the location of intangible property for tax purposes has variously been attributed to the owner's legal or commercial domicile,⁶⁸ to the intangible's business situs,⁶⁹ to the place where the evidence of the intangible

⁶⁴ 161 S.W.2d at 970-71 (emphasis added.)

⁶⁵ *Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 445 (1980) (citation omitted).

⁶⁶ *Greenough v. Tax Assessors of City of Newport*, 331 U.S. 486, 493 (1947).

⁶⁷ *Curry*, 307 U.S. at 366.

⁶⁸ See, e.g., *Wheeling Steel Corp. v. Fox*, 298 U.S. 193 (1936) (commercial domicile); *Cream of Wheat Co. v. Grand Forks County*, 253 U.S. 325 (1920) (legal domicile);

⁶⁹ See, e.g., *Farmer's Loan & Trust Co. v. Minnesota*, 280 U.S. 204 (1930).

rights is physically located,⁷⁰ and to the location of those who possess rights or obligations under the intangibles (for example, the issuer of corporate stock⁷¹ or the debtor under a loan⁷²).

Therefore, just as we decline to accept the Director's application of the formula found in § 143.451.4 as decisive, so too do we decline to accept WML's argument that the "location" of WML's intangible assets is relevant to its resolution.⁷³

C. The gain from the sale of WML's intangible assets should be excluded from Missouri income tax because, like the sale of Freight Terminals' assets, it was nonbusiness income

As stated in the findings of fact, both WML's and Freight Terminals' assets were sold to FedEx; and, when Freight Terminals asserted that the gain from its sale was nonbusiness income under the Multistate Tax Compact, the Director agreed with that assertion. WML asks us to exclude the gain from the sale of its intangible property from taxation because the income in question is properly characterized as nonbusiness income due to the factual similarities of the two sales.

However, WML chose to be taxed under § 143.451.4, not the Multistate Tax Compact. The General Assembly created two discrete sets of laws regarding allocation and apportionment of multistate income, from which taxpayers could choose. Furthermore, Art. III, § 1 of the Compact lets taxpayers elect between being taxed under the Compact, or it may "apportion and allocate [its] income in the manner provided by the laws of [Missouri] without reference to [the Compact]." WML made that election and must live with the law under it chose.

⁷⁰ See, e.g., *Wheeler v. Sohmer*, 233 U.S. 434 (1914).

⁷¹ See, e.g., *State Tax Comm'n of Utah v. Aldrich*, 316 U.S. 174 (1942).

⁷² See, e.g., *Blackstone v. Miller*, 188 U.S. 189 (1903).

⁷³ We also note that a leading commentator on the issue refers to the "distorting consequences of assigning the intangible property and receipts to the commercial domicile under the traditional *mobilia* rule." Walter Hellerstein, *State Taxation of Corporate Income from Intangibles: Allied-Signal and Beyond*, 48 Tax L.R. 739, 865 n.590 (1993). The footnote relates to Prof. Hellerstein's analysis of capital gain income from the sale of intangible property, which he suggests ought to be tied to the three factors set out in the Uniform Division of Income for Tax Purposes Act ("UDITPA"), enacted in Missouri as § 32.200, art. IV. *Id.* at 865. We note that Prof. Hellerstein also lists Missouri as the only state providing corporate taxpayers an option between the UDITPA formula and a single-factor receipts formula. *Id.* at 753 n.69.

Conclusion

WML is entitled to a refund of the income tax it paid because its income from the sale of its software, customer lists, and goodwill is not income from a Missouri source, and therefore is not subject to income tax under §§ 143.431 and § 143.451.4. We grant WML's motion for summary decision and deny the Director's motion for summary decision. We order the Director to refund the sum of \$419,425, plus statutory interest, to WML.

SO ORDERED on September 27, 2013.

\s\ Marvin O. Teer, Jr.

MARVIN O. TEER, JR.

Commissioner