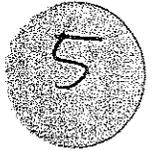


A08-1632



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STATE OF MINNESOTA

IN SUPREME COURT

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McLane Minnesota, Inc.,

Relator,

v.

Commissioner of Revenue,

Respondent.

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BRIEF  
OF  
RELATOR MCLANE MINNESOTA, INC.

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**TABLE OF CONTENTS**

	<u>Page</u>
TABLE OF AUTHORITIES .....	iv
STATEMENT OF ISSUES .....	1
STATEMENT OF CASE.....	2
STATEMENT OF FACTS .....	3
ARGUMENT .....	6
I. THE STATUTORY BASE (MEASURE) OF THE TOBACCO PRODUCTS TAX IS ALWAYS THE MANUFACTURER’S LIST PRICE AND NOT THE LIST PRICE OF A NON-MANUFACTURER SUPPLIER THAT SELLS PRODUCTS TO THE TAXABLE DISTRIBUTOR. ....	6
A. The Minnesota Tobacco Tax Is Imposed on the Product, and the Tax Base Is the Manufacturer’s List Price. It Is Not Imposed on a Transaction.....	6
B. For Tax Periods May 2002 through June 2003, the Tax Base (Tax Measure) Was the Manufacturer’s List Price Rather than the List Price of McLane’s Non-Manufacturer Suppliers.....	9
1. For Tax Periods May 2002 through June 2003, the Statute Defining the Tax Base Reveals that the Measure of the Tobacco Products Tax Is a Fixed and Certain Price—the Manufacturer’s List Price. ....	9
2. The Tax Court Erred in Its Conclusion that the Base of the Tobacco Products Tax Is the List Price of McLane’s Non-Manufacturer Suppliers.....	11
a) The Tax Court’s Misguided Focus on Treating the Tobacco Tax as a Tax on a Transaction Tainted the Court’s Analysis of Identifying the Proper Base of the Tobacco Products Tax and Caused It to Err as a Matter of Law.....	12
b) The Tax Court Erred as a Matter of Law in Determining that the Tax Base Is the List Price of Any Non-Manufacturer “Person” Who Sells Products to a Taxable Minnesota Distributor.....	13

c)	The Tax Court Made Several Errors of Fact in Its Opinion Which Caused It to Misapply Even Its Own Erroneous Standard for the Tax Base. ....	18
C.	For Tax Periods July 2003 through June 2005, the Statute Defining the Tax Base States that the Measure of the Tobacco Products Tax Is the Manufacturer’s List Price. ....	19
1.	The Tobacco Products Tax Statutes Reveal that the Base of the Tobacco Products Tax Is a Fixed and Certain Price—the Manufacturer’s List Price. ....	19
2.	The Tax Court Erred in Its Conclusion that the Base of the Tobacco Products Tax Is the List Price of McLane’s Non-Manufacturer Suppliers.....	22
a)	When Faced with an Ambiguity in this Tax Statute, Which Its Flawed Analysis Had Caused It to Encounter, the Tax Court Erred as a Matter of Law by Not Resolving the Ambiguity in Favor of the Taxpayer. ....	23
b)	In Its Consideration of the Ambiguities It Perceived, the Tax Court Made Yet Additional Errors in Construing the Language of the 2003 Version of the Statute and Concluded Its Analysis with Four Reasons, None of Which Survive Scrutiny.....	24
c)	The Tax Court Judicially Amended the Statute that Defines the Tax Base Instead of Resolving the Ambiguity for the Taxpayer. ....	28
d)	The Tax Court Made the Same Errors of Fact that It Had Made in Its Analysis of the Pre-2003 Version of the Statute, Causing It to Misapply Even Its Own Erroneous Standard for the Tax Base. ....	29
II.	IF THE TOBACCO PRODUCTS TAX WERE BASED ON THE LIST PRICE OF THE TAXABLE DISTRIBUTOR’S SUPPLIER, THEN THE TOBACCO PRODUCTS TAX WOULD VIOLATE THE COMMERCE CLAUSE OF THE U.S. CONSTITUTION.....	30
A.	Statutes Should Be Interpreted to Avoid an Unconstitutional Result.....	30
B.	The Interpretation that the Base of Minnesota’s Tobacco Products Tax Is the List Price of the Taxable Distributor’s Supplier Is in Conflict with the Commerce Clause.....	30

1.	The Commerce Clause Prohibits Taxing Products that Have Traveled Through Interstate Commerce More Heavily Than Products that Have Not Traveled Through Interstate Commerce.....	31
2.	A “Shifting Tax Base,” Which Causes the Tobacco Tax to Fall More Heavily on Products That Have Traveled In Interstate Commerce, Discriminates Against Interstate Commerce.....	33
3.	A Tax Burden that Increases Based on the Amount a Tobacco Product has Traveled Through Interstate Commerce Outside Minnesota Discriminates Against Tobacco Products Manufactured and Distributed Outside the State.....	35
C.	The Commerce Clause Forbids All Forms of Discrimination Against Interstate Commerce, Regardless of Mechanism. The Tax Court Failed to Analyze the Commerce Clause Implications of Its Interpretation of the Tobacco Products Tax in Accordance with Long-Standing Commerce Clause Jurisprudence.....	41
1.	The Tax Court Erred In Concluding that Its Interpretation of the Tobacco Products Tax Does Not Violate the Commerce Clause Because the Tax Applies Equally to In-State and Out-of-State Parties.....	42
2.	The Tax Court Erred in Concluding that Its Interpretation of the Tobacco Products Tax Is Constitutional Because It Taxes Only In-State Activity.....	46
3.	The Tax Court Erred in Concluding that Its Interpretation of the Tobacco Products Tax Is Constitutional Because It Is Imposed at a Uniform Rate.....	46
4.	The Tax Court Erred In Suggesting McLane’s Commerce Clause Argument Was Mere Dissatisfaction With Its Tax Liability that Was Caused By the Reorganization of the Tobacco Companies.....	48
	CONCLUSION.....	49

## TABLE OF AUTHORITIES

Page(s)

### FEDERAL CASES

<u>Best &amp; Co. v. Maxwell</u> , 311 U.S. 454 (1940).....	32, 33, 42, 47
<u>Bacchus Imports, Ltd. v. Dias</u> , 468 U.S. 263 (1984).....	32, 43
<u>Brown v. Maryland</u> , 25 U.S. 419 (1827) .....	43
<u>Commonwealth Edison Co. v. Montana</u> , 453 U.S. 609 (1981) .....	46
<u>Complete Auto Transit Inc. v. Brady</u> , 430 U.S. 274 (1977),.....	31
<u>Fulton Corp. v. Faulkner</u> , 516 U.S. 325 (1996) .....	34, 42
<u>Granholm v. Heald</u> , 544 U.S. 460 (2005) .....	31
<u>Halliburton Oil Well Cementing Co. v. Reily</u> , 373 U.S. 64 (1963).....	33, 34, 47
<u>I.M. Darnell &amp; Son Co. v. City of Memphis</u> , 208 U.S. 113 (1908).....	32, 40
<u>Kraft General Foods, Inc. v. Iowa Department of Revenue &amp; Finance</u> , 505 U.S. 71 (1992) .....	42
<u>Oregon Waste Systems, Inc. v. Department of Environmental Quality</u> , 511 U.S. 93 (1994).....	31, 42
<u>Quill Corp. v. North Dakota</u> , 504 U.S. 298 (1992).....	31
<u>Walling v. Michigan</u> , 116 U.S. 446 (1886).....	32
<u>West Lynn Creamery Inc. v. Healy</u> , 512 U.S. 186 (1994).....	32, 43, 46

### STATE CASES

<u>Busch v. Commissioner of Revenue</u> , 713 N.W.2d 337 (Minn. 2006).....	3
<u>Chapman v. Commissioner of Revenue</u> , 651 N.W.2d 825 (Minn. 2002).....	31
<u>Charles W. Sexton Co. v. Hatfield</u> , 116 N.W.2d 574 (Minn. 1962).....	23

Green Giant Co. v. Commissioner of Revenue, 534 N.W.2d 710 (Minn. 1995) .....28

Head v. Special Sch. District No. 1, 182 N.W.2d 887 (Minn. 1970), overruled on other grounds by Nyhus v. Civil Serv. Bd., 232 N.W.2d 779 (Minn. 1975).....30

Hutchinson Tech., Inc. v. Commissioner of Revenue, 698 N.W.2d 1 (Minn. 2005) .....30

Kansas Tobacco-Candy Distributors & Vendors, Inc. v. McDonald, 519 P.2d 1110 (Kan. 1974) .....47

Kmart Corp. v. County of Stearns, 710 N.W.2d 761 (Minn. 2006) .....3

Manpower, Inc. v. Commissioner of Revenue, 724 N.W.2d 526 (Minn. 2006) .....3

McLane Co. v. Department of Revenue, 19 P.3d 1119 (Wash. Ct. App. 2001).....47

McLane Western, Inc. v. Colorado Department of Revenue, 126 P.3d 221 (Colo. Ct. App. 2005).....44

Northland Country Club v. Commissioner of Taxation, 241 N.W.2d 806 (Minn. 1976) .....23

**FEDERAL STATUTES**

U.S. Const. Art. I, § 8, cl. 3.....30

**STATE STATUTES**

Minn. Laws 1955, ch. 2, art. 5, § 1 .....7

Minn. Laws 1997, ch. 106, art. 1, § 1 .....7

Minn. Laws 1999, ch. 243, art. 7, § 9 .....7, 14

Minn. Laws 2003, ch. 127, art. 7, § 5 .....8, 10, 17

Minn. Stat. § 271.10, subd. 1 .....3

Minn. Stat. § 297A.62 .....9

Minn. Stat. § 297F.01, subd. 20 .....19, 35

Minn. Stat. § 297F.01, subd. 23 (Supp. 2003) (2004) .....8, 19, 20, 21

Minn. Stat. § 297F.01, subd. 23 (1998) .....10

Minn. Stat. § 297F.01, subd. 23 (2000) (2002).....9, 36

Minn. Stat. § 297F.01, subd. 23 (Supp. 1997) .....7

Minn. Stat. § 297F.03.....3

Minn. Stat. § 297F.05, subd. 1 .....6, 8

Minn. Stat. § 297F.05, subd. 3 .....6, 9, 15, 35, 39

Minn. Stat. § 645.08(1) .....9

Minn. Stat. § 645.17 .....26, 30

**OTHER**

Jerome R. Hellerstein & Walter Hellerstein, State Taxation ¶ 4.13 [2][k][xi] .....45

## STATEMENT OF ISSUES

(1) Whether the base of the tobacco products tax is the manufacturer's list price or the list price of the taxable distributor's non-manufacturer suppliers?

Trial Court Held: The base of the tobacco products tax is the list price of the taxable distributor's non-manufacturer suppliers.

*Authorities:*

Minn. Stat. § 297F.01, subd. 23 (2002)

Minn. Stat. § 297F.01, subd. 23 (Supp. 2003) (2004)

(2) Whether there is an undue burden upon interstate commerce in violation of the Commerce Clause of the U.S. Constitution when the State imposes a tax on tobacco products that has a shifting tax base that causes the tax to increase as the tobacco products travel through interstate commerce?

Trial Court Held: The tobacco products tax does not violate the Commerce Clause of the U.S. Constitution.

*Authorities:*

Bacchus Imps., Ltd. v. Dias, 468 U.S. 263 (1984)

W. Lynn Creamery Inc. v. Healy, 512 U.S. 186 (1994)

Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64 (1963)

## STATEMENT OF CASE

This is a review by certiorari of Order of the Tax Court, Honorable Kathleen Sanberg, denying Relator McLane Minnesota Inc.'s (hereinafter "McLane") refund claim for overpayment of tobacco product taxes. (See Order, July 21, 2008 at A-61<sup>1</sup>; Order Granting Appellee's Mot. for Partial Summ. J. & Den. Appellant's Mot. for Partial Summ. J., Feb 5, 2008 at A-42 to A-60 [hereinafter "Tax Court Order"].)

McLane filed a refund claim with the Respondent Commissioner of Revenue (hereinafter "Commissioner") for May 1, 2002, through June 30, 2005, on the ground that it had overpaid tobacco products taxes because it had erroneously calculated its tax on the price that McLane had paid its non-manufacturer suppliers for tobacco products rather than on the manufacturer's list price. McLane also contested the Commissioner's assessment of additional taxes on tobacco products that the Commissioner had determined were products sold with a discount, promotional offer, or other reduction. The Commissioner denied McLane's refund claim and affirmed the assessment.

McLane appealed to the Minnesota Tax Court (hereinafter "Tax Court"). The Commissioner and McLane submitted the refund claim to the Tax Court on cross motions for partial summary judgment. The Tax Court granted the Commissioner's motion and denied McLane's motion. (See Tax Court Order at A-42 to A-60.) The parties later reached a settlement regarding the Commissioner's assessment of additional taxes on tobacco products that the Commissioner had determined were products sold with a

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<sup>1</sup> Citations in the form "A-\_\_\_" refer to pages of Relator's Appendix.

discount, promotional offer, or other reduction. Upon approving the settlement, the Tax Court issued a final Order which entered final judgment on its earlier issued summary judgment orders. (See Order, July 21, 2008 at A-61.)

McLane appealed to this court with a petition for writ of certiorari.<sup>2</sup>

### **STATEMENT OF FACTS**

McLane distributes food, candy, cigarettes, and tobacco products to grocery, convenience stores, and mass merchandisers in Minnesota and seven other states. (See Koch Aff. ¶ 6.) The tobacco products that McLane sells include smokeless tobacco, snuff, and little cigars. (See *id.*) McLane has been licensed as a Minnesota “tobacco products distributor” under Minn. Stat. § 297F.03 since May 2002. (DeMeules Aff., Ex. 9.)

McLane purchases 90–95% of its tobacco products from two distributors: UST Sales and Conwood Sales.<sup>3</sup> (Gilliam Dep. 32-33.) UST Sales and Conwood Sales are

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<sup>2</sup> The Minnesota Supreme Court reviews final orders of the Tax Court to determine whether the Tax Court had jurisdiction, whether the order of the Tax Court was not justified by the evidence or was not in conformity with law, or whether the Tax Court committed any other errors of law. Minn. Stat. § 271.10, subd. 1 (2006).

In a summary judgment context where the facts are undisputed, the Court reviews the Tax Court’s legal determinations, including the interpretation of statutes, *de novo*. Manpower, Inc. v. Comm’r of Revenue, 724 N.W.2d 526, 528 (Minn. 2006) (citing Busch v. Comm’r of Revenue, 713 N.W.2d 337, 342 (Minn. 2006)). The Minnesota Supreme Court is “not bound by decisions of the Tax Court, especially in the area of statutory interpretation.” Kmart Corp. v. County of Stearns, 710 N.W.2d 761, 765 (Minn. 2006).

<sup>3</sup> McLane refers to the distributors from whom it purchases tobacco products as UST Sales and Conwood Sales for convenience, as their corporate names have changed several times.

themselves licensed Minnesota distributors of tobacco products. (See Tamaro Aff., Ex. 8.) Neither UST Sales nor Conwood Sales manufactures tobacco products. (See id. ¶¶ 22-23 at A-81; Street Aff. ¶¶ 3-4 at A-86.) Instead, they purchase tobacco products from manufacturers of tobacco products. (See Tamaro Aff. ¶ 10 at A-80; Street Aff. ¶¶ 3-7 at A-86 to A-87.)

UST Sales purchases tobacco products from UST Manufacturing, which is a manufacturer of tobacco products. (See Tamaro Aff. ¶¶ 8, 10 at A-79 and A-80.) UST Sales and UST Manufacturing are related entities. UST Sales is a Minnesota tobacco products distributor. (Id. ¶¶ 24-25 at A-82.) It buys, markets, promotes, and distributes tobacco products for resale. (Id. ¶¶ 10, 20-21, 26-27, 29 at A-80 to A-82.) UST Sales sells tobacco products for a higher price than that for which UST Manufacturing sells tobacco products because UST Sales increases the value of the tobacco products it buys through an array of activities including sales, marketing, promotions, product sampling, and distribution. (See id. ¶ 30 at A-82.)

Similarly, Conwood Sales purchases tobacco products from a related entity called Conwood Manufacturing through an intermediary—Rosswil, LLC. (See Street Aff. ¶¶ 7-8 at A-87.) Conwood Manufacturing manufactures tobacco products. (See id. ¶ 3 at A-86.) Conwood Sales buys, markets, promotes, and distributes tobacco products for sale. Conwood Sales is a licensed Minnesota distributor. (See Tamaro Aff., Ex. 8.)

For convenience, the Conwood and UST manufacturing entities will be referred to generally as “Manufacturing” and their sales entities will be referred to as “Sales.”

When Sales receives a purchase order for smokeless tobacco products from McLane, Sales orders the requested products from Manufacturing. (See, e.g., id. ¶ 18 at A-81.) Manufacturing transfers ownership of the products to Sales outside Minnesota. (See, e.g., id.) Sales retains ownership of the tobacco products until they are delivered to McLane's warehouse in Northfield, Minnesota. (See, e.g., id.) Upon delivery and acceptance of the tobacco products by McLane, Sales transfers ownership (including title and risk of loss) of the tobacco products to McLane. (See, e.g., id. ¶ 19 at A-81.)

On June 30, 2005, McLane filed a refund claim. In its refund claim, McLane recalculated its tax, basing its tobacco products tax liability on the list prices for which Manufacturing sells tobacco products to Sales. (See Gilliam Aff. ¶ 5 at A-71.) The prices were taken from Manufacturing's price lists. (See id.) The price lists show the amounts for which Manufacturing sells tobacco products to the distributors with which it does business—Sales. (See Tamaro Aff. ¶ 11, Ex. 2 at A-80 and A-85; Street Aff. ¶ 12, Ex. A at A-87 and A-88 to A-89; Gilliam Aff. ¶ 4, Attachment 2 at A-70 and A-73 to A-77; Gilliam Aff. ¶ 3, Attachment 1 at A-70 and A-72.)

The Commissioner denied the refund claim.

## ARGUMENT

### **I. THE STATUTORY BASE (MEASURE) OF THE TOBACCO PRODUCTS TAX IS ALWAYS THE MANUFACTURER'S LIST PRICE AND NOT THE LIST PRICE OF A NON-MANUFACTURER SUPPLIER THAT SELLS PRODUCTS TO THE TAXABLE DISTRIBUTOR.**

#### **A. The Minnesota Tobacco Tax Is Imposed on the Product, and the Tax Base Is the Manufacturer's List Price. It Is Not Imposed on a Transaction.**

Minn. Stat. § 297F.05, subd. 3 imposes a tax on tobacco products:<sup>4</sup>

Subd. 3. **Rates; tobacco products.** A tax is imposed upon all tobacco products in this state and upon any person engaged in business as a distributor, at the rate of 35 percent of the wholesale sales price of the tobacco products. The tax is imposed at the time the distributor:

- (1) brings, or causes to be brought, into this state from outside the state tobacco products for sale;
- (2) makes, manufactures, or fabricates tobacco products in this state for sale in this state; or
- (3) ships or transports tobacco products to retailers in this state, to be sold by those retailers.

Minn. Stat. § 297F.05 subd. 3 (2002) (2004).

The tax is thus imposed on the product itself. It is imposed upon the distributor only in the sense that the distributor is obligated to pay the tax. Moreover, Subdivision 3 provides that the tax is imposed at a certain time, which demonstrates that the objective of the Legislature is to tax the product when it first enters the state. This is so because the tax is imposed when the product is brought into the state, when it is manufactured in the state, or when it is shipped directly to a retailer in the state.

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<sup>4</sup> The taxing provision specifically imposes the tax on tobacco products other than cigarettes, which are subject to a separate tax. See Minn. Stat. § 297F.05, subd. 1. (2006).

The amount of tax a distributor has to pay on tobacco products is measured by, or “based” on, 35% of what the statute refers to as the “wholesale sales price” of the tobacco products. The phrase “wholesale sales price” is a defined term in the tobacco products tax scheme.

In 1955 the Minnesota Legislature enacted the “wholesale price” definition provision and codified it in Minnesota Statutes section 297.31, subdivision 9. See Minn. Laws 1955, ch. 2, art. 5, § 1. As enacted, the provision stated,

“Wholesale price” means the established price for which a manufacturer sells a tobacco product to a distributor, exclusive of any discount or other reduction.

Id. This provision was recodified in 1997. See Minn. Laws 1997, ch. 106, art. 1, § 1; Minn. Stat. § 297F.01, subd. 23 (Supp. 1997).

Traditionally therefore, the tax base of the tobacco tax has been the manufacturer’s “established price.” The Legislature twice amended the definition in recent years with clarifying amendments which were not intended to change the base of the tax.

In 1999, the Legislature passed the first clarification, see infra pp. 14-17, of the definition of “wholesale price”:

Subd. 23. [WHOLESALE PRICE.] “Wholesale price” means the established price for which a manufacturer or person sells a tobacco product to a distributor, exclusive of any discount or other reduction.

Minn. Laws 1999, ch. 243, art. 7, § 9. This provision is applicable to tax periods May 2002 through June 30, 2003 for which McLane seeks a refund in the instant case.

Effective July 1, 2003, the Legislature once again clarified, see infra pp. 20-21, what it meant by “wholesale sales price” by amending the definition of “wholesale price” as follows:

Subd. 23. [WHOLESALE SALES PRICE.] “Wholesale sales price” means the established price stated on the price list in effect at the time of sale for which a manufacturer or person sells a tobacco product to a distributor, exclusive of any discount, promotional offer, or other reduction. For purposes of this subdivision, “price list” means the manufacturer’s price at which tobacco products are made available for sale to all distributors on an ongoing basis.

Minn. Laws 2003, ch. 127, art. 7, § 5; see also Minn. Stat. § 297F.01, subd. 23 (Supp. 2003) (2004). This provision is applicable to tax periods July 1, 2003 through June 30, 2005 for which McLane seeks a refund.

The terms “established price” in the pre-2003 version of the definition and the terms “price list” and “manufacturers price at which tobacco products are made available for sale to all distributors on an ongoing basis” in the post-2003 version make it clear that the tobacco products tax is a tax on a product that has a fixed and certain tax base—the manufacturer’s list price, rather than a shifting base such as the price in a transaction. The statute does not provide that the tax base is “the” price for which a manufacturer or person sells the product. The base instead is the manufacturer’s “established price” (pre-2003) or the manufacturer’s “price list” price (post-2003) in effect when the product is sold to a distributor.

The tobacco tax is unlike some other taxes, which are taxes on transactions. For example, the Minnesota cigarette tax is imposed “upon the sale of cigarettes” or possessing cigarettes with “intent to sell.” See Minn. Stat. § 297F.05 subd. 1 (2002)

(2004). The tobacco tax is also unlike the Minnesota sales tax, which is imposed on “gross receipts from retail sales . . . made in this State.” See Minn. Stat. § 297A.62.

The definition makes clear that the tobacco products tax is imposed on the tobacco products themselves and not on the sale of products. Minn. Stat. § 297F.05, subd. 3. The base, or measure, of the tax is that on which the tax is computed—the “wholesale sales price” of tobacco products, which the Legislature has defined as the manufacturer’s list price.

**B. For Tax Periods May 2002 through June 2003, the Tax Base (Tax Measure) Was the Manufacturer’s List Price Rather than the List Price of McLane’s Non-Manufacturer Suppliers.**

**1. For Tax Periods May 2002 through June 2003, the Statute Defining the Tax Base Reveals that the Measure of the Tobacco Products Tax Is a Fixed and Certain Price—the Manufacturer’s List Price.**

Minn. Stat. § 297F.01, subd. 23 (2002) was applicable during the May 1, 2002 to July 1, 2003 tax periods at issue. It provided:

**Subd. 23. Wholesale price.** “Wholesale price” means the established price for which a manufacturer or person sells a tobacco product to a distributor, exclusive of any discount or other reduction.

Minn. Stat. § 297F.01, subd. 23 (2000) (2002) (emphasis added).

Because the phrase “established price” is not defined in the statutes, its common and approved usage governs. Minn. Stat. § 645.08(1) (2006).

Webster’s Third New International dictionary defines “establish” as follows:

**1 a :** to make firm or stable . . . **b :** to place, install, or set up in a permanent or relatively enduring position . . . **2 a :** to settle or fix after consideration or by enactment or agreement.

Webster's Third New International Dictionary Unabridged 778 (1986).

When the term "established price" is considered in combination with the remaining language in the definition—that it be the "established" price for which a manufacturer or person sells a tobacco product to a distributor—it is clear that what the Legislature had in mind was a "list price" contained on a price list.

That "established price" means manufacturer's list price is borne out by the clarifying amendments of 1999 and 2003. Before 1999, the base of the tax was "the established price for which a manufacturer sells a tobacco product." Minn. Stat. § 297F.01, subd. 23 (1998). In 1999, as discussed infra at pages 14 to 17, the Legislature passed a "clarifying amendment." The amendment clarified the pre-1999 provision and was not a change in the law. See Minn. Dep't of Revenue Submission to Senate Taxes Comm. (Feb. 1, 1999); infra pp. 14-17. That the Legislature never intended to change the base of the tax is further evidenced by another clarifying amendment that it passed in 2003. In 2003, the Legislature unambiguously explained through newly-enacted language that "established price" means "price list" and that "price list" means "manufacturer's price." See Minn. Laws 2003, ch. 127, art. 7, § 5. It is therefore clear that the Legislature has always intended for the base of the tax to remain fixed and certain as the manufacturer's list price.

In addition, the definition of "wholesale price" in effect after 1999 recognizes that either a manufacturer or some other person can sell tobacco products at the manufacturer's established price, or list price, of tobacco products. The phrase "or person" in the definition merely explains that tobacco products may be sold by suppliers

who are not manufacturers at the same manufacturer's established price. Regardless of who sells the tobacco products or who imports them into the state, the base of the tax remains the manufacturer's list price. See infra pp. 15-16.

Applying this tax base to this case, it is plain that the Tax Court was wrong in its conclusions. On the undisputed facts in this case, the measure/base of the tax is the list price of Manufacturing to the distributors with whom it does business—Sales. Both UST Sales and Conwood Sales are licensed distributors of tobacco products in Minnesota. (Tamaro Aff., Ex. 8.) Manufacturing sells tobacco products at established (list) prices to distributors. Those prices are on price lists contained in the record. (See Tamaro Aff. ¶ 11, Ex. 2 at A-80 and A-85; Street Aff. ¶ 12, Ex. A at A-87 and A-88 to A-89; Gilliam Aff. ¶ 4, Attachment 2 at A-70 and A-73 to A-77; Gilliam Aff. ¶ 3, Attachment 1 at A-70 and A-72.) Those prices, therefore, meet the definition of “wholesale price” and are determinative of the base of the tobacco products tax.

**2. The Tax Court Erred in Its Conclusion that the Base of the Tobacco Products Tax Is the List Price of McLane's Non-Manufacturer Suppliers.**

The Tax Court at page 9 found otherwise. In an opinion in which it used the terms “price paid” and “list price” as though it regarded the two to be synonyms, it appears to have held that the “or person” language added in 1999 requires that the measure of the tax be the list price for which McLane purchases tobacco products from its non-manufacturer suppliers.

**a) The Tax Court's Misguided Focus on Treating the Tobacco Tax as a Tax on a Transaction Tainted the Court's Analysis of Identifying the Proper Base of the Tobacco Products Tax and Caused It to Err as a Matter of Law.**

The Tax Court's errors of law started with its misperception of what the tobacco tax is imposed upon. The opinion is full of references to transactions (Tax Court Order 8 & n.20 at A-49), the parties to transactions (id.), and prices paid (id. at 9 at A-50). And, the Court vacillated between using the term price paid (id.) and list price (id.), seemingly confusing the two. Ultimately, it seemed to lose sight of the fact that list price is the tax base, concluding that "the price McLane paid Sales is the base for Tobacco Products Tax prior to July 2003." (Id.)

Assuming that the Court ultimately held that it is the list price, not the price paid (or sales price), of the non-manufacturer supplier that determines the tax base, the Court erred. Its error and its confused analysis are a function of its misunderstanding of what the tobacco tax is imposed upon. The tobacco tax is not upon the sale of products. It is not on a transaction. It is upon the product. The measure of the tax is not the price in a particular transaction. Rather, it is measured by the established price (or "list price") of the product itself, which the Legislature has set at the manufacturer's list price. The only relevance of the transaction in determining the tax base is that it fixes a point in time that identifies what the "current" price list is. The Tax Court's confusion prevented it from seeing this fundamental of the tobacco tax and blighted its analysis.

**b) The Tax Court Erred as a Matter of Law in Determining that the Tax Base Is the List Price of Any Non-Manufacturer “Person” Who Sells Products to a Taxable Minnesota Distributor.**

The Legislature intended that the established price be that of the manufacturer and not that of a supplier that enters the picture later in the production/distribution chain.

This is evident because before 1999 the definition of “wholesale price” only mentioned the manufacturer’s list price. See supra p. 7. The addition of the “or person” language in 1999 was a clarification of the previous version, not a change. See infra pp. 14-17. And, the 2003 clarification of the definition then confirmed that the Legislature has all along intended that the base of the tax be the manufacturer’s list price. See infra pp. 17, 20-21. The Legislature never intended to change the base of the tax from being fixed and certain to one that changed depending on the list price of whomever acted as the supplier in a transaction with the Minnesota taxable distributor.

However, at pages 8-9 of its opinion, the Tax Court, laboring under confusion as to the nature of the tobacco tax, determined that the phrase “or person” added by the Legislature in 1999, required that the tax base be the list price of whatever supplier sells the product to a Minnesota taxable distributor, even though that supplier is not a manufacturer. It did so stating that were it to find otherwise, the words “or person” would have no effect. (See Tax Court Order 8 at A-49.)

In this, the Tax Court erred as a matter of law. It apparently thought the addition of the terms “or person” in 1999 was a change in the law. And it misperceived the purpose of the words “or person.”

The “or person” language was added to the definition of the tax base in 1999. See Minn. Laws 1999 ch. 243 art. 7, § 9. The language of the session law shows the language of the definition before and after the amendment:

Sec. 9. Minnesota Statutes 1998, section 297F.01, subdivision 23, is amended to read:

Subd. 23. **WHOLESALE PRICE.** “Wholesale price” means the established price for which a manufacturer or person sells a tobacco product to a distributor, exclusive of any discount or other reduction.

Minn. Laws 1999 ch. 243 art. 7, § 9.

The legislative history regarding this 1999 amendment makes clear that the amendment was not intended to change the law. It was repeatedly referred to instead as a clarification.

A Bill Summary (presented by the Department of Revenue) to the Senate Committee described the amendment as a clarification.<sup>5</sup>

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<sup>5</sup> Specifically, the summary said:

“Wholesale Price. Amends Minn. Stat. § 297F.01, subd. 23 to clarify that “wholesale price” means the established price for which a manufacturer or person sells a tobacco product to a distributor, exclusive of any discounts or reductions. This will clarify that the wholesale sales price is determined by the sales price of whomever imports the tobacco products into Minnesota, whether it is or is not a manufacturer. Effective the day following final enactment.”

Minn. Dep’t of Revenue Submission to Senate Taxes Comm. (Feb. 1, 1999) (emphasis added).

Brief testimony presented by a representative of the Department of Revenue to the House Tax Committee on February 2, 1999 also described the amendment as a clarification:

Finnegan: My name is Finnegan, I'm an attorney with the Department. I'll be going through articles four and five. Article four is a mixed bag of technical changes dealing with several special taxes within the department.

...

Traditionally tobacco products were shipped to the state directly from manufacturers and we're finding more and more that there are third party entities, so we're adding to the definition just the word "person" to clarify that the wholesale price is determined by whoever imports the tobacco products into Minnesota, whether or not it's the initial manufacturer.

Audiotapes of the Minnesota Legislature, Hearing Before the Minn. House Taxes Comm. on H.F. 380 (Feb. 2, 1999) (statement of P. Finnegan, Dep't of Revenue) (audiotape).

This testimony is the same as the language appearing on the Bill Summary submitted to the House. The statement by the testifying representative of the Department that the wholesale price is determined by "whoever imports the tobacco products" is consistent with the timing provision, which states that the tax is imposed at the time a distributor brings product into the state. See Minn. Stat. § 297F.05, subd. 3. So, a distributor that imports the product into the state, sets, or determines, the tax base. The addition of "or person" was likely seen by the Legislature as a reflection of the fact that sometimes persons other than tobacco manufacturers were importing<sup>6</sup> tobacco products

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<sup>6</sup> The common meaning of the term "import" is "to bring (as wares or merchandise) into a place or country from another country." Webster's Third New International Dictionary Unabridged 1135 (1986).

into Minnesota. The testimony is therefore consistent with concluding that the base of the tax is the manufacturer's list price because the distributor who brings, or "imports," the product into the state is Sales. (See, e.g., Tamaro Aff. ¶¶ 18-19 at A-81.)

A Bill Summary submitted to the House Works & Means Committee, while still referring to the change as a clarification, contained slightly different wording that could be interpreted to suggest that the wholesale price includes the established prices set by sellers other than manufacturers.<sup>7</sup>

Consequently, although the legislative history is not crystal clear, overall it contains repeated statements that the amendment was just a clarification.

A mere "clarification" would not contemplate a change in the measure of the tax, such as changing the fixed and certain measure consisting of the manufacturer's list price to a shifting list price of whatever non-manufacturer person sold tobacco products to a Minnesota distributor. And, a change in the measure from the manufacturer's list price to the list price of some supplier would certainly entail an increase in the base of the tax. Indeed, the more suppliers there are in the distribution chain outside the state, the higher the list price becomes, since it can be expected that each supplier in the chain will establish its price at a level which allows it to recover its expenses and to make a

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<sup>7</sup> The House Research Bill Summary stated:

Summary of Article 4: Special Taxes, No. 11: **"Wholesale price. Clarifies** that 'wholesale' price for the tobacco products tax includes established prices (excluding discounts) set by sellers other than manufacturers. Present law only refers to purchases from a manufacturer."  
House Research Bill Summary of H.F. 380 (Feb. 1, 1999) (emphasis added), available at <http://www.house.leg.state.mn.us/hrd/bs/81/hf0380a.html>.

reasonable profit. So, to change from a fixed and stable tax base (consisting of manufacturer's list price) to one which changes depending upon the list price of the supplier to the taxpayer distributor is a substantial change, not a clarification. Such a change would cause a constitutional problem as shown in Argument section II. See infra pp. 36-41.

Consequently, because the status quo prior to the 1999 amendment was that the tobacco tax was a tax upon the product measured by the price on the manufacturer's price list (the manufacturer's "established price") and the 1999 amendment was a clarification rather than a change in the tax base, the status quo after the amendment is no different. That is, the measure of the tax is still the manufacturer's list price.

That the intention of the Legislature in enacting the 1999 amendment was to keep the base of the tax at the manufacturer's list price is clearly confirmed by another clarifying amendment enacted in 2003. In this amendment, which is discussed more fully at Argument section I.C.1, see infra pp. 20-21, the Legislature specified first, that the wholesale sales price it intended as the measure of the tax was the price stated on the price list and, further, defined price list to be the manufacturer's price at which tobacco products are made available for sale to all distributors on an ongoing basis. See Minn. Laws 2003, ch. 127, art. 7, § 5. There is no mention of the list price of some other "person." Had it been the intention of the Legislature to change the tax base from a fixed base to one that shifted with the list price of the supplier to the taxable distributor that language would surely have been included.

Consequently, the base/measure of the tax for the period May 2002 through June 2003 is always the manufacturer's list price—whether the manufacturer or some other person imports the product into the state. The Tax Court erred as a matter of law in concluding otherwise.

**c) The Tax Court Made Several Errors of Fact in Its Opinion Which Caused It to Misapply Even Its Own Erroneous Standard for the Tax Base.**

The Tax Court made several errors of fact in its opinion which caused it to misapply even its own erroneous standard. First, it said that Sales (McLane's non-manufacturer suppliers) is not a distributor.<sup>8</sup> Second, it made a related factual error when it said that Sales does not bring tobacco products into Minnesota. (Tax Court Order 8 n.20 at A-49.) Third, the Tax Court stated that the manufacturing companies had no price lists. Specifically, it said that they had none available to McLane. (*Id.* at 5, 12 at A-46 and A-53.)

The undisputed facts before the Tax Court on the cross motions for summary judgment, however, were that both UST Sales and Conwood Sales are distributors of tobacco products. They are both licensed as tobacco products distributors by the Minnesota Department of Revenue. (*See* Tamaro Aff., Ex. 8.) They bring tobacco products to McLane's warehouse in Minnesota, where title passes within the meaning of

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<sup>8</sup> The Court determined that Sales could not itself be a distributor because "it did not manufacture tobacco products in Minnesota, did not bring tobacco products into Minnesota, and did not sell and ship tobacco products to retailers in Minnesota." (Tax Court Order 8 & n.20 at A-49.)

Minn. Stat. § 297F.01, subd. 20(1). (See, e.g., *id.* ¶¶ 18-19 at A-81.)<sup>9</sup> And, contrary to the Tax Court’s statements, the record in fact contains price lists of both UST Manufacturing and Conwood Manufacturing. (See *id.* ¶ 11, Ex. 2 at A-80 and A-85; Street Aff. ¶ 12, Ex. A at A-87 and A-88 to A-89; Gilliam Aff. ¶ 4, Attachment 2 at A-70 and A-73 to A-77; Gilliam Aff. ¶ 3, Attachment 1 at A-70 and A-72.)

Because the Sales companies are the importers of the products, even under the flawed legal analysis of the Tax Court, it is their purchase from the manufacturing companies and the manufacturer’s list price, which is pertinent to that purchase, that determines the tax base. Had the Tax Court correctly found that Sales was the importer, then it would have concluded that the base of the tax is the price Sales “paid as the importer of tobacco products into Minnesota.” (See Tax Court Order 9 n.27 at A-50.)

Consequently, even assuming that the Court’s legal analysis regarding the tax base were correct, it got the facts wrong, and erred in its ultimate conclusion.

**C. For Tax Periods July 2003 through June 2005, the Statute Defining the Tax Base States that the Measure of the Tobacco Products Tax Is the Manufacturer’s List Price.**

**1. The Tobacco Products Tax Statutes Reveal that the Base of the Tobacco Products Tax Is a Fixed and Certain Price—the Manufacturer’s List Price.**

The definition of “wholesale sales price,” found in Minn. Stat. § 297F.01, subd. 23 (Supp. 2003) (2004), is applicable for July 2003 through June 2005, the majority of the tax periods at issue. It became effective July 1, 2003. It confirms that the Legislature

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<sup>9</sup> The Tax Court, however, presumed that McLane was the “importer” despite the fact that it does not bring” OTP into Minnesota.

intended a fixed and certain tax base, consisting of the manufacturer's list price. It provides:

Subd. 23. **Wholesale sales price.** "Wholesale sales price" means the price stated on the price list in effect at the time of sale for which a manufacturer or person sells a tobacco product to a distributor, exclusive of any discount, promotional offer, or other reduction. For purposes of this subdivision, "price list" means the manufacturer's price at which tobacco products are made available for sale to all distributors on an ongoing basis.

Minn. Stat. § 297F.01, subd. 23 (Supp. 2003) (2004) (emphasis added).

The first sentence of subd. 23 states that the tax base should be "the price stated on the price list." *Id.* (emphasis added). The term "price list" is defined in the second sentence, which unambiguously states that "price list" means "the manufacturer's price at which tobacco products are made available for sale to all distributors on an ongoing basis." *Id.* (emphasis added).

The amended definition of "wholesale sales price," therefore, makes clear that the wholesale sales price is "[the manufacturer's price] in effect at the time of sale for which a manufacturer or person sells tobacco products to a distributor." The definition of "wholesale sales price" continues to recognize that either a manufacturer "or [some other] person" can sell tobacco products. But, regardless of who sells the tobacco products, the base of the tax remains the manufacturer's price.

Such legislative history as there is regarding the 2003 amendment reveals that it, like the 1999 amendment, discussed at pages 14-17, *supra*, was a clarification of the definition, rather than a change. The Bill Summaries provided to the House and Senate Tax Committees, as well as testimony, said that it clarifies that the base of the tobacco tax

is the manufacturer's price at which tobacco products are made available for sale to all distributors.<sup>10</sup>

So, the 2003 amendment, like the 1999 amendment, was not intended to change the tax base of the tobacco tax.

McLane's refund claim should therefore have been allowed. McLane should have been allowed to calculate its tobacco products tax liability based on the manufacturer's list price. The undisputed facts in this case show that only UST Manufacturing and Conwood Manufacturing meet the definition of "manufacturer" found in the tobacco products taxing scheme because only they "produce and sell" tobacco products. UST Manufacturing and Conwood Manufacturing's price lists show prices "for which a manufacturer or person sells tobacco products to a distributor." See Minn. Stat. § 297F.01, subd. 23. Neither UST Sales nor Conwood Sales are manufacturers. Only UST Manufacturing and Conwood Manufacturing's prices, therefore, meet the definition of "price list" under the second sentence of Minn. Stat. § 297F.01, subd. 23. UST Sales and Conwood Sales are both licensed tobacco products distributors in Minnesota. (Tamaro Aff., Ex. 8.) Accordingly, UST Manufacturing and Conwood Manufacturing sell tobacco products at prices stated on the manufacturers' price lists to distributors

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<sup>10</sup> House Research Bill Summary of H.F. 1597 (May 9, 2003), available at <http://www.house.leg.state.mn.us/hrd/bs/83/hf1597.html>; House Research Bill Summary of S.F. 1505 (May 19, 2003), available at <http://www.house.leg.state.mn.us/hrd/bs/83/sf1505.html>; Audiotapes of the Minnesota Legislature, Hearing Before the Minn. House Taxes Comm. on H.F. 759 (Mar. 11, 2003) (statement of R. Krause, Assistant Comm'r of Revenue for Tax Policy) (audiotape).

(UST Sales and Conwood Sales) thereby determining the tax base as the manufacturer's list prices.

**2. The Tax Court Erred in Its Conclusion that the Base of the Tobacco Products Tax Is the List Price of McLane's Non-Manufacturer Suppliers.**

In its February 5, 2008 Order, the Minnesota Tax Court determined that the base of the tobacco products tax under the statute as amended in 2003 is the list price in a transaction between the non-manufacturer supplier and the taxable distributor, sometimes referring to it as "the price McLane paid to Sales." (Tax Court Order 13, 18 at A-54 and A-59.)

The Tax Court's analysis of the 2003 amended version of the definition of "wholesale sales price" was hindered by the conclusions it had reached on the previous version. And it again made the same factual and legal errors.

Having held on the earlier version of the statute that the phrase "or person" required that the tax base be the list price of a "person" in a transaction with the taxable distributor, the Tax Court found itself in a conundrum. The 2003 version of the statute did not seem consistent with its holding. The 2003 version in defining "price list" emphasizes manufacturer's list price and makes no mention of list prices of other "persons."

The Tax Court therefore found itself at the end of a blind alley. It noted, at this point, that the definition of price list is "manufacturer's price" and found that the language of the statute becomes "problematic" because "there is no manufacturer's price list, only the supplier's (Sales) price list." (*Id.* at 12 at A-53.) On the other hand, the

Court acknowledged that the base of the tax cannot be Sales' price list because "Sales is not a manufacturer." (Id.) The Court therefore determined that "[t]he statutory language is not clear." (Id.)

**a) When Faced with an Ambiguity in this Tax Statute, Which Its Flawed Analysis Had Caused It to Encounter, the Tax Court Erred as a Matter of Law by Not Resolving the Ambiguity in Favor of the Taxpayer.**

The first error of law of the Tax Court as to the 2003 version of the definition was that when confronted with an ambiguity in a tax statute, rather than resolving the ambiguity in favor of the taxpayer, the Tax Court resolved the ambiguity in favor of the State and determined that "the legislature intended that the wholesale sales price was that on Sales' price list." (Id. at 13 at A-54.)

The Tax Court's analysis should have ended, and the issue decided for the taxpayer, as soon as it found that "the statutory language is not clear." (Id. at 12 at A-53). As this Court stated in Northland Country Club v. Comm'r of Taxation, 241 N.W.2d 806 (Minn. 1976):

The general principle for interpretation of any tax statute was stated in the case of Charles W. Sexton Co. v. Hatfield, 263 Minn. 187, 195, 116 N.W.2d 574, 580 (1962):

"[W]here the meaning of a taxing statute is doubtful, the doubt must be resolved in favor of the taxpayer."

241 N.W.2d at 807. Thus, if the Tax Court found that there are any ambiguities in the tobacco product tax's statutory scheme, or that the Legislature's intent was unclear as to whether the tax should be assessed on the manufacturer's price or the price McLane pays

to its supplier, the Tax Court should have resolved those ambiguities in favor of the taxpayer. It failed to do so.

**b) In Its Consideration of the Ambiguities It Perceived, the Tax Court Made Yet Additional Errors in Construing the Language of the 2003 Version of the Statute and Concluded Its Analysis with Four Reasons, None of Which Survive Scrutiny.**

The Tax Court had found as to the earlier version of the statute that the list price of the supplier to the taxable distributor determines the tax base and that this supplier need not be a manufacturer. Had the Tax Court correctly determined that the term “or person” did not change the tax base in 1999 but was instead a recognition that entities other than the manufacturers were bringing products into the state and that the tax base remained the manufacturer’s established (or “list”) price, it would have readily found the right path.

The 2003 amendment clarified that the “established price” at which product is sold—the pre-2003 language—is indeed the list price of the manufacturer.

These conclusions may be discerned from the language of the 2003 version. Yet, because the court had reached an erroneous conclusion as to the “or person” language in the earlier version, it was forced to take a tortuous analytic path, along which it made errors at nearly every point. The Tax Court concluded its analysis of the 2003 version of the statute, and its attempt to deal with the ambiguities which its earlier holding had created, at p. 13 of its opinion, where it offered four reasons for its ultimate conclusion. (Tax Court Order 13 at A-54.)

The Tax Court’s **first reason** for its conclusion was the determination that “the Tobacco Products Tax covers only transactions where tobacco products are brought into

Minnesota” and that “[o]nly the sales from Sales to McLane are those types of transactions.” (Id. (emphasis added).) This analysis was a continuation of the Tax Court’s confusion regarding what the tobacco tax is imposed upon and what its measure is.

As it had in its analysis of the earlier version of the definition, it alternated between referring to prices paid (transactional prices) and list prices, revealing that it was fundamentally confused as a matter of law about what the tobacco tax was imposed upon and what its base was intended to be. (See id. at 11-12 at A-52 to A-53 (analyzing the “sale at issue” and the price list in effect at the time of the sale from Sales to McLane); id. at 13 at A-54 (“The Tobacco Products Tax covers only transactions where tobacco products are brought into Minnesota.”) (emphasis added).) Consequently, the Tax Court’s first reason for its conclusion is erroneous.

**Second**, the Tax Court stated that the “price list must be prices that are available to all distributors on an ongoing basis” and that the “prices from Manufacturing are not available to McLane or other distributors.” (Id. at 13 at A-54.) McLane submits that the fact that it cannot purchase tobacco products at the prices charged by Manufacturing to Sales is entirely irrelevant. The phrase “available to all distributors on an ongoing basis” cannot mean that the manufacturer has to actually make its prices available to all existing distributors. This would be impossible as no Manufacturer or Sales company does business with all distributors.

The Tax Court’s construction of the phrase “available for sale to all distributors” is unreasonable and impossible of execution. In interpreting statutes, it is presumed that the

Legislature does not intend a result that is absurd, impossible of execution, or unreasonable. See Minn. Stat. § 645.17. But the Tax Court’s interpretation of the phrase “available for sale to all distributors” to mean that the prices must actually be available to all distributors, including McLane, indeed causes a result that is unreasonable and impossible of execution. The Legislature would not require a company to do business with all existing distributors. The commercial reality is that no company does business, or makes its prices available, to all potential customers because for various reasons, such as credit reasons, a customer may not be considered viable. Companies typically only make prices available to all distributors with whom they do business—their customers. So, the workable and reasonable interpretation of “available for sale to all distributors” is that the list price be available to all distributors with whom the manufacturer does business in Minnesota.

The Tax Court’s analysis caused it to be blind to the real purpose of the language. The language “available to all distributors” and “on an ongoing basis” merely reaffirms what the Legislature meant by a list price. Specifically, it means the price available to “all distributors” in the sense that it did not intend that a special price (e.g., discounted price) to some of its distributor customers, but not all of its customers, be the list price. It means the “starting point price.” The phrase “available to all distributors” is therefore a reaffirmation of the language in the first sentence of the definition of “wholesale sales price.” Both sentences describe what constitutes a “price list” and effectively contrast the concept of a price list with an invoice price in a particular transaction. By “on an ongoing basis” it meant the regular list price, not one reduced by a temporary

promotional program of some kind. It meant, in other words, the regular list price of a tobacco product.

Therefore, the Tax Court's construction was wrong and the manufacturing entities' list prices meet the definition of "wholesale sales price." The manufacturing entities' prices are available to all of their customers with whom they do business. Each manufacturing entity happens to do business with only one distributor/customer, but the definition of "wholesale sales price" does not require (and indeed cannot require) that manufacturers have more than one customer.

The Tax Court's reasoning that the manufacturer's price is not available to all distributors, therefore, is erroneous.

The **third reason** the Tax Court gave for its conclusion is that the "prices must be in effect at the time of the sale" and that "[o]nly Sales' price list was in effect at the time of the sales to McLane." (Tax Court Order 13 at A-54.) Surely, the statute's directive that the price must be in effect at the time of sale means that the prices must be current, as opposed to outdated. The price lists attached to affidavits that are in the record indeed displayed list prices of tobacco products that were in effect at the time that McLane purchased tobacco products. (See Tamaro Aff. ¶ 11, Ex. 2 at A-80 and A-85; Street Aff. ¶ 12, Ex. A at A-87 and A-88 to A-89; Gilliam Aff. ¶ 4, Attachment 2 at A-70 and A-73 to A-77; Gilliam Aff. ¶ 3, Attachment 1 at A-70 and A-72.) The Tax Court's analysis is, therefore, contrary to the undisputed facts before it.

The **fourth and final reason** provided by the Tax Court was that "the Legislature stated that the price had to be a fair price as it must be exclusive of any discount,

promotional offer, or other reduction and it must be available to all distributors on an ongoing basis.” (Tax Court Order 13 at A-54 (emphasis added).) Curiously, although the Tax Court was presumably analyzing “the best indicator [of legislative intent],” which it identified as “the language actually used,” the phrase “fair price” was never used by the Legislature.

In conclusion, none of the four reasons cited by the Tax Court offer a resolution to the ambiguity in the definition of “wholesale sales price” that the Tax Court described.

**c) The Tax Court Judicially Amended the Statute that Defines the Tax Base Instead of Resolving the Ambiguity for the Taxpayer.**

It is apparent that, given the ambiguities which its earlier erroneous holding regarding the “or person” language caused it to perceive, the Tax Court amended the statute judicially to avoid them. The Tax Court’s attempt to enact language which the legislation did not should be rejected. See Green Giant Co. v. Comm’r of Revenue, 534 N.W.2d 710, 712 (Minn. 1995) (explaining that a court cannot add words to a statute by supplying “that which the legislature purposefully omits or inadvertently overlooks”).

The Court amended the statute to read as follows:

**Subd. 23. Wholesale sales price.** “Wholesale sales price” means the price stated on the price list in effect at the time of sale for which a manufacturer or person sells a tobacco product to a distributor, exclusive of any discount, promotional offer, or other reduction. For purposes of this subdivision, “price list” means the manufacturer’s price or the price list of another person selling tobacco products at which tobacco products are made available for sale to all distributors on an ongoing basis.

Had the Legislature wanted to define the measure of the tax in this way and thereby create a shifting tax base, which changes depending upon the list price of the

person selling to the Minnesota taxable distributor, it could have easily done so. It did not.

The Tax Court's decision that the base of the tobacco products tax under the definition of "wholesale sales price" is the list price in the transaction between McLane and Sales is therefore erroneous and should be reversed.

**d) The Tax Court Made the Same Errors of Fact that It Had Made in Its Analysis of the Pre-2003 Version of the Statute, Causing It to Misapply Even Its Own Erroneous Standard for the Tax Base.**

The Tax Court made the same errors of fact as it did when it analyzed the pre-2003 version of the statute. See supra pp. 18-19. It did not recognize the fact that the distributor that imports the tobacco products is Sales and that it brings the products into the state to McLane's warehouse. (See Tamaro Aff. ¶¶ 18-19 at A-81.) The Court again found, contrary to the record, "there is no manufacturer's price list." (Tax Court Order 12 at A-53; see also Tamaro Aff. ¶ 11, Ex. 2 at A-80 and A-85; Street Aff. ¶ 12, Ex. A at A-87 and A-88 to A-89; Gilliam Aff. ¶ 4, Attachment 2 at A-70 and A-73 to A-77; Gilliam Aff. ¶ 3, Attachment 1 at A-70 and A-72.).

Had it not made these errors of fact, it would have applied its own standard to conclude that Sales was the importer of the product and that therefore the list prices that governed the base were those relevant to Sales' purchases from the Manufacturing Companies.

**II. IF THE TOBACCO PRODUCTS TAX WERE BASED ON THE LIST PRICE OF THE TAXABLE DISTRIBUTOR'S SUPPLIER, THEN THE TOBACCO PRODUCTS TAX WOULD VIOLATE THE COMMERCE CLAUSE OF THE U.S. CONSTITUTION.**

**A. Statutes Should Be Interpreted to Avoid an Unconstitutional Result.**

Minnesota law presumes that in enacting legislation, the Legislature did not intend to violate the U.S. Constitution. Minn. Stat. § 645.17(3) (2006). Thus, if one interpretation of a statutory provision yields an unconstitutional result while another does not, courts must adopt that interpretation which is consistent with the U.S. and Minnesota Constitutions. See Hutchinson Tech., Inc. v. Comm'r of Revenue, 698 N.W.2d 1, 18 (Minn. 2005) (“Where possible, this court should interpret a statute to preserve its constitutionality.”); Head v. Special Sch. Dist. No. 1, 182 N.W.2d 887, 893 (Minn. 1970), overruled on other grounds by Nyhus v. Civil Serv. Bd., 232 N.W.2d 779, 780 n.1 (Minn. 1975) (“If the language of a law can be given two constructions, one constitutional and the other unconstitutional, the constitutional one must be adopted, although the unconstitutional construction may be more natural.”).

The construction placed upon the statute by the Tax Court would make it unconstitutional.

**B. The Interpretation that the Base of Minnesota's Tobacco Products Tax Is the List Price of the Taxable Distributor's Supplier Is in Conflict with the Commerce Clause.**

The Commerce Clause of the U.S. Constitution provides that “[t]he Congress shall have the Power . . . to regulate commerce with foreign Nations and among the several states.” U.S. Const. Art. I, § 8, cl. 3. Contained in the Commerce Clause is an implied

negative command, commonly referred to as the “dormant” Commerce Clause, which prohibits states from discriminating against or unduly burdening interstate commerce. See Chapman v. Comm’r of Revenue, 651 N.W.2d 825, 832 (Minn. 2002) (citing Quill Corp. v. North Dakota, 504 U.S. 298, 312 (1992)).

In Complete Auto Transit, Inc. v. Brady, the U.S. Supreme Court announced that a tax is valid under the Commerce Clause only if (1) the activity taxed has a substantial nexus with the taxing state; (2) the tax is fairly apportioned; (3) the tax does not discriminate against interstate commerce; and (4) the tax is fairly related to benefits provided by the state. 430 U.S. 274, 279 (1977), cited in Chapman, 651 N.W.2d at 834.

The U.S. Supreme Court has said of discrimination against interstate commerce:

Time and again this Court has held that, in all but the narrowest circumstances, state laws violate the Commerce Clause if they mandate “differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.”

Granholm v. Heald, 544 U.S. 460, 472 (2005) (quoting Oregon Waste Sys., Inc. v. Dep’t of Env’tl. Quality, 511 U.S. 93, 99 (1994)); see also Chapman, 651 N.W.2d at 834.

**1. The Commerce Clause Prohibits Taxing Products that Have Traveled Through Interstate Commerce More Heavily Than Products that Have Not Traveled Through Interstate Commerce.**

Under the third prong of the Complete Auto test, state measures are invalid if they “unjustifiably . . . discriminate against or burden the interstate flow of articles of commerce.” Chapman, 651 N.W.2d at 834 (citing Oregon Waste Sys., Inc., 511 U.S. at 98).

It has, therefore, been the long-standing position of the U.S. Supreme Court that if a tax discriminates between in-state and out-of-state goods, it violates the Commerce Clause. See, e.g., Bacchus Imps., Ltd. v. Dias, 468 U.S. 263, 268 n.8 (1984) (“Our cases make clear that discrimination between in-state and out-of-state goods is as offensive to the Commerce Clause as discrimination between in-state and out-of-state taxpayers.”); I.M. Darnell & Son Co. v. City of Memphis, 208 U.S. 113, 120 (1908) (holding that the state cannot, without directly burdening interstate commerce, discriminate against property manufactured outside the state “by imposing upon it a burden of taxation greater than that levied upon domestic property of a like nature”); Walling v. Michigan, 116 U.S. 446, 455 (1886) (“A discriminating tax imposed by a State operating to the disadvantage of products of other States . . . is, in effect, a regulation in restraint of commerce among the States.”).

According to the U.S. Supreme Court, “[t]he paradigmatic example of a law discriminating against interstate commerce is the protective tariff or customs duty, which taxes goods imported from other States, but does not tax similar products produced in State.” W. Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 193 (1994). But because tariffs are “so patently unconstitutional,” state laws have aspired “to reap some of the benefits of tariffs by other means.” Id. The Court pointed out, however, that “[o]ur Commerce Clause jurisprudence is not so rigid as to be controlled by the form by which a State erects barriers to commerce.” Id. at 201. As the Supreme Court declared in Best & Co. v. Maxwell:

The commerce clause forbids discrimination, whether forthright or ingenious. In each case it is our duty to determine whether the statute under attack, whatever its name may be, will in its practical operation work discrimination against interstate commerce.

311 U.S. 454, 455–56 (1940), cited in W. Lynn Creamery, Inc., 512 U.S. at 201.

**2. A “Shifting Tax Base,” Which Causes the Tobacco Tax to Fall More Heavily on Products That Have Traveled In Interstate Commerce, Discriminates Against Interstate Commerce.**

Consistent with the notion that taxing statutes must be analyzed on a case-by-case basis to ascertain their purpose and effects, in Halliburton Oil Well Cementing Co. v. Reily, 373 U.S. 64 (1963), the U.S. Supreme Court considered the constitutionality of a sales tax and its associated use tax. The base for the sales tax was the “sales price” of items sold in the state and the base of the use tax was the “cost price” of articles sold outside the state but used in the state. Although the sales and use taxes were imposed at the same rate, the definitions of “sales price” and “cost price” caused the two taxes to be computed on a different base for the same products. The “cost price” on which the use tax was computed was higher than the “sales price” because it included labor and shop overhead.

It was therefore clear that there was a disparity in the tax bases of the sales and use taxes. This disparity was visited upon the plaintiff in the case, an Oklahoma company that serviced oil wells. To service wells for its customers in Louisiana, the plaintiff used specialized equipment which it manufactured in Oklahoma using materials and components it had purchased in states other than Louisiana, in transactions in which Louisiana sales tax had not been paid. The plaintiff filed a Louisiana use tax return. It

reported, however, only the cost of the raw materials and components parts used by it to manufacture the equipment. Louisiana then added to that cost, the cost of plaintiff's labor and shop overhead costs in assembling the equipment and assessed additional tax. Louisiana admitted that if the raw materials and components had been purchased in Louisiana and assembled there, then no tax would have fallen on the labor and shop overhead costs in assembling the equipment.

It was therefore apparent that interstate commerce was prejudiced since a taxpayer that bought materials and components in another state and assembled them there for use in Louisiana was taxed on a higher tax base than a taxpayer that bought the material and components in Louisiana and assembled them there. As to this disparity, the U.S. Supreme Court said:

Although the rate is the same, the appellant's tax base is increased through the inclusion of its product's labor and shop overhead.

373 U.S. at 70.

The U.S. Supreme Court held that this "shifting tax base" resulted in discrimination against interstate commerce. Although the rate of tax was the same regardless of where the equipment was assembled, the Court observed that the tax base is increased only because the product's assembly had occurred out of state. *Id.* at 70. The Court concluded that an increase in the tax base attributable to out-of-state activity was a source of discrimination and invalidated the tax because of the "resulting tax inequality." *Id.* at 71; see also Fulton Corp. v. Faulkner, 516 U.S. 325 (1996) (striking as discriminatory a tax on intangible property that was assessed at a fixed rate, but that

forced shareholders in out-of-state corporations to pay tax based on a higher percentage of share value than shareholders of corporations operating solely in the state).

**3. A Tax Burden that Increases Based on the Amount a Tobacco Product has Traveled Through Interstate Commerce Outside Minnesota Discriminates Against Tobacco Products Manufactured and Distributed Outside the State.**

Minnesota's tobacco products tax is imposed upon tobacco products and paid by tobacco products distributors. Minn. Stat. § 297F.05, subd. 3 (2002) (2004). A "tobacco products distributor" is defined as follows:

**Subd. 20. Tobacco products distributor.** "Tobacco products distributor" means any of the following:

- (1) a person engaged in the business of selling tobacco products in this state who brings, or causes to be brought, into this state from outside the state any tobacco products for sale;
- (2) a person who makes, manufactures, or fabricates tobacco products in this state for sale in this state;
- (3) a person engaged in the business of selling tobacco products outside this state who ships or transports tobacco products to retailers in this state, to be sold by those retailers.

Minn. Stat. § 297F.01, subd. 20. The tax is imposed at the time the distributor:

- (1) brings, or causes to be brought, into this state from outside the state tobacco products for sale;
- (2) makes, manufactures, or fabricates tobacco products in this state for sale in this state; or
- (3) ships or transports tobacco products to retailers in this state, to be sold by those retailers.

Minn. Stat. § 297F.05, subd. 3. The rate of the tax is 35% of the wholesale sales price.

Minn. Stat. § 297F.05, subd. 3.

McLane has shown above that the Minnesota Legislature intended that, pursuant to Minn. Stat. § 297F.01, subd. 23 (2002) (2004), the base of the tobacco products tax be a fixed and certain tax base—the manufacturer’s list price. See supra pp. 6-29

Were the tax base so computed, the tax would be applied as follows:

(1) If the tax were imposed when a distributor brings, or causes to be brought, into this state, from outside the state, tobacco products for sale, the base of the tobacco products tax would be the manufacturer’s list price;

(2) If the tax were imposed when a distributor makes, manufactures, or fabricates tobacco products in this state for sale in this state, the base of the tobacco products tax would be the manufacturer’s list price; and

(3) If the tax were imposed when a distributor ships tobacco products to retailers in this state, to be sold by those retailers, the base of the tobacco products tax would be the manufacturer’s list price.

Consequently, regardless of when the tax would be imposed or who happened to be the taxable distributor, the base of the tobacco products tax would remain constant. It would be the manufacturer’s list price.

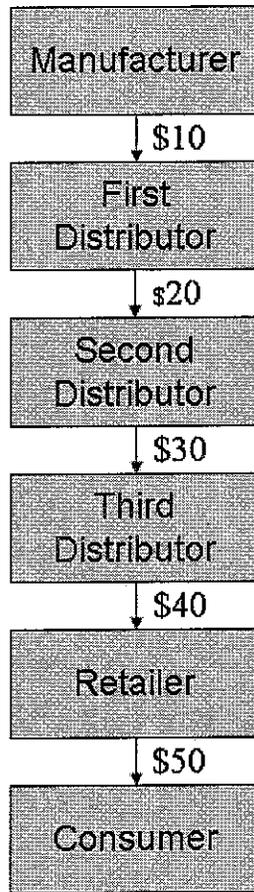
But the Tax Court has interpreted the base of the tax to be the list price relevant to the transaction between McLane and its supplier. (See Tax Court Order 9, 13 at A-50 and A-54.)

If the tax base is measured by the list price of the distributor from whom a Minnesota taxable distributor purchases the product, the tax will fall more heavily on tobacco products involved in out-of-state distribution than those involved in in-state

distribution. That it will do so is inescapable because with each transaction through which the tobacco products travel, the list price of the product increases. Thus, if the tax base is determined by the list price of the distributor's supplier, the timing provision of the tobacco products tax causes the tax base to be greater for tobacco products that have traveled through interstate commerce. Therefore, the tax burden is greater to the extent the product is involved in transactions outside Minnesota before it is brought into or manufactured in the state.

The cost of a tobacco product increases as it moves through its distribution network. For example, the manufacturer of the product sells it to a distributor (the first distributor), which is typically the manufacturer's affiliated sales company, for \$10. After the first distributor increases the product's value through marketing, packaging, and labeling, the first distributor resells the tobacco product to the second distributor for \$20. Then, the second distributor resells the product to a third distributor for \$30 who in turn resells the product to a retailer for \$40 and, ultimately, to the consumer for \$50.

The distribution chain and the increasing price of the tobacco product may be illustrated as follows:



The Tax Court's interpretation of Minnesota's tobacco products taxing scheme results in tax base fluctuations that will inevitably tend to increase the tax base (and resulting tax burden) depending upon the number of times the tobacco product is transferred outside the state. The base of the tax would fluctuate as follows:

(1) If the tax were imposed when a distributor brings, or causes to be brought, into this state, from outside the state, tobacco products for sale, the base of the tobacco products tax would vary based on whether the first, second, or third distributor, in the above example, was the one to bring the products into Minnesota.

(a) If the first distributor brought, or caused to be brought, products into Minnesota, then the base of the tax would be the list price between the first distributor and its supplier, or the manufacturer's price of \$10.<sup>11</sup>

(b) If the second distributor brought, or caused to be brought, tobacco products into Minnesota, then the base of the tax would be the list price between the second distributor and its supplier, or the first distributor's price of \$20.

(c) If the third distributor brought, or caused to be brought, products into Minnesota, then the base of the tax would be the list price between the third distributor and its supplier, or the second distributor's price of \$30.

(2) If the tax were imposed when a distributor made, manufactured, or fabricated tobacco products in this state for sale in this state, the base of the tobacco products tax would be the manufacturer's price of \$10.<sup>12</sup>

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<sup>11</sup> This, in fact, has been the Commissioner's practice in applying his interpretation of the tax base. When UST Sales, a Minnesota distributor and the first distributor in the chain, was the taxable distributor, the Commissioner allowed it to pay tax based on the list price between UST Sales and its supplier—UST Manufacturing. (See Tamaro Aff. ¶ 32, Ex. 7 at A-82.) This continues to be the Commissioner's interpretation of how the statute is to be applied. (See Comm'r Mem. 7 (“[I]f U.S. Smokeless Sales purchased tobacco products from U.S. Smokeless Manufacturing . . . [and] brought them into Minnesota as sample products, Minnesota's tobacco tax is calculated and paid on the price Sales paid the manufacturer.”); Comm'r Resp. Interrog. No. 22 (admitting that if the Sales company is considered the taxable distributor because it brought the tobacco products into Minnesota, then the manufacturer's price would be the correct tax base).)

<sup>12</sup> The Tax Court's interpretation that the base of the tax is the list price between the taxable distributor and its supplier does not apply to Minn. Stat. § 297F.05, subd. 3(2) because manufacturers do not have suppliers. Presumably, however, the Tax Court

(3) If the tax were imposed when a distributor shipped tobacco products to retailers in this state, to be sold by those retailers, the base of the tobacco products tax would be the list price between the third distributor and its supplier, or the second distributor's price of \$30.

Under the Tax Court's interpretation, the timing provision of the tobacco products taxing scheme would require a product that was manufactured outside the state and transferred to one or more distributors outside the state before being brought into Minnesota to be taxed more heavily than a product that was manufactured in Minnesota. Because the tax is imposed when a distributor "brings or causes to be brought" tobacco products into Minnesota, if the tax is interpreted not to have a fixed and certain tax base, but, instead, a "shifting" tax base, then it will necessarily tax products that enter the state after traveling extensively through interstate products more than it will tax products that were either manufactured in the state or that have traveled less extensively through interstate commerce.

This type of discrimination is contrary to well-established Commerce Clause jurisprudence which specifically forbids discriminating against property manufactured outside the state "by imposing upon it a burden of taxation greater than that levied upon domestic property of a like nature." I.M. Darnell & Son Co. v. City of Memphis, 208 U.S. 113, 120 (1908).

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would then allow the manufacturer/distributor to pay the tax based on the manufacturer's price.

The Tax Court's interpretation of Minnesota's tobacco products taxing scheme, therefore, discourages the purchase of tobacco products that have traveled through interstate commerce. Accordingly, the Department's interpretation burdens the interstate flow of tobacco products and therefore violates the Commerce Clause.

C. **The Commerce Clause Forbids All Forms of Discrimination Against Interstate Commerce, Regardless of Mechanism. The Tax Court Failed to Analyze the Commerce Clause Implications of Its Interpretation of the Tobacco Products Tax in Accordance with Long-Standing Commerce Clause Jurisprudence.**

At pages 13 to 17 of its Order, the Minnesota Tax Court analyzed whether its interpretation of the tobacco products tax violates the Commerce Clause. (Tax Court Order 13–17 at A-54 to A-58.)

The Tax Court focused on several ways in which the tobacco products tax statute may violate the Commerce Clause. The court then reasoned that its interpretation of the tobacco products tax does not discriminate against interstate commerce (1) because the tax applies equally to in-state and out-of state taxpayers, (2) because it taxes only in-state activity, and (3) because it is imposed at a uniform rate. The Tax Court concluded that the tobacco tax passed constitutional muster as to these ways. However, it completely failed to address the constitutional challenge that McLane had actually made—that the tax is unconstitutional because, via a shifting tax base, it burdens products that have traveled through interstate commerce.

It was as if the Tax Court thought that if it could conceive of some ways in which the tax was constitutional, that its findings on those ways absolved the tax from constitutional attack on other grounds. In fact, the Tax Court failed to look for

discrimination that may be “ingenious” rather than “forthright.” The Tax Court, therefore, failed to exercise its duty “to determine whether the statute under attack, whatever its name may be, will in its practical operation work discrimination against interstate commerce.” Best & Co. v. Maxwell, 311 U.S. 454, 455–56 (1940), cited in W. Lynn Creamery, Inc., 512 U.S. 186, 201 (1994).

**1. The Tax Court Erred In Concluding that Its Interpretation of the Tobacco Products Tax Does Not Violate the Commerce Clause Because the Tax Applies Equally to In-State and Out-of-State Parties.**

The Tax Court’s first reason for finding its interpretation of the tobacco products tax constitutional was that the tax “does not tax out-of-state parties differently than in-state parties.” (Tax Court Order 16 at A-57.) The Tax Court distinguished Halliburton, by stating that unlike in Halliburton, the tobacco products tax is “assessed against any party who causes tobacco products to be in Minnesota.” (Id.) The Tax Court stated that the tobacco products tax is “levied on everyone inside or outside of Minnesota who manufactures, brings or causes to bring [*sic*] Tobacco Products into the state.” (Id.) This analysis led the Tax Court to conclude that “[a] tax applied equally to in-state and out-of-state parties does not burden interstate commerce.” (Id. (citing Fulton Corp. v. Faulkner, 516 U.S. 325 (1996); Or. Waste Sys., Inc. v. Dep’t of Env’t Quality, 511 U.S. 93 (1994); Kraft Gen. Foods, Inc. v. Iowa Dep’t of Revenue & Fin., 505 U.S. 71 (1992)).)<sup>13</sup>

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<sup>13</sup> Each of the cases cited by the Tax Court, however, merely provides an example of an instance in which the Supreme Court found a taxing provision unconstitutional. The Tax Court seemingly presumed that unless a taxing provision is similar in form to one of these cases, it cannot violate the Commerce Clause of the U.S. Constitution.

The Tax Court, however, failed to consider that while the tax may apply equally to in-state and out-of-state parties, it nonetheless burdens products that travel through interstate commerce. In Bacchus Imports, Ltd. v. Dias, the U.S. Supreme Court dismissed as absurd the notion that “because there was no discrimination between in-state and out-of-state *taxpayers* there was no Commerce Clause violation.” 468 U.S. 263, 269 n.8 (1984). Instead, the Court stated, “[o]ur cases make clear that discrimination between in-state and out-of-state goods is as offensive to the Commerce Clause as discrimination between in-state and out-of-state taxpayers.” Id. Similarly, in West Lynn Creamery, Inc. v. Healy, the Court stated, ““The distinction between a tax on the thing imported, and on the person of the importer, can have no influence on this part of the subject. It is too obvious for controversy, that they interfere equally with the power to regulate commerce.”” 512 U.S. 186, 203 (1994) (quoting Brown v. Maryland, 25 U.S. 419 (1827)).

Although McLane argued to the Tax Court that the discrimination resulting from the Commissioner’s interpretation of the tobacco products tax is due to the burden that the tax would place on interstate *products*, rather than taxpayers, the Tax Court failed to acknowledge McLane’s argument in its opinion. Instead of analyzing whether its interpretation of the tobacco products tax does discriminate against tobacco products that travel through interstate commerce, the Tax Court cut its analysis short when it concluded that since the tax treats in-state and out-of-state parties the same, it does not run afoul of the Commerce Clause.

Even if, however, this Court were to examine the effect of the Tax Court's interpretation of the tobacco products tax on in-state and out-of-state taxpayers, it would become evident that the Tax Court reached the wrong conclusion on such analysis as it did perform.

At page 15 of its Order, the Tax Court distinguished Halliburton and cited McLane Western, Inc. v. Colorado Department of Revenue, 126 P.3d 221 (Colo. Ct. App. 2005), for the proposition that there is no Commerce Clause discrimination because the tobacco products tax does not encourage out-of-state distributors to move into Minnesota. McLane had argued to the Tax Court that out-of-state taxpayers would be pressured to move into Minnesota under the Commissioner's interpretation of the statute to relieve the burden that a shifting tax base would have on out-of-state tobacco products. The Tax Court stated, however, that McLane's argument fails because if another distributor moved into the state and sold tobacco products to McLane, McLane would not be paying the tax and the other distributor would be. (Tax Court Order 17 at A-58.)

But the Tax Court's interpretation does indeed pressure out-of-state taxpayers to move into Minnesota.

A well-known constitutional and state and local tax law scholar, Walter Hellerstein, analyzed Colorado's McLane Western opinion and explained:

The Colorado court's opinion is troublesome. Although the statute has a surface neutrality—"[a]ll taxable distributors of OTP are taxed at the same rate and on a base determined in the same fashion"—it does not take a Nobel prize-winning economist to figure out that the earlier in the economic process one triggers the OTP tax, the lower the tax on OTP in Colorado. Indeed, as noted above, the court acknowledges this point. To be sure, the court manages to distinguish the Colorado statute from the

discriminatory statutory provisions at issue in cases like *Armco* and *Halliburton*. Yet, the court's ultimate conclusion ("[t]he OTP tax scheme does not pressure out-of-state businesses to move to Colorado") rings hollow. How can a business that conducts its "upstream" OTP operations outside of Colorado and sells OTP into Colorado not feel "pressure" to move those operations into Colorado to lower the tax (and, presumably, the price) at which its OTP is sold "downstream" in Colorado? The court never provides a satisfactory answer to this fundamental question.

Jerome R. Hellerstein & Walter Hellerstein, *State Taxation* ¶ 4.13 [2][k][xi] (Supp. 2008).

And, indeed, a careful analysis makes clear that although an out-of-state manufacturer or distributor would become the taxable distributor, there is nevertheless a financial incentive to move into Minnesota. (See *Muck Aff.* ¶ 5, Ex. D.) Currently, McLane is the taxable distributor and pays 35% tax on the price for which it purchases tobacco products. Its current profits are decreased by the amount of tax it has to pay. If the out-of-state distributor from whom McLane currently purchases were to move into Minnesota and become the taxable distributor, it would pay a substantially lower tax than McLane does. (See *id.*) Additionally, that distributor could make a higher profit than it currently does by selling to McLane from inside Minnesota and recapturing most of the profit that McLane currently loses as a result of paying the tax on a much higher tax base. (See *id.*) Thus, that distributor is encouraged to move into the state under the Tax Court's interpretation of the tobacco products tax.

The Tax Court's interpretation of Minnesota's tobacco tax, therefore, does in fact create an incentive for out-of-state businesses to move into the state and therefore violates the Commerce Clause.

**2. The Tax Court Erred in Concluding that Its Interpretation of the Tobacco Products Tax Is Constitutional Because It Taxes Only In-State Activity.**

At page 16 of its Order, the Tax Court reasoned that there is no discrimination or burdening of interstate commerce because “[t]he tax is imposed only on in-state activity.” (Tax Court Order 16 at A-57.)

Such reasoning, however, has been long rejected by the U.S. Supreme Court. In Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981), the Court explained that it has “long [] rejected any suggestion that a state tax or regulation affecting interstate commerce is immune from Commerce Clause scrutiny because it attaches only to ‘local’ or intrastate activity.” 453 U.S. at 615 (citations omitted). Instead, the Court pointed out, “[i]n reviewing Commerce Clause challenges to state taxes, our goal has instead been to ‘establish a consistent and rational method of inquiry’ focusing on ‘the practical effect of a challenged tax.’” Id. (citations omitted); see also W. Lynn Creamery, Inc., 512 U.S. 186, 201 (1994).

The Tax Court’s decision that there is no Commerce Clause violation because the tax is imposed only on “in-state activity” should therefore be rejected as contrary to modern Commerce Clause jurisprudence.

**3. The Tax Court Erred in Concluding that Its Interpretation of the Tobacco Products Tax Is Constitutional Because It Is Imposed at a Uniform Rate.**

Throughout its Commerce Clause analysis, the Tax Court emphasized that its interpretation of the tobacco products tax does not violate the Commerce Clause because it is assessed “at the same rate” or at a rate that “has not changed.” (Tax Court Order 16

at A-57.)<sup>14</sup> Again, the Tax Court discussed the ways in which it thought its interpretation of the statute was constitutional (i.e. it has a fixed tax rate) rather than the way in which it is unconstitutional (it has a shifting tax base).

By focusing on the tax rate, rather than the tax base of the tobacco products tax, however, the Tax Court failed to take into account that in Halliburton, the U.S. Supreme Court specifically rejected the view that so long as a tax rate is uniform, there is no Commerce Clause violation. 373 U.S. at 70. Instead, it was the duty of the Tax Court to determine “whether the statute under attack . . . will in its practical operation work discrimination against interstate commerce.” Best & Co. v. Maxwell, 311 U.S. 454, 455–56 (1940), cited in W. Lynn Creamery, Inc., 512 U.S. at 201. Following such an examination, the Court in Halliburton concluded that even when a tax rate is uniform, a shifting tax base, in its practical operation, discriminates against interstate commerce. See Halliburton, 373 U.S. at 70.

The interpretation that the tax base of the tobacco products tax base shifts based on how late in the distribution chain the product enters Minnesota, tobacco products that

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<sup>14</sup> At page 17 of its opinion, the Tax Court also cited Kansas Tobacco-Candy Distrib. & Vendors, Inc. v. McDonald, 519 P.2d 1110 (Kan. 1974) and McLane Co. v. Department of Revenue, 19 P.3d 1119 (Wash. Ct. App. 2001) in support of its decision that its interpretation of Minnesota’s tobacco products tax is constitutional. Both cases, however, involved statutes that imposed the tobacco tax on a fixed and certain tax base. See Kansas Tobacco-Candy, 519 P.2d at 1114 (stating that the tax is imposed on the manufacturer’s price, which is an “established tax base”); McLane Co., 19 P.3d at 1123 (explaining that the tax is imposed on the fair market price of the product when the manufacturer sells to a distributor). Neither case concerned a statute that resulted in a shifting tax base that increased the tax burden if products were manufactured and sold outside Minnesota before being brought into the state.

have traveled through interstate commerce are unduly burdened. Accordingly, the Tax Court's interpretation of the tobacco products tax causes the tax to discriminate against interstate commerce.

**4. The Tax Court Erred In Suggesting McLane's Commerce Clause Argument Was Mere Dissatisfaction With Its Tax Liability that Was Caused By the Reorganization of the Tobacco Companies.**

At page 16 of its Order, the Tax Court characterized McLane's Commerce Clause argument as a "complaint." The court stated, "What McLane complains about is the fact it now pays a higher price for tobacco products, and a resulting higher tax, because of the UST and Conwood reorganizations." (Tax Court Order 16 at A-57.) In this, the Tax Court was referring to reorganization of the UST Companies in 1990 and of the Conwood organizations in the 1997, which included the creation of the Sales companies as entities separate in organization and function from the Manufacturing companies. (See Tamaro Aff. ¶ 3 at A-79.) The court decided that the "ultimate increases in the taxes ... was due to the change in pricing by McLane's supplier." (Tax Court Order 16 at A-57.)

Succinctly stated, McLane never made such an argument and, indeed, the Tax Court's statements are not supported by the record or the undisputed facts before the court. There is nothing in the record regarding what the pre-reorganization prices were compared with current times.

In any event, the Tax Court's statement that McLane's taxes increased due to the reorganizations of the UST and Conwood entities is irrelevant to McLane's argument that the Tax Court's interpretation of the tobacco products taxing scheme violates the

Commerce Clause. Assuming there were price increases, the same constitutional problems—the tax base shifts depending on the amount of times a product has traveled through interstate commerce—exists, except they would, with the tax computed at 35% of list price, be magnified.

The Tax Court's final reason is therefore inconsequential.

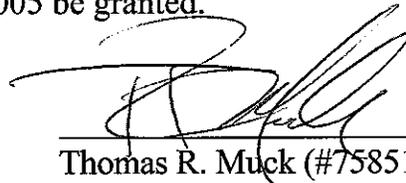
The Tax Court's decision that its interpretation of the tobacco products tax does not violate the Commerce Clause was therefore based on a faulty and incomplete analysis. Instead of determining whether the statute would, "in its practical operation work discrimination against interstate commerce," the court set up straw-person commerce clause arguments that it then analyzed. The Tax Court's shallow analysis resulted in its failure to see that its interpretation of the tobacco products tax unduly burdens products the more they travel through interstate commerce. Accordingly, the Tax Court's interpretation of the statute should be rejected.

### CONCLUSION

The Tax Court's order should be reversed. This Court should order that McLane's refund claims for May 2002 through June 2005 be granted.

Dated: \_\_\_\_\_

10/20/08



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**CERTIFICATE OF COMPLIANCE**

The undersigned, Thomas R. Muck, hereby certifies pursuant to Minn. R. Civ. App. P. 132.01, subd. 3(c), that the word count of the attached Brief of Relator McLane Minnesota, Inc., is 13,393 words. The Brief complies with the typeface requirements of the rule and was prepared, and the word count was made, using Microsoft Word 2000.

Dated: 10/20/08



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