Before the
Administrative Hearing Commission
State of Missouri

DREYER ELECTRIC CO., LLC, Petitioner, v. DIRECTOR OF REVENUE, Respondent.	)	No. 17-1611

DECISION

Dreyer Electric Co., LLC (Dreyer) is entitled to a sales tax refund in the amount of $6,336.61, plus statutory interest at 6% per annum pursuant to § 621.050.2.[1]

Procedure

On August 22, 2017, Dreyer filed its complaint alleging that it is entitled to a refund for sales tax that it paid to the Director of Revenue (Director) based on a business transaction with B&B Timber Company (B&B) in 2016. On September 20, 2017, the Director filed an answer. With leave, Dreyer filed an amended complaint on January 5, 2018. On January 23, 2018, the Director filed an answer to the amended complaint. On April 23, 2018, we held a hearing. Scott Fetterhoff of Lichtenegger, Weiss & Fetterhoff represented Dreyer, and Benjamin Slawson represented the Director. This case became ready for decision on October 9, 2018, when the last written argument was filed.

[1] Statutory citations are to the RSMo 2016, unless otherwise indicated.

Commissioner Renee T. Slusher, having read the full record including all the evidence, renders the decision. Section 536.080.2; *Angelos v. State Bd. of Regis'n for the Healing Arts*, 90 S.W.3d 189 (Mo. App. S.D. 2002).

Findings of Fact

1. B&B is a manufacturing, lumber, sawmill, and timber corporation located in Marble Hill, Missouri, and owned by Barry Booth. It saws logs into products such as flooring, railroad ties, and pallet material. It sells its products wholesale. B&B also sells its byproducts, which include sawdust, mulch, and scrap material that it chips into pulp for paper.

2. B&B's manufacturing machinery includes, in part, a debarker (removes the bark from the logs), head saw (starts the initial breakdown of the logs), resaw (part of the sawing system), edger, transfer chain rollers, grinder (regrinds the bark), chipper (chips waste wood), blowers, transfer chains, cutoff saws, and conveyor that moves logs from saw to saw. (collectively, "manufacturing machinery").

3. B&B maintains most of its manufacturing machinery in its manufacturing building (Building A). Some of the machinery is located in its shop building (Building B), such as its grinder (to sharpen the chipper knives), chipper knives, and an air compressor.

4. As a result of a fire that occurred on April 28, 2016, B&B replaced 75% of Building A's structure, 100% of Building A's electrical system, and the machinery housed in Building A. Part of Building B's structure was also destroyed.

5. B&B hired Dreyer to replace and install the electrical system (hereinafter "disputed items") within Building A, which included soft starters, a 1,200 Amp service, NEMA overload relay, H2009B-3 heater element, disconnects, and numerous other items.[2]

[2] The other disputed items include, but are not limited to, stranded wire, reducing washer, connectors, tape, conduits, couplings, ground rods, breakers, cables, and many others.

6. The disputed items power B&B's manufacturing machinery that in turn produces the lumber, railroad ties, and other products sold by B&B.

7. The soft starters are an integral part of B&B's electrical system, and they start the machinery motors turning.

8. Due to the weight of the machinery motors, the soft starters allow the motors to start moving slowly at first, which ensures that too much power is not pulled from the power company's transmission lines. Soft starters are required by the power company because the motors would otherwise put a tremendous draw on the power system coming into the facility, and this could affect other customers' power supply.

9. Each soft starter was specifically designed and measured for the size of each machine motor. The soft starters also protect the motors from spikes that may come straight off the transmission lines, and they help protect the longevity of the machinery.

10. B&B's electrical system has main power wires that supply the main voltage to the machine motors, and then control wires are present that are remotely operated by B&B's operators so they can control the motors. The electrical wires go to and from the motors to the main electrical voltage.

11. The electrical wiring is not "your normal household-type wire." Tr. at 47. For example, the wiring size is different, the coating is endurable for blows or any kind of hard cuts into it, it contains a mechanism to register heat in order to shut down a system if it becomes too hot, and the wiring was designed to run B&B's particular machines. The motors would not run or endure without the disputed items.

12. Disconnects are a safety mechanism that disconnect the main power from a soft starter so that all of the power stops. Each motor has its own breaker that feeds into it, and each disconnect is within eyesight of each motor per the applicable electrical code. These breakers

are “a lot larger” than would be in a home. Tr. at 19. This is an important safety feature for employees who work on the machinery.

13. The 1,200 Amp service provides the power for B&B’s electrical service that in turn powers B&B’s machinery. The machines are all physically wired together, and they do not need to be plugged into an outlet to operate. The only other thing the disputed items do is provide lighting to Buildings A and B. B&B has a separate electrical service that runs to its separate office building.

14. The NEMA overload relay is used to automatically trip (“stop”) the motor if it pulls too many amps.

15. Building A contains a rack that holds all of the electrical wiring that Dreyer installed. The wires are needed to carry the power from the soft starters to the motors in order to power B&B’s manufacturing machinery. This rack was placed on the ceiling above the transfer chain rollers.

16. Dreyer also installed a cabinet that held some of the disputed items, including several soft starters. This cabinet is located on the west side of Building A.

17. Dreyer’s invoices for the disputed items were dated July 8, 2016 through September 22, 2016.

18. B&B’s electrical bill for its office building is approximately $100 a month, while its electrical bill for Buildings A and B is approximately $4,000 to $5,000 a month.

19. The disputed items do not directly touch, grind, chop or saw the wood processed by B&B’s facility, and they are not used up in the manufacturing process.

20. B&B intends to use the disputed items for years.

21. After Dreyer installed the disputed items, B&B provided Dreyer with a sales tax exemption certificate. Section 5 of the exemption certificate, titled "Product or Services Purchased," states: "Electrical panels, starters, wiring, motors, support materials etc."

22. On May 2, 2017, Dreyer submitted a refund claim for $6,336.61 to the Director on B&B's behalf for the sales of the disputed items.[3] Dreyer's claims were for the tax periods from July 1, 2016 through December 31, 2016.

23. On June 22, 2017, the Director issued a final decision denying Dreyer's refund claim and stated that the "items do not qualify under the manufacturing exemption." Ex. A.

Conclusions of Law

This Commission has authority over appeals from the Director's final decisions. Section 621.050.1. Dreyer has the burden to prove it is entitled to its requested sales tax refund. Sections 136.300.1, 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. Director of Revenue*, 796 S.W.2d 16, 20-21 (Mo. banc 1990). We may do what the Director can do, and must do what the Director is required to do. *Id.*

Statutes imposing a tax are construed strictly in favor of the taxpayer. Section 136.300. However, tax exemptions are "strictly constructed against the taxpayer" and the taxpayer must prove an exemption by "'clear and unequivocal proof,' and 'any doubts are resolved against the party claiming it. *Bartlett International, Inc. v. Director of Revenue*, 487 S.W.3d 470, 472 (Mo. banc 2016) (internal citations omitted); *see also Mississippi River Fuel Corp. v. Smith,*

[3] Dreyer's refund claim requested a sales tax refund in the amount of 6,336.61. However, according to Dreyer's invoices within Ex. 2, the total cost of the materials was $23,467.03 + $66,535.95 + $1,266.95 +$14,458.05 = $105,727.98 x 6.1% sales tax rate = $6,449.41. In that Dreyer only requested a refund of $6,336.61 from the Director, we award only this amount.

164 S.W.2d 370, 377 (Mo. 1942) (a tax exemption is "an abandonment of the sovereign right to exercise the vital power of taxation [and] can never be presumed . . . [t]he intention to abandon must appear in the most clear and unequivocal terms . . . and [any tax exemption] should be construed strictly . . .[.]" (internal citations omitted)).

Dreyer claims that it is entitled to a sales tax refund due to the tax exemption contained in § 144.030.2(5),[4] which provides, in relevant part, a sales tax exemption for:

> Replacement machinery, equipment, and parts and the materials and supplies solely required for the installation or construction of such replacement machinery, equipment, and parts, used directly in manufacturing, mining, fabricating or producing a product which is intended to be sold ultimately for final use or consumption[.]

The issues in this case are: 1) whether the disputed items purchased by B&B are replacement machinery, equipment, or parts and materials required for the installation or construction of such replacement machinery, equipment or parts and, if so, 2) were the disputed items directly used in the manufacturing, fabrication or production of B&B's products.

Replacement Machinery, Equipment, or Parts and Materials

Dreyer argues that the disputed items that it sold to B&B qualify for a sales tax exemption pursuant to § 144.030.2(5) because they are necessary for the operation of B&B's machinery and constitute equipment or parts. Dreyer argues that the disputed items are permanent electrical components that direct and manage the electric current to each of B&B's machines and many are required for the protection of the motors used to operate the machinery. Dreyer argues that the disputed items are part of B&B's integrated automated production line.

[4] In Dreyer's amended complaint, Dreyer argues that it is entitled to a refund under § 144.030.2(5) and (6). However, in its written argument and reply brief, Dreyer only cites § 144.030.2(5). We therefore deem § 144.030.2(6) to be abandoned. Section 144.030.2(5) was amended effective August 28, 2016; however, there was substantive change to subdivision (5). After August 28, 2018, subdivision (5) was renumbered to subdivision (4).

The Director argues, in part, that Dreyer failed to meet its burden to prove that the disputed items were "fixed assets other than land and buildings of a business enterprise" because: a) the disputed items were listed on the applicable invoice from Dreyer as "supply material;" b) B&B could not state if it depreciated the disputed items as fixed assets on its federal tax returns; c) the disputed items are not parts because they do not touch the manufacturing equipment; are not inside the machines, but are instead part of the breaker boxes, which direct power from the transmitter to the machinery; and are physically separated from the machinery in a climate controlled area of the warehouse; and d) in the alternative, if the disputed items are considered equipment or parts, they are not directly used in the manufacturing process when analyzed under the "integration plant doctrine." Resp. brief at 7-9, citing *Walsworth Pub. Co., Inc. v. Director of Revenue*, 935 S.W.2d 39, 40 (Mo. banc 1996), citing *Webster's Third New International Dictionary* 768 (3rd ed. 1976), and *Floyd Charcoal Co. v. Director of Revenue*, 599 S.W.2d 173, 177 (Mo. 1980). We analyze these arguments below.

Regulation 12 CSR 10-111.010 (2)(D) and (G) define the terms machinery, equipment and parts as follows:

> (D) Machinery and equipment--Devices that have a degree of permanence to the business, contribute to multiple processing cycles over time and generally constitute fixed assets other than land and buildings for purposes of business and accounting practices.
>
> (G) Parts--Articles of tangible personal property that are components of machinery or equipment, which can be separated from the machinery or equipment and replaced. Like machinery and equipment, parts must have a degree of permanence and durability. Items that are consumed in a single processing and benefit only one production cycle are materials and supplies, not parts. Items such as: nuts, bolts, hoses, hose clamps, chains, belts, gears, drill bits, grinding heads, blades, and bearings, would ordinarily be considered as parts.

In *Walsworth*, the court analyzed whether phototypesetting paper used in the taxpayer's commercial printing process was "equipment" for purposes of § 144.030.2(5).[5] The court defined "equipment" in relevant part as "all the fixed assets other than land and buildings of a business enterprise." *Walsworth*, 935 S.W.2d at 40. The court held that the paper was not equipment because it was consumed in one production cycle and it was "not 'fixed' in any sense." *Id*.

In *Lincoln Indus. Co. v. Director of Revenue*, 51 S.W.3d 462 (Mo. banc 2001), a taxpayer argued that machinery replacement parts were exempt "equipment" pursuant to § 144.030.2(4), RSMo Supp. 1996.[6] The court disagreed because the taxpayer had not capitalized the parts as equipment on its books by depreciating them over a number of years, but rather expensed them as deductions from current income. The court concluded that since tax exemption statutes are construed against the taxpayer, the items were not exempt as equipment. However, the court further noted that while "business and accounting practices normally resolve what is and is not equipment," this was "not controlling." *Id.* at 466. In other words, the business and accounting practices of a company are not the determinative factor as to whether the item(s) at issue are equipment, but it can be further evidence used in the analysis.

In the present case, Booth (owner of B&B) testified that he expected to use the disputed items purchased from Dreyer for years and that none of the disputed items were used up in the manufacturing process. The disputed items were purchased by B&B to replace items that were destroyed due to a fire. They are primarily used to power and help regulate B&B's machinery. They also serve as a safety mechanism so that the machines do not overheat. B&B's machinery

[5] The numbering of the subdivisions in §144.030.2 for the manufacturing exemptions were changed from (4), (5) to (5), (6) when § 144.030 was amended after the date of *Walsworth*.

[6] Per the court decision, § 144.030.2(4), RSMo Supp. 1996 "provided a sales and use tax exemption for 'machinery and equipment ... replacing and used for the same purposes ... as the machinery and equipment, which is purchased for and used directly for manufacturing or fabricating a product which is intended to be sold ultimately for final use or consumption.'" *Id*. at 464.

cannot operate without the disputed items. The items are a permanent part of B&B's manufacturing process.

At the hearing, no evidence was introduced as to whether B&B depreciated the disputed items on its taxes. When Booth was asked about it at the hearing, he did not know the answer. While this information would have been helpful, it is not controlling, and the lack of information is not determinative. Likewise, how the disputed items are labeled on an invoice is not determinative.

The disputed items can be distinguished from those in *Walsworth* because they are not consumed in one processing cycle. Instead, the disputed items are "devices" that "have a degree of permanence to [B&B's] business, contribute to multiple processing cycles over time and generally constitute fixed assets other than land and buildings for purposes of business and accounting practices." 12 CSR 10-111.010(2)(D).

In addition, the disputed items are more appropriately defined as replacement equipment as opposed to parts or materials because they are a combination of parts that work together to create an electrical system designed specifically for B&B's manufacturing machinery as opposed to items such as nuts and bolts as identified in the definition of the term "Parts" found in 12 CSR 10-111.010(2)(G).[7] In *Lincoln*, the court held that the term "replacement machinery:"

> includes those items that are combinations of parts that work together as a functioning unit. These components are machinery even though they are subordinate elements of more complex machinery that is part of the "integrated plant." In contrast, "machinery" does not include the replacement of an individual part even if that part becomes an element of a functioning machine. In common usage "machinery" includes not just a complex machinery, but also simple machinery. Also the dictionary definition does not distinguish between machinery that is valuable or quite inexpensive. These distinctions . . . are irrelevant. The

[7] The Director did not argue that the disputed items were a structural component of a building per 12 CSR 10-111.010(2)(D), so we do not analyze it here.

> legislature made no distinction between more or less expensive, or between complex and simple machinery, and neither should the Court.

Id. at 466 (internal citation omitted), *see also* 12 CSR 10-111.010(3)(D) and (E).[8]

Based upon the preponderance of the evidence, the disputed items constitute replacement equipment as used in § 144.030.2(5).

Were the Disputed Items Directly Used to Manufacturing Products?

The Director argues that even if the disputed items constitute replacement machinery, equipment, or parts, they were not used directly in the manufacturing of B&B's product as required by § 144.030.2(5). Regulation 12 CSR 10-111.010(2)(E) defines the term manufacturing as:

> i) the alteration or physical change of an object or material to produce an article with a use, identity and value different from the use, identity and value of the original; or ii) a process which changes and adapts something practically unsuitable for any common use into something suitable for common use; or iii) the production of new and different articles, by the use of machinery, labor and skill, in forms suitable for new applications; or iv) a process that makes more than a superficial transformation in quality and adaptability and creates an end product quite different from the original; or v) requires the manipulation of an item in such a way as to create a new and distinct item, with a value and identity completely different from the original. Manufacturing does not include processes that restore articles to their original condition (e.g., cleaning, repairing); processes that maintain a product (e.g., refrigeration); or processes that do not result in a change in the articles being processed (e.g., inspecting, sorting).

Both parties reference the integrated plant theory, which has been adopted in Missouri.[9] The doctrine was first adopted in Missouri in *Floyd Charcoal v. Director of Revenue*, 599

[8] No argument was made that the disputed items were not consistent with these subdivisions of the regulation.

[9] See 12 CSR 10-111.010(3)(A), which provides, in pertinent part:

> In determining whether machinery, equipment and parts are used directly in producing a product, Missouri has adopted the integrated plant theory that permits *a broad construction* of the machinery, equipment and parts exemptions. The language "used directly in" exempts purchases of articles that are *both essential and comprise an integral part of the manufacturing process*.

(Emphasis added).

S.W.2d 173 (Mo. 1980) (abrogated on other grounds by *Al-Tom Inv., Inc. v. Director of Revenue*, 774 S.W.2d 131 (Mo. banc 1989).[10] It was applied for the purpose of determining whether machinery and equipment was "directly used" in the manufacturing process so as to qualify for tax exemption under § 144.030.2(5).[11] The court in *Floyd* "rejected the argument that equipment could not qualify for the manufacturing exemption if it did not produce a change in the composition of raw materials involved in the manufacturing process" because

> Modern manufacturing facilities are designed to operate on an integrated basis … and limiting the exemption to those items of machinery or equipment which produce a change in the composition of the raw materials … would ignore the essential contribution of the devices required for such operations.

Southwestern Bell Telephone Co. v. Director of Revenue, 182 S.W.3d 226, 230 (Mo. banc. 2005) (abrogated by *IBM Corporation v. Director of Revenue*, 491 S.W.3d 535 (Mo. banc 2006) (overturned due to legislative action L.2018, S.B. No. 768, § A), quoting *Floyd Charcoal*, 599 S.W.2d at 178.[12]

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[10] *See Sears, Roebuck & Co. v. Seven Palms Motor Inn, Inc.*, 530 S.W.2d 695, 698 (Mo. banc 1975), for a general discussion of the integrated industrial plant rule prior to *Floyd*.

[11] The Director does not argue that B&B's business is not engaged in manufacturing.

[12] At the time Dreyer submitted its invoices to B&B for the disputed items from July through September 2016, *IBM* had been issued in May 2016. In *IBM*, the court examined the term "manufacturing" under § 144.054.2. The court abrogated the interpretation of the term in *Southwestern Bell Tel. Co. v. Director of Revenue*, 78 S.W.3d 763 (Mo. banc 2002) and *Southwestern Bell Telephone Co. v. Director of Revenue*, 182 S.W.2d 226 (Mo. banc 2005). In 2017, the legislature amended the manufacturing exemption, which included the following:

> the term "manufacturing" *has included and continues to include* the production and transmission of "telecommunications services", as enacted in this subdivision and subdivision (5) of this subsection …[.] The preceding two sentences reaffirm the legislative intent consistent with the interpretation of this subdivision and subdivision (5) of this subsection in *Southwestern Bell Tel. Co. v. Director of Revenue*, 78 S.W.2d 763 (Mo. banc 2002) and *Southwestern Bell Tel. Co. v. Director of Revenue*, 182 S.W.3d 226 (Mo. banc 2005), and accordingly abrogates the Missouri supreme court's interpretation of those exemptions in *IBM Corporation v. Director of Revenu*e, 491 S.W.3d 535 (Mo banc 2016) to the extent inconsistent with this section and …[.] The construction and application of this subdivision as expressed by the Missouri supreme court in *DST Systems, Inc. v. Director of Revenue*, 43 S.W.3d 799 (Mo. banc 2001); *Southwestern Bell Tel. Co. v. Director of Revenue*, 78 S.W.3d 763 (Mo. banc 2002); and *Southwestern Bell Tel. Co. v. Director of Revenue*, 182 S.W.3d 226 (Mo. banc 2005), is hereby affirmed.

Section 144.030.2(4) (emphasis added.) Because the legislature made its abrogation of *IBM* retroactive per the above emphasized language, we do not apply *IBM* to the extent it may have been applicable when Dreyer issued its invoices to B&B. *See Meehan v. PNC Financial Services Group, Inc.*, 2018 WL 2117655 at *3 (Mo. App. E.D. May 8, 2018), *citing Lawson v. Ford Motor Co.*, 217 S.W.3d 345, 349 (Mo. App. E.D. 2007).

As discussed in *Southwestern Bell*, the purpose of Missouri's manufacturing exemption is "to encourage the production of items ultimately subject to sales tax and to encourage the location and expansion of industry in Missouri." *Southwestern Bell*, 182 S.W.3d at 230. "The exemption reduces multiple taxation that occurs where purchases for resale are taxed numerous times during the journey of goods to the ultimate consumer, such that the tax paid by the manufacturing is passed on to the consumer, who is, in turn, effectively taxed on a tax." *Id.*

Under the integrated plant doctrine, this Commission is required to apply the following three factors: 1) is the disputed item necessary to production; 2) how close, physically and causally, is the disputed item to the finished product; and 3) does the disputed item operate harmoniously with the admittedly exempt machinery to make an integrated and synchronized system?[13] *Floyd Charcoal*, 599 S.W.2d at 177. We examine the three prongs of the integrated plant doctrine below.

Were the Disputed Items Necessary to B&B's Production?

At the hearing, Booth testified that the disputed items were needed to power B&B's manufacturing machinery such as its debarker, various industrial saws, transfer chains and rollers, grinder, chipper, and blowers. Therefore, the disputed items installed by Dreyer were necessary in order for B&B to manufacture its products.

[13] *See also* 12 CSR 10-111.010(2)(J), which reiterates that all three factors of the theory must be present. The regulation gives the following examples of what aspects of a manufacturing operation is not considered used directly in the manufacturing process:

> items used in material storage or handling before the manufacturing process begins may be essential to the process, but generally are not an integral part of the manufacturing process and are therefore not used directly in manufacturing. Similarly, items used for storing the finished product are generally not an integral part of the manufacturing process.

How Close, Physically and Causally, are the Disputed Items to B&B's Finished Product?

In *Concord Publishing House, Inc. v. Director of Revenue*, 916 S.W.2d 186 (Mo. banc 1996), the Missouri Supreme Court provided an example of the role and relative importance that distance plays within the second prong of the integrated plant doctrine. In *Concord*, the court held that computers used in producing a newspaper were directly used in manufacturing and that the exemption was not limited to materials used to physically print the newspaper. *Concord*, 916 S.W.2d at 190-92. The court stated:

> By holding the computers are used in manufacturing a newspaper, we also find they are directly used in manufacturing because they are an integral part of the publication process. The computers are as essential to the printing of the paper as the printing presses themselves. A more limited view of the process would arguably exclude the most important step in manufacturing a newspaper, the composition and editing of its contents.

Id. at 192. The court rejected the Director's argument that because the publishing operation was physically separated from the printing press, the computer equipment was not an integral part of manufacturing a newspaper. The court noted that physical distance is a factor to consider, but is not determinative, and explained:

> The composition and editing process is as essential to manufacturing a newspaper as the printing press, regardless of whether it is located in the same building or across town. We find the physical distance between the operations in this case does not break the direct tie between the composition and printing . . . [.]

Id. at 193. The court concluded that even laptop computers used by reporters qualified for the exemption. *Id*., s*ee also, DST Systems, Inc. v. Director. of Revenue,* 43 S.W.3d 799 (Mo. banc 2001) (legislatively affirmed by L.2018, S.B. No. 768, § A) (the court held that DST's computer system was part of its integrated plant that produced printed statements through a DST subsidiary, even though the printing and the computing occurred at different sites).

In the present case, Booth testified that B&B's Building A primarily housed the disputed items. Dreyer installed a cabinet within Building A that held some of the disputed items, including several soft starters that were used to power B&B's manufacturing machinery within Building A. Furthermore, Dreyer installed a rack on the ceiling of Building A above the machinery that held electrical wires. Some of the disputed items were wired into the machinery motors, such as the control wires that allow the operators to manage the motors and the breakers that prevent the motors from overheating. We therefore find that the disputed items were physically and causally close to B&B's manufacturing machinery.

Do the Disputed Items Operate Harmoniously with the Exempt Machinery to make an Integrated and Synchronized System?

In *Utilicorp United, Inc. v. Director of Revenue,* 75 S.W.3d 725 (Mo. banc 2001), the Missouri Supreme Court decided that transformers, voltage regulators, and other such equipment did not qualify under § 144.030.2(4) and (5) because they were not used to generate the product (electricity) produced by the plaintiffs (utility companies). Instead, the equipment was used by the plaintiffs to transmit and distribute the electricity that had already been manufactured. Furthermore, the equipment was not part of an integrated plant because it was not located at the same site the electricity was generated, and much of the electricity transmitted by the plaintiffs was not generated by them. The court held that:

> none 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 (internal citations omitted) (emphasis added).

The Director relies on *Utilicorp* to argue the disputed items are not directly related to B&B's manufacturing process. The Director argues that the court in *Utilicorp* held that "equipment used in the transmission and distribution of electricity was not directly used in manufacturing the electricity." Resp. brief at 10, citing *Utilicorp*, 75 S.W.2d at 728-729. Accordingly, the Director argues that, "As in *Utilicorp*, the materials and electrical components installed and sold by Dreyer are used to merely transmit and distribute electricity to the machinery in B&B's sawmill, not directly [to] manufacture a product." Resp. brief at 10.

The court in *Utilicorp* did not hold that any equipment used to transmit electricity is barred from the exemption found in §144.030.2(5). Instead, the court held that such equipment could not qualify under the manufacturing exemption if it was used to distribute or transmit a product already manufactured. Consequently, through the court's analysis it can be reasoned that if the court found that electrical equipment, such as transformers and voltage regulators, were directly related to the manufacturing side of a business, then they would qualify under the manufacturing tax exemption allowed by § 144.030.2(5). This is the fact situation in which Dreyer and B&B now finds themselves.

Both parties cite to *Emerson Electric Co. v. Director of Revenue,* 204 S.W.3d 642 (Mo. banc 2006), in their written arguments. Emerson was a corporation that manufactured electronic motors. Emerson sought a manufacturing exemption for machinery and equipment under § 144.030.2(5) from the Director for a computer assisted design (CAD) system,[14] stereolithography machine, and dynamometer. The court in *Emerson* made a distinction between research and development (R&D) and manufacturing. The court held that while R&D was necessary to production, it was separate from and preliminary to manufacturing. *Id*. at 646. In reaching this conclusion, the court applied the integrated plant doctrine, and determined that: 1) the CAD

[14] The CAD system allowed engineers to create 3-D versions of blueprints. *Emerson*, 204 S.W.3d at 644.

system, stereolithography machine, and dynamometer were necessary for production, 2) the physical distance between the equipment was not determinative, and 3) "[t]he disputed items do not operate 'harmoniously' with exempt machinery but rather they perform the 'prelude.' The disputed equipment does not operate with the exempt machines in a 'synchronized' system; the operations of the former must precede the work of the latter." *Id.* at 646. WEBSTER'S THIRD NEW INTERNATIONAL DICTIONARY (unabr. 1986) defines "synchronize" as "to happen or take place at the same time[.]" *Id.* at 2319.

The Director argues that the disputed items in this case, like in *Emerson*, are not harmonious to B&B manufacturing equipment because, while "electricity is essential to power machinery, the electrical components perform the 'prelude' to production." Resp. brief at 10. The Director further argues that, "The electrical components which make up the breaker boxes are sold separately from the rest of the machinery and can be disconnected from the machinery while leaving that machine intact." *Id.*

In *Emerson*, the court used the word "prelude" to differentiate R&D from the actual manufacturing of the products. It found that the items in dispute were used for "engineering design, protoyping, and sample testing," but not for manufacturing. *Id.* at 644. In this case, the disputed items are directly used in manufacturing. The items ensure that the machine motors operate, are protected from electrical spikes, do not overheat, and are directly wired into the machine motors. They are not a prelude to manufacturing, but directly assist in the manufacturing operation.

In *Empire District Electric Co. v. Director of Revenue*, Case No. RS-79-0249 (Mo. Admin. Hearing Comm'n March 29, 1983),[15] the taxpayer was in the business of manufacturing

[15] This Commission's previous decisions do not have precedential authority. *Central Hardware Co. v. Director of Revenue*, 887 S.W.2d 593, 596 (Mo. banc 1994). This case is cited at the end of 12 CSR 10-111.010.

and distributing electricity. This Commission held that the taxpayer's set-up transformer served two functions. First, it transmitted and distributed electricity, which we concluded was not part of the manufacturing process because the electricity had already been manufactured and the transformer was merely distributing it.[16] This is the same rationale found in *Utilicorp*. Second, this Commission concluded that the transformers also started the generators several times a year, and because the starting function was part of the manufacturing process, the transformer was exempt. In reaching this decision, this Commission concluded that the transformer did not need to be used exclusively or even primarily in the manufacturing process. Instead, it needed to be "directly used" in the process, which means it is '"essential to and comprise[s] an integral part of" the manufacturing process." *Empire District Electric Co*. at *7, quoting *Noranda Aluminum v. Missouri Department of Revenu*e, 599 S.W.2d 1, *4 (Mo. 1980) (an aluminum metal and products manufacturer could exempt the purchase of a device designed to prevent spillage of molten aluminum onto portions of the electrical system of each of its reduction cell because the device was "essential to and comprised an integral part of [the taxpayer's] manufacturing process and were 'used directly for manufacturing or fabricating a product as the term is used in Section 144.030 RSMo 1969").[17]

The disputed items in this case are replacement equipment used directly in B&B's manufacturing process because: a) they are necessary to the production of B&B's products because they deliver electricity to the manufacturing machines in a proper manner required by the machines themselves and the power company, they help operate the machines, and they provide safety features; b) they are close, physically and causally, to the finished product; and

[16] The Commission cited as authority *Niagara Mohawk Power Corp. v. Wanamaker*, 144 N.Y.S.2d 458 (1955).

[17] The court in *Southwestern Bell* stated that it discussed in *Noranda*, "that equipment at issue was 'used in steps or operations that ware essential to and comprise an integral part of [the] manufacturing process, and [was therefore,] used directly for manufacturing or fabricating a product." *Southwestern Bell*, 182 S.W.3d at 230-231, quoting *Noranda* 599 S.W.2d at 4 (internal citations omitted).

c) they operate harmoniously with the exempt manufacturing machinery to make integrated and synchronized systems because they power the machines, make sure the machines operate efficient and safely, were designed specifically for each of the machinery's motors, are wired into the motors, and work at the same time as the machinery. The disputed items do not actually change the makeup of the logs or directly touch B&B's products, but this is not a requirement of the integrated plant doctrine.

Accordingly, Dreyer is entitled to a tax refund of sales tax it paid to the Director based on B&B's purchase of the disputed items because the items constitute replacement machinery that is used directly by B&B to manufacture its products, which are intended to be sold ultimately for final use or consumption pursuant to § 144.030.2(5).

Summary

Dreyer is entitled to a refund of the sales tax it remitted on sales of the disputed items to B&B in the amount of $6,336.61, plus statutory interest at 6% per annum pursuant to § 621.050.2.

SO ORDERED on June 13, 2019.

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RENEE T. SLUSHER
Commissioner