

Before the
Administrative Hearing Commission
State of Missouri



CITY UTILITIES OF SPRINGFIELD, MO,)
)
) Petitioner,)
)
) vs.) No. 13-0652 RS
)
DIRECTOR OF REVENUE,)
)
) Respondent.)

DECISION

City Utilities of Springfield, Missouri (“City Utilities”) is not entitled to a refund of sales tax paid on electricity sold to Reckitt Benckiser (“Reckitt”).

Procedure

On April 24, 2013, City Utilities filed a complaint in which it appealed the denial of its request for a sales tax refund in connection with sales of electricity to Reckitt. The Director of Revenue (“the Director”) filed his answer on May 29, 2013.

We held a hearing on December 4, 2013. Anne H. Rogers of Ellis, Ellis, Hammons & Johnson, P.C., represented City Utilities. Spencer Adam Martin represented the Director. The case became ready for decision on June 12, 2014, the date the last written argument was filed.

Findings of Fact

1. Reckitt is a manufacturer of household consumer products such as condiments, cleaning products, and over-the-counter medication.

2. Reckitt has several manufacturing plants, both in and out of the United States, that make these products, including one in Springfield, Missouri.

3. At all relevant times, Reckitt operated a “logistic center” in Springfield, Missouri.

4. The logistic center is 619,000 square feet. Of that space, the “custom manufacturing plant” (“the custom plant”) takes up 50,000 square feet. The remainder of the logistic center is used as office and storage space.

5. The electricity in the logistic center is used, among other things, for lighting, powering a battery-recharging station, business offices, and operating the equipment in the custom plant. This equipment includes a Thermatron auto welder, three shrink-bundling lines, an air compressor, and an air dryer.

6. The custom plant takes products from Reckitt’s different product lines and assembles and packages them to make custom displays and new “value” packages of products. For example, it might package together three bottles of Lysol hand soap refill, or four packages of Airwick air freshener refills to make an “Airwick Freshmatic value pack.”

7. Reckitt sells about thirty percent of these “value packages” to wholesalers such as Costco or Sam’s Club. The rest are sold to retailers such as Wal-Mart, Target, and dollar stores.

8. When a wholesaler such as Sam’s Club places a custom order, the custom plant requests that the manufacturing plant make additional stock of a particular item for the use of the custom plant to fulfill the order.

9. Employees at the custom plant unbox individual items such as bottles of hand soap received from the manufacturing plant and place them in a plastic “blister.” They then apply a backer card and seal it to the blister. The newly packaged item is placed in a tray, then on a pallet, then sent to the wholesaler.

10. In another example, employees might unbox individual AirWick Freshmatic Refills and put them into a “boot,”¹ after which shrink-wrap is applied, the items are heat sealed, and a value sticker is applied. The new “value-pack” items are then placed in trays and then onto a pallet to be sent to the wholesaler.

11. Items that are “co-packed” in this way have the same universal product code (“UPC”) as the items sold individually. But the new “value package” bears a new UPC that is different from the UPC on the individual items.

12. For example, the individual AirWick Freshmatic Refill item and the four-item value pack have different UPC numbers and different prices. They may also have different markets and different buyers. Some purchasers buy value packages more commonly found at a wholesaler such as Sam’s Club. Some purchasers might buy an individual item at Wal-Mart.

13. Reckitt paid City Utilities for electricity used in the logistic center, including the custom plant, and paid sales tax on that electricity.

14. The total amount of sales tax paid for electricity used at the logistic center during that period is \$21,402.27.

15. The percentage of electricity used by the custom plant in the logistic center is 20.18%.

16. City Utilities submitted a refund claim on Reckitt’s behalf for electricity used in the custom plant for the period from April 1, 2009 through March 31, 2012.

17. City Utilities claims a 25% exemption of the total amount of electricity, or a refund of \$5,350.57.

¹ The “boot” appears to be a piece of cardboard packaging on which the items rest.

18. On March 4, 2013, the Director issued a final decision denying City Utilities' refund claim.²

Conclusions of Law

This Commission has jurisdiction over appeals from the Director's final decisions. Section 621.050.1.³ City Utilities has the burden to prove it is entitled to the refund it has requested. Sections 136.300.1, RSMo 2000, and 621.050.2. Our duty in a tax case is not merely 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. *J.C. Nichols Co. v. Dir. of Revenue*, 796 S.W.2d 16, 20-21 (Mo. banc 1990).

City Utilities has requested a refund of sales taxes based on an exemption found in § 144.054.2, which states:

In addition to all other exemptions granted under this chapter, there is hereby specifically exempted from the provisions of sections 144.010 to 144.525 and 144.600 to 144.761, and from the computation of the tax levied, assessed, or payable under sections 144.010 to 144.525 . . . , **electrical 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** The exemptions granted in this subsection shall not apply to local sales taxes as defined in section 32.085 and the provisions of this subsection shall be in addition to any state and local sales tax exemption provided in section 144.030.

As City Utilities claims an exemption from taxation, we construe the statute strictly against it. *Union Electric Co. v. Dir. of Revenue*, 425 S.W.3d 118, 125 (Mo. banc 2014). An exemption "is allowed only upon clear and unequivocal proof, and doubts are resolved against

² The original refund claim was for \$10,195.65, based on the theory that Reckitt's cardboard recycling system also operated at the custom plant might qualify for sales tax exemption. This claim is discussed in the letter that serves as the complaint in this case, but no evidence was presented to support it and we deem it to have been abandoned.

³RSMo 2000. Statutory references are to RSMo Supp. 2013, unless otherwise noted.

the party claiming it.” *Branson Properties USA v. Dir. of Revenue*, 110 S.W.3d 824, 826 (Mo. banc 2003).

The issue in this case is whether the activities engaged in by Reckitt at the custom plant constitute the manufacturing of a product. Manufacturing is:

the alteration or physical change of an object or material in such a way that produces an article with a use, identity, and value different from the use, identity, and value of the original.

Id. A product is “an output with a market value.” *International Business Machines Corp. v. Dir. of Revenue*, 958 S.W.2d 554, 557 (Mo. banc 1997), quoted in *E&B Granite v. Dir. of Revenue*, 331 S.W.3d 314, 316 (Mo. banc 2011). But inherent in the definition of manufacturing is the additional requirement that it produce an article with a new and different “use, identity, and value.”

To convince us that Reckitt manufactures products at the custom plant, City Utilities makes two arguments. First, it argues that the items produced in the custom plant are new products, with unique identities, markets, and values, so that it is entitled to the manufacturing exemption found in § 144.054.2. Second, it invokes the “integrated plant doctrine,” arguing that the activity in the custom plant “is merely a continuation of the manufacturing process that is started in a Reckitt Manufacturing Plant.” Pet. Post-Hearing Brief at 7. The Director argues that Reckitt is not manufacturing new products in the custom plant, but repackaging existing products, so that it does not qualify for the exemption.

Both parties agree that we may look not only to cases decided under that statute, but also to cases interpreting the manufacturing exemptions found in § 144.030.2. And both rely on *House of Lloyd, Inc. v. Dir. of Revenue*, 824 S.W.2d 914 (Mo. banc 1992) (*abrogated on other grounds by Sipco, Inc. v. Dir. of Revenue*, 875 S.W.2d 539 (Mo. banc 1994)), although they draw different lessons from that case.

The taxpayer in *House of Lloyd* sold merchandise such as Christmas decorations, toys, and other gift items, which it marketed through a “party plan.” *Id.* at 917. The taxpayer bought such items from other manufacturers and selected items to put together in a “demonstrator kit” that it sold to individuals who in turn hosted parties to sell more merchandise. *Id.* House of Lloyd claimed that it was “fabricating” the kits within the meaning of § 144.030.2(5), so its purchase of the machinery and supplies for repackaging the items into a demonstrator kit was exempt from sales tax. *Id.*

The court first decided that the terms “manufacturing” and “fabricating” were “functionally synonymous in this case.” *Id.* at 919. It then summarized the taxpayer’s argument: “Appellant claims that the demonstrator kit is a ‘product’ with its own identity, having a utility and value wholly distinct from any of its component parts.” *Id.* But, the court reasoned, “If the demonstrator kit is not a product, as contemplated by the statute, then the fabrication issue is moot.” *Id.* It found that the demonstrator kit was not a product.

In the most basic terms, appellant’s process is a garden variety repackaging and shipping of merchandise that arrives at the appellant’s plant from outside sources. When the merchandise arrives, appellant removes the items from their cartons, and then inspects, repairs, sorts and repackages the merchandise for shipping. **The items of merchandise are in their final state when appellant receives them. They retain their function and remain structurally independent.**

Id. (emphasis added).

City Utilities agrees that the facts in this case are similar to those in *House of Lloyd*, but argues that there are several key differences. It points out that when the items are assembled into value packs, they receive a UPC and a price different from the individual item, and that the value packs are more frequently sold to wholesalers such as Sam’s Club and Costco for customers who wish to buy in bulk. We find these to be distinctions without a difference. Of course three bottles of hand soap refill will cost more than one, but the important factor for determining

whether they are a distinct “product” is that the “items are in their final state” when the custom plant receives them. They “retain their function and remain structurally independent.” They are no more new “products” when packaged together in value packs than were House of Lloyd’s demonstrator kits when the Christmas items were assembled and packaged together.

Invoking the “integrated plant doctrine,” City Utilities also argues that an important distinction between this case and *House of Lloyd* is that Reckitt does not purchase the items from other companies, but manufactures them itself at its own manufacturing plants. Thus, it argues that what takes place at the custom plant is actually a continuation of the manufacturing process begun in its manufacturing plant.

The integrated plant doctrine was first discussed in Missouri in *Floyd Charcoal v. Dir. of Revenue*, 599 S.W.2d 173 (Mo. 1980) (*abrogated on other grounds by Al-Tom Inv., Inc. v. Dir. of Revenue*, 774 S.W.2d 131 (Mo. banc 1989)). It was applied for the purpose of determining whether machinery and equipment was “directly used” in manufacturing so as to qualify for tax exemption under § 144.030.2(5). Under the integrated plant doctrine:

The basic questions are the following: (1) Is the disputed item necessary to production? (2) How close, physically and causally, is the disputed item to the finished product? (3) Does the disputed item operate harmoniously with the admittedly exempt machinery to make an integrated and synchronized system?

Id. at 177.

The only context in which the integrated plant doctrine has been applied is to the tax exemption on purchases of machinery and equipment used in manufacturing. *See Noranda Aluminum, Inc. v. Mo. Dep’t of Revenue*, 599 S.W.2d 1 (Mo. 1980) (anode production for aluminum manufacturing process); *Concord Publishing House, Inc. v. Dir. of Revenue*, 916 S.W.2d 186 (Mo. banc 1996) (computers used in newspaper publishing); *DST Systems, Inc. v. Dir. of Revenue*, 43 S.W.3d 799 (Mo. banc 2001) (computers used in printing financial

information); and *Southwestern Bell Telephone Co. v. Dir. of Revenue*, 182 S.W.3d 226 (Mo. banc 2005) (network equipment used to produce telephone service). Attempting to apply the doctrine here, to the purchase of electricity, is like fitting a square peg into a round hole, but City Utilities gamely tries.

The first prong of this test asks whether the disputed item is necessary to production. . . . The electricity used to maintain the lights and run the machines used in the Custom Manufacturing Plant is essential to the production of the value pack products completed in the Custom Manufacturing Plant. . . . The second and third prongs of the *Floyd Charcoal Co.* test ask how close physically and causally the disputed item is to the finished product and whether it operates in a harmonious and synchronized way with the other exempt machinery (or in this case electricity). As previously stated herein, the items that are used in Custom Manufacturing begin the production process in another Reckitt manufacturing plant; and then are sent to the Custom Manufacturing Plant to finish the manufacture of the value pack items. . . . The court has previously allowed for exemptions when equipment is used in a different location from a manufacturing plant. Although it takes two locations to produce the specialty value pack items, the manufacturing of those items is performed in one “harmonious” and “synchronized” stream; and therefore, the tax exemption should be applied in this case, as well.

Pet. Reply Brief at 6-7 (internal citations omitted).

But City Utilities still cannot escape the ultimate issue in this case. To paraphrase the *House of Lloyd* court, if the value package is not a product, as contemplated by the statute, the manufacturing issue is moot. On very similar facts, that court stated, “[a]ny “manufacturing” . . . of the merchandise items that appellant sells was complete prior to those items being sorted and placed in the cardboard boxes for shipping.” 824 S.W.2d at 919. Even in an integrated plant case, the machinery, equipment, or electricity on which tax is paid must still play an integral role in producing a new product, with a new and different identity, use, and value.

The “product” issue was pivotal in the “integrated plant” case we find to be most similar to this one. In *Utilicorp United, Inc. v. Dir. of Revenue*, 75 S.W.3d 725 (Mo. banc 2001), the

Missouri Supreme Court decided that the machinery and equipment used by utility companies to transform and regulate electricity in order for them to deliver electricity at a voltage suitable for consumers' needs was not used in manufacturing.

[N]one of the utilities can show that, through the use of this equipment, the utility makes something new and different, whether it generates the electricity or buys the electricity from others. Though volts and amperes may change during the transmission and distribution, **not every change is “manufacturing.” . . . The product is the same; only its measurements change. By either measure it is the same product,** and nearly the same total amount of product.

Id. at 729 (emphasis added).

This analysis points our way to a more recent case decided under § 144.054. City Utilities takes pains to distinguish the facts of this case from those in *AAA Laundry & Linen Supply Co. v. Dir. of Revenue*, 425 S.W.3d 126 (Mo. banc 2014), and at first blush, the laundering of uniforms seems to be dissimilar to the creation of value packs of air freshener. But as the AAA court noted, quoting *Unitog Rental Services, Inc. v. Dir. of Revenue*, 779 S.W.2d 568, 570 (Mo. banc 1989), “[t]he common thread running throughout all of the cases in which we have defined “manufacturing” is the production of an article with a new use different from its original use.” 425 S.W.3d at 129. Coming full circle, we note that the same phrase appears in *House of Lloyd*, 824 S.W.2d at 918. As in that case, any manufacturing of the merchandise items that Reckitt sells was complete prior to its combining three of the items together and shrink-wrapping them into a new package.

We find that Reckitt's activities at the custom plant do not constitute manufacturing, and it is not entitled to the exemption for sales tax on electricity in § 144.054.2. Because there is no refund to calculate, we do not address the appropriate percentage to be applied to the total sales tax paid on the electricity used in the custom plant.

Summary

City Utilities is not entitled to a refund of the sales tax it remitted on sales of electricity to Reckitt.

SO ORDERED on August 26, 2014.

/s/ Karen A. Winn

KAREN A. WINN

Commissioner