

Missouri Supreme Court: Financial services hardware and software does not qualify for sales tax manufacturing exemption

Overview

On April 5, 2016, in *IBM Corporation vs Director of Revenue*¹, the Missouri Supreme Court overturned an Administrative Hearing Commission decision and held that hardware and software sold to a credit card company did not qualify for an exemption from sales tax because the credit card company's use of the hardware and software did not qualify as "manufacturing ...of any product" under the exemption statute.²

In this tax alert, we summarize the Missouri Supreme Court's decision in *IBM Corporation v. Director of Revenue* and provide some taxpayer considerations.

Background

A credit card company purchased computer hardware and software from IBM for use in providing various financial services to its customers including what are referred to as "ACS services"—authorization, clearing, and settlement of transactions made with bank-issued credit and debit cards.³

In 2012, IBM sought a refund of use tax on behalf of the credit card company for purchases of computer hardware and software, asserting that the equipment was exempt from use tax because the credit card company's activities qualify as "manufacturing" under section 144.054.2.⁴ Pursuant to this statute, "equipment and materials used or consumed in the manufacturing, processing, compounding, mining, or producing of any product..." are exempt.⁵ The Administrative Hearing Commission (Commission) granted IBM's refund, finding that the credit card company's activities could not be distinguished from earlier decisions of the Missouri Supreme Court in which the Commission believed the Court had broadly construed the manufacturing exemption, notably two cases involving Southwestern Bell in which the Missouri Supreme Court had held that the transmission of a voice over telephone lines qualified as "manufacturing."⁶ In both *Bell* decisions, the court had stated that "voices transmitted over a telephone are 'products' that are 'manufactured' into electronic impulses that can be transmitted and reproduced into an understandable replica."⁷

The Director of Revenue (Director) sought a review of the Commission's decision. The Missouri Supreme Court denied IBM a use tax exemption on hardware and software it sold to the credit card company because the credit card company's ACS services did not qualify as manufacturing a product as was required under the Missouri exemption statute.

Credit card company's activities did not qualify as manufacturing of a product under section 144.054.2

Pursuant to 144.054.2, an exemption from Missouri sales or use tax is provided for "[m]achinery, equipment and materials which are used or consumed in the manufacturing, processing, compounding, mining, or producing of any product...."⁸

Acknowledging that the Missouri Supreme Court has held that the production of intangible products such as computer data may be "manufacturing," it rejected the idea that every use of a computer to aid a business or transmit information is "manufacturing."⁹ Referencing the "long recognized" principle that exemptions from taxation are to be strictly construed against a taxpayer, and any doubt is resolved in favor of taxing the transaction at issue,¹⁰ the Missouri Supreme Court held that the "[credit card company's] computers do not "manufacture" a

¹ *IBM Corporation v. Director of Revenue*, No. SC94999, at *1 (Mo. banc April 5, 2016, modified May 24, 2016), available [here](#).

² *Id.* at *2.

³ *Id.* at *3.

⁴ *Id.* at *4.

⁵ *Id.*; RSMo § 144.054.2.

⁶ *IBM Corporation*, No. SC94999 at 4 citing *Southwestern Bell Tel. Co. v. Dir. of Revenue*, 78 S.W.3d 763, 768 (2002) ("Bell I") and *Southwestern Bell Tel. Co. v. Dir. of Revenue*, 182 S.W.3d 226 (2005) ("Bell II").

⁷ *Id.* at 4 quoting *Southwestern Bell Tel. Co. v. Dir. of Revenue*, 78 S.W.3d 763, 768 (2002).

⁸ Sec. 144.054.2

⁹ *IBM Corporation*, No. SC94999, at *6.

¹⁰ *Id.*

tangible or intangible product.” “Rather, they receive information, analyze and make determinations based on this information, and relay these determinations to their customers.”¹¹ Citing its 2014 decision in *Union Electric*, the Missouri Supreme Court stated that “[t]his type of activity is not ‘manufacturing’ under section 144.054.2 or under the common lay terminology one uses in speaking of analyzing credit card transactions.”¹²

The Missouri Supreme Court also noted, “[h]ad the legislature intended section 144.054.2 to apply to the processing of credit card transactions, it could have included additional language within the exemption so indicating, rather than relying on an unreasonably broad interpretation of ‘manufacturing’ inconsistent with this Court’s most basic rule of interpreting exemptions narrowly. Moreover, one does not speak of the transmission and analysis of credit card data as ‘manufacturing.’”¹³

The court further stated that, “[t]o the extent cases such as *Bell I* and *Bell II* suggest that an expansive interpretation of the word ‘manufacturing’ is authorized by the ‘manufacturing’ exemption, and to the extent that they hold that the electronic transfer of voices is itself manufacturing as that term is used in the exemption, they are no longer to be followed.”¹⁴

Considerations

IBM has 90 days from entry of judgment to file a writ of certiorari seeking leave to appeal to the US Supreme Court.¹⁵ Notwithstanding, taxpayers may wish to consult with their tax advisers if they have relied on an expansive definition of manufacturing, pursuant to *Bell I* and *Bell II*.

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¹¹ *Id* at *9.

¹² *Id. citing Union Electric Co. v. Dir. Of Revenue* 425 S.W.3d 118, 123 (2014).

¹³ *Id* at *12.

¹⁴ *Id* at *13.

¹⁵ SUP. CT. R. 13.