

No. A08-1632

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STATE OF MINNESOTA  
IN SUPREME COURT

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McLane Minnesota, Inc.,

Relator,

vs.

Commissioner of Revenue,

Respondent.

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**BRIEF OF  
RESPONDENT COMMISSIONER OF REVENUE**

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## STATEMENT OF THE ISSUES

1. Minnesota imposes a tax on the price for which “a manufacturer or person” sells tobacco products to a distributor. Relator McLane Minnesota, Inc. (“McLane”), a Minnesota tobacco products distributor, argued below that this language imposes the tax on the price a manufacturer charges its affiliated sales entity before the products are resold to McLane, even if the manufacturer will not sell tobacco products to McLane at that price. Is the statute defining the price on which Minnesota’s tobacco tax is imposed properly construed to apply to the price that McLane pays for the tobacco products it purchases?

*The Tax Court construed Section 297F.01, subdivision 23 to apply to the price that McLane pays, rather than the price charged in a separate transaction to which McLane is not a party.*

### **Authorities:**

Minn. Stat. § 297F.01, subd. 23 (2002), (2004)

*Willmus v. Comm’r of Revenue*, 371 N.W.2d 210 (Minn. 1985)

*McLane Western, Inc. v. Dep’t of Revenue*, 126 P.3d 211 (Colo. Ct. App. 2005) *cert. denied*, 2006 WL 349738 (Colo. Jan. 9, 2006) and *cert. denied*, 127 S. Ct. 42 (2006).

2. McLane argued that imposing Minnesota's tobacco tax on the price that McLane pays for tobacco products violates the Commerce Clause of the United States Constitution because it favors out-of-state distributors over in-state distributors.

*The Tax Court held that Minnesota's Tobacco Tax does not treat out-of-state distributors differently than in-state distributors, and therefore does not violate the Commerce Clause of the United States Constitution.*

**Authorities:**

U.S. CONST., ART. I, § 8, CL. 3

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

*Mayo Collaborative Serv., Inc. v. Comm'r of Revenue*, 698 N.W.2d 408 (Minn. 2005) *cert. denied*, 546 U.S. 1171 (2006).

**STATEMENT OF THE CASE**

The Commissioner audited McLane's 2004 tobacco purchases and sales, after which he issued an Order assessing additional Minnesota tobacco tax. *See* Notice of Appeal, ¶ 2 & Exh. 1 (A.1, 9). McLane appealed that Order administratively and then sought a refund for tobacco tax paid from January 1, 2002 through June 30, 2005, asserting that Minnesota's tobacco tax is unconstitutional under the United States and Minnesota Constitutions. *Id.*, ¶ 3 (A.1).<sup>1</sup> McLane's administrative appeal and refund

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<sup>1</sup> The Commissioner had audited McLane in 2003 and 2004, allowing a credit to McLane in the 2003 audit, and assessing additional tobacco tax in the 2004 audit. McLane did not appeal from these Orders. *See* Affidavit of Rita Coyle DeMeules, Exhs. 14, 15 (filed, Minn. Tax Ct., Sept. 26, 2007).

claim were denied, Notice of Appeal, Exh. 2 (A.24-26), and McLane then appealed to the Minnesota Tax Court.<sup>2</sup>

After a period of discovery, the Tax Court heard the parties' cross-motions for partial summary judgment on October 24, 2007. The Court issued its Order on February 5, 2008, granting the Commissioner's Motion for Partial Summary Judgment and denying McLane's cross-motion for Partial Summary Judgment (A.42). Final judgment was entered on July 21, 2008 and this appeal followed. (A.61).

## STATEMENT OF THE FACTS

### A. Background: McLane Minnesota and Minnesota's Tobacco Tax.

Relator McLane Minnesota, Inc. is located in Northfield, Minnesota, and distributes food, cigarettes, and tobacco products to grocery, convenience stores, and mass merchandisers in Minnesota and seven other upper-Midwest states. *See* Notice of Appeal, ¶¶ 8-9 (A.2). McLane has been a licensed Minnesota "tobacco products distributor" since May, 2002. *See* Minn. Stat. § 297F.03 (2006); DeMeules Aff., Exh. 9 (date of first sale May 1, 2002) (filed Minn. Tx. Ct., Sept. 26, 2007).<sup>3</sup> McLane sells

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<sup>2</sup> McLane also appealed the Commissioner's assessment of additional tax on certain discounted or promotional items and the Commissioner's penalty assessment. *See* Notice of Appeal, ¶¶ 32, 41 (A.6-7). The parties separately resolved those claims. *See* A.61-67.

<sup>3</sup> McLane Company, through its 19 divisions and subsidiaries, is the largest convenience store supplier and tobacco distributor in the United States. *See* DeMeules Aff., Exh. 4, Koch Depo. at 8 (R.A.22); DeMeules Aff., Exh. 5, Gilliam Depo. at 15 (R.A.48). Other McLane entities previously distributed tobacco products in Minnesota, though not as a Minnesota resident distributor. *See* Gilliam Depo. at 36 (R.A.53); *see also* Minn. Stat. § 297F.03, subd. 4 (nonresident license application requirements).

cigars, snuff, and smokeless tobacco (collectively referred to in McLane's Notice of Appeal as "OTPs"). See Notice of Appeal, ¶ 9 (A.2).

Minnesota's tobacco tax is imposed on "all tobacco products in [Minnesota] and upon any person engaged in business as a distributor." Minn. Stat. § 297F.05, subd. 3 (2006).<sup>4</sup> The tobacco tax is imposed when 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.

*Id.*, subd. 3 (1)-(3). The tax rate is "35 percent of the wholesale sales price of the tobacco products." *Id.* (emphasis added).

The "wholesale sales price" upon which the tax is calculated has had two definitions during McLane's tenure as a licensed Minnesota resident distributor. Until June 30, 2003, that price was defined as "*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 (2002) (emphasis added).

After June 30, 2003, that price has been defined as:

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

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<sup>4</sup> With a few exceptions, the language in most of the relevant Chapter 297F sections has remained unchanged between 2002 and 2006. The Commissioner will cite only to the current statutory version, unless the language has been amended.

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 (2004).

**B. McLane’s Tobacco Products Purchases.**

McLane buys tobacco products for distribution in Minnesota from several suppliers. DeMeules Aff., Exh. 1 at 10-11 (Ans. to Interrog. No. 16) (R.A.15-16). In some cases, McLane purchases those products directly from the tobacco product manufacturer. DeMeules Aff., Exh. 5, Gilliam Depo. at 30-31 (R.A.52); DeMeules Aff., Exh. 4, Koch Depo. at 35-36 (R.A.29). When it does so, McLane pays the Minnesota tobacco tax on the price charged by that manufacturer. DeMeules Aff., Exh. 5, Gilliam Depo. at 73-74 (R.A.63).

In other cases, McLane purchases tobacco products from a sales company that is affiliated with the tobacco product manufacturer. *See* Notice of Appeal, ¶ 12 (A.3). For example, US Smokeless and Conwood, the two companies that hold or have held the majority of the market for smokeless tobacco product sales, *see, e.g., Conwood Co., L.P. v. U.S. Tobacco Co.*, 290 F.3d 768, 773-74 (6th Cir. 2002) *cert. denied*, 537 U.S. 1148 (2003), have separate entities for manufacturing and sales/marketing. *See* Notice of Appeal, ¶¶ 15-17 (A.3); *see also* DeMeules Aff., Exh. 11 (Letter of Feb. 8, 1990) (R.A.80). US Smokeless and Conwood are McLane’s largest smokeless tobacco products suppliers. *See* DeMeules Aff., Exh. 5, Gilliam Depo. at 32-33 (R.A.52-53).

Prior to 1990, US Smokeless Tobacco Company, then known as United States Tobacco Company, “performed both the manufacturing and marketing functions” for its

smokeless tobacco products. *United States Tobacco Sales & Marketing Co., Inc. v. Dep't of Revenue*, 982 P.2d 652, 654 n.2 (Wash. Ct. App. 1999). Effective January 1, 1990, US Smokeless Tobacco Company reorganized and created two separate, wholly-owned subsidiaries, UST Manufacturing and UST Sales.<sup>5</sup> See DeMeules Aff., Exh. 11 (Letter of Feb. 8, 1990) (R.A.80). Thereafter, UST Sales purchased tobacco products exclusively from UST Manufacturing. See *United States Tobacco Sales & Marketing Company, Inc.*, 982 P.2d at 654, n.2. UST Sales does not manufacture smokeless tobacco products, but sells those products to distributors such as McLane. Notice of Appeal, ¶ 15 (A.3).

Similarly, the Conwood organization originally manufactured and sold its smokeless tobacco products through a single entity. Thereafter, Conwood's tobacco products were manufactured by Conwood Manufacturing and sold exclusively, in the United States, to Conwood Sales Company, which in turn sold those products to distributors such as McLane. See Notice of Appeal, ¶ 17 (A.3).<sup>6</sup> Conwood Sales does not manufacture tobacco products. See *Id.*

After UST and Conwood reorganized their companies into separate, affiliated manufacturing and sales entities, McLane's tobacco purchases generally occurred as follows. The sales entity — UST Sales or Conwood Sales — purchased tobacco products from its affiliated manufacturer, i.e., UST Manufacturing or Conwood Manufacturing, at

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<sup>5</sup> As does McLane, see McLane Br. at 3, n.3, the Commissioner refers to these entities as UST Manufacturing and UST Sales.

<sup>6</sup> The Conwood structure includes Rosswill, LLC, between the manufacturer and Conwood Sales, which results in more than one price increase before products are sold to (Footnote Continued on Next Page)

a price that reflected the manufacturing entity's costs and anticipated profits. *See, e.g., United States Tobacco Sales & Marketing Co., Inc.* 982 P.2d at 658 (manufacturer's price includes costs and profits); DeMeules Aff. Exh. 4, Koch Depo. at 42 (assuming manufacturing entity would mark up price in part for profit) (R.A.31). The sales entity then re-sold those products to distributors such as McLane, at an increased price that reflected the sales entity's operating costs, profit margins, and added value. *See McLane Western, Inc. v. Colorado Dep't of Revenue*, 126 P.3d 211, 213 (Colo. Ct. App. 2005); *see also* DeMeules Aff., Exh. 21 (prices between affiliated manufacturing and sales entities) (R.A.82).

After these reorganizations, McLane bought UST or Conwood tobacco products only from the sales entity; it cannot buy tobacco products directly from the manufacturer. DeMeules Aff. Exh. 5, Gilliam Depo. at 81-82 (R.A.65). McLane has never tried to purchase tobacco products from the UST or Conwood manufacturing entity, has never requested the opportunity to purchase those products at the price charged by the manufacturer, and does not know whether it can purchase those products from the manufacturer. DeMeules Aff. Exh. 4, Koch Depo. at 39-42 (R.A.30-31). McLane admitted below that the manufacturing entity's price is not available to McLane. DeMeules Aff. Exh. 5, Gilliam Depo. at 118-19; 123-24 (R.A.74-75).

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(Footnote Continued From Previous Page)

McLane. *See* Street Aff., ¶ 7 (A.87). As with the UST entities, *see supra* note 5, the Commissioner refers to the Conwood entities as either "Manufacturing" or "Sales."

McLane receives price lists from its tobacco products suppliers, including Altadis, Swedish Match, Swisher International, UST Sales, and Conwood Sales. *See DeMeules Aff.*, Exhs. 22-25 (R.A.85-93). These price lists state the prices in effect at the time of McLane's purchases from its suppliers. *See Id.* (stating effective dates); *see also DeMeules Aff.* Exh. 5, Gilliam Depo. at 125 (R.A.76). McLane created, from information given to it by UST Sales, a spreadsheet of transfer prices between UST Manufacturing and UST Sales. *DeMeules Aff.* Exh. 4, Koch Depo. at 81 (R.A.41). McLane obtained from Conwood the pricing structure between the affiliated Conwood entities. *See Gilliam Aff.*, ¶ 4 (A.70).

**C. The Tobacco Tax That Minnesota Distributors Pay.**

Between 2002 and 2005, Minnesota's tobacco tax was (as it is now) imposed on the wholesale sales price charged by *either* a manufacturer *or* a person. *See Minn. Stat. § 297F.01, subd. 23 (2006).*

For example, when McLane purchases tobacco products directly from the manufacturer (rather than from an intervening supplier), the tax is imposed on the price charged by the manufacturer. *See Minn. Stat. § 297F.01, subd. 23* (price "for which a manufacturer or person" sells tobacco products).

When a sales entity purchases tobacco products outside of Minnesota from its affiliated manufacturer and then resells those products to a Minnesota distributor, Minnesota's tax is imposed on the price the sales entity charges the Minnesota distributor. *See Minn. Stat. § 297F.01, subd. 23 (2006)* (price charged by "a person");

Minn. Stat. § 297F.05, subd. 3 (1) (brings or causes to be brought into Minnesota). Thus, when UST Sales (a) purchases tobacco products from UST Manufacturing, then (b) resells those products to a tobacco distributor such as McLane, who (c) resells those same products to retailers, Minnesota's tobacco tax is imposed on the price UST Sales charges McLane. See DeMeules Aff. Exh. 6, Lang Depo. at 138-144; DeMeules Aff. Exh. 7, Hoyum Depo. at 75-76 (filed Minn. Tx. Ct., Sept. 26, 2007).

McLane argued below that Minnesota's tobacco tax should be imposed on the manufacturer's list price, even when McLane does not purchase those products from a manufacturer. See Notice of Appeal, ¶ 29 (A.5); DeMeules Aff. Exh. 5, Gilliam Depo. at 63-64 (R.A.60). McLane acknowledges that the statute uses an alternative, but equates those alternatives to mean only a manufacturer. See McLane Br. at 10-11. Below, McLane admitted that the two terms were distinct, but applied through a priority system. Ms. Gilliam, McLane Company's tax supervisor, testified as follows:

Q: . . . why can't the State use the price charged or the established price charged by a person rather than the manufacturer's list price . . .

A: If the state does not have knowledge of the manufacturer's list price, the next level they would go to would be the person.

Q: And my question had been where in this subdivision 23 of the 2002 statute does it limit the state to its knowledge of the manufacturer's list price?

A: If they can't satisfy the first part of it, then you go to "or," which would be the person.

Q: So in your view [] the established price charged by a person is only available if there is no manufacturer's list price.?

A: Correct.

DeMeules Aff. Exh. 5, Gilliam Depo. at 130 (R.A.77).

**D. McLane Western's Challenge To Colorado's Tobacco Tax.**

A separate McLane division, McLane Western, Inc. pursued similar statutory construction arguments in Colorado. McLane Western argued that Colorado's tobacco tax was only imposed on the price that the manufacturing entity charged its affiliated sales entity, rather than the price McLane Western paid to the sales entity. *See DeMeules Aff.*, Exh. 8 at 1, 3 (filed Minn. Tx. Ct., Sept. 26, 2007).<sup>7</sup> In addition, McLane Western alleged that imposing the tax on the price that McLane Western paid, rather than the price the supplier paid to the manufacturer, violated the United States Constitution's Commerce and Equal Protection Clauses. *Id.* at 2.

McLane Western and the State of Colorado cross-moved for summary judgment. The trial court granted the State's motion for summary judgment. On McLane Western's statutory argument, the Colorado trial court agreed that McLane Western's supplier, UST Sales, was a "distributor" under Colorado's statute, but found that UST Sales was also a

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<sup>7</sup> Colorado's tax was upon "the sale, use, consumption, handling, or distribution of all tobacco products in [Colorado]," and was imposed "at the time the distributor" brought or caused the OTP to be brought into the state, manufactured the tobacco products in the state, or shipped or transported tobacco products to retailers in the state to be sold by those retailers. *See McLane Western, Inc. v. Dep't of Revenue*, 126 P.3d 211, 213-14 (Colo. Ct. App. 2005) (quoting Colo. Rev. Stat. §39-28.5-102 (2004)), *cert. denied*, 2006 WL 349738 (Colo., Jan. 9, 2006), and *cert. denied*, 127 S.Ct. 42 (2006). The tax was 20% of the "manufacturer's list price," which was defined as "the invoice price for which a manufacturer or supplier sells a tobacco product to a distributor exclusive of any discount or other reduction." *Id.* at 214 (quoting Colo. Rev. Stat. §29-38-101(3)).

“supplier” for purposes of its transactions with McLane. *Id.* at 5. The trial court then rejected McLane Western’s argument that the tax was properly imposed on the price its supplier paid, rather than the price McLane Western paid to that supplier:

Adopting McLane’s position would require a strained and unnatural interpretation of the statute. For McLane as a distributor, its ‘manufacturer’s list price’ is the price for which its supplier (U.S.T. Sales) sells product to McLane. If the term “supplier” were not in the definition of manufacturer’s list price, McLane’s argument that it should use its distributor’s purchase price as McLane’s tax base would carry weight. However, I cannot ignore the legislature’s inclusion of the term “supplier” or its natural application here. It is a sensible construction of the statute that the price paid by the distributor who owes the tax should be the tax base. . . . Further, it is unreasonable to expect that a distributor would be required to pay a tax based on a transaction to which it was not a party. . . . McLane has not cited any other excise tax scheme which operates in the unusual manner which McLane proposes here.

*Id.* at 6-7. The trial court also rejected McLane Western’s Commerce Clause challenge, noting that regardless of the in-state or out-of-state location of other manufacturers and distributors, McLane Western’s tax base “would be the same: the price it pays to its supplier.” *Id.* at 7.

The Colorado Court of Appeals affirmed the trial court. *See McLane Western, Inc. v. Dep’t of Revenue*, 126 P.3d 211, 215-18 (Colo. Ct. App. 2005) (rejecting Commerce Clause challenge and noting, in rejecting statutory construction argument that McLane purchased tobacco products from a supplier, not a manufacturer, and therefore statute “necessarily imposes the tax on the price McLane paid.”) *cert. denied*, 2006 WL 349738 (Colo., Jan. 9, 2006) and *cert. denied*, 127 S.Ct. 42 (2006).

## SUMMARY OF ARGUMENT

As it did in Colorado, McLane dissects the plain and unambiguous language of Minnesota's tobacco tax statute to rearrange it into a frame fitting the business model McLane uses. This approach violates every principle of statutory construction. Rather than reading the tobacco tax statutes in context and as a whole, McLane takes the phrase "manufacturer's price" out of context and then for both the 2002 and the 2003 versions of the statute, elevates that single phrase to controlling effect. Neither the plain language of either version of the statute, nor the unmistakable legislative intent to impose the tax on the price the admittedly taxable distributor (McLane) pays, supports this strained construction. Moreover, the undisputed facts demonstrate that the Tax Court properly granted the Commissioner's summary judgment motion based on the undisputed facts. It was undisputed below that the prices that UST Manufacturing and Conwood Manufacturing charge their respective affiliated sales organizations are not available to McLane, and McLane did not demonstrate that it can purchase tobacco products from UST Manufacturing or Conwood Manufacturing at the prices those entities charge their sales affiliates.

McLane's Commerce Clause claim fails for the same reasons it has failed in other states. McLane may prefer to pay Minnesota's tobacco tax on the lowest price it can identify. The special prices at which some manufacturers choose to make their products available to affiliated companies do not, however, make Minnesota's tobacco tax unconstitutional nor show any discrimination against out-of-state businesses.

The Commissioner's Order correctly recognized that Minnesota's tobacco tax is imposed on the price that McLane paid to its supplier, rather than the price charged in a transaction to which McLane is not a party. Not only is that Order correct under the statutory language, Minnesota's tobacco tax is well within constitutional bounds for tax legislation. Given the presumed constitutionality of the statutes and McLane's demanding evidentiary burden, the Tax Court correctly granted the Commissioner's motion for partial summary judgment.

## ARGUMENT

### I. STANDARD OF REVIEW

An Order granting summary judgment is reviewed to determine if the lower court correctly applied the law and whether any material facts were disputed. *See Chapman v. Comm'r of Revenue*, 651 N.W.2d 825, 830 (Minn. 2002). This Court reviews the Tax Court's legal conclusions de novo. *See Wybierala v. Comm'r of Revenue*, 587 N.W.2d 832, 835 (Minn. 1998).

The Tax Court correctly rejected McLane's challenges to Minnesota's tobacco tax by applying the proper, well-established standards for such claims. First, orders of the Commissioner are presumed correct and valid. *See Minn. Stat. §271.06, subd. 6* (2006). McLane therefore bore the burden of demonstrating that the challenged Order is incorrect. *See S. Minnesota Beet Sugar Coop v. County of Renville*, 737 NW.2d 545, 557 (2007). Second, legislation is presumed constitutional, and a court's power to declare otherwise must be exercised "with extreme caution." *Walker v. Zuehlke*, 642 N.W.2d

745, 750 (Minn. 2002); *see also Council of Indep't Tobacco Mfrs. of America v. State of Minnesota*, 713 N.W.2d 300, 305 (Minn.) (courts make every presumption in favor of statute's constitutionality) *cert. denied*, 127 S.Ct. 666 (2006). McLane was therefore required to establish its constitutional claim "beyond a reasonable doubt." *Walker*, 642 N.W.2d at 751; *see also Mayo Collaborative Servs., Inc. v. Comm'r of Revenue*, 698 N.W.2d 408, 412 (Minn. 2005) (noting state's "wide latitude" in establishing tax program, and taxpayer's "heavy burden" in challenging constitutionality) *cert. denied*, 126 S. Ct. 1334 (2006).

**II. THE PLAIN LANGUAGE OF THE STATUTE IMPOSES MINNESOTA'S TOBACCO TAX ON THE WHOLESALE PRICE THAT MCLANE PAYS ITS SUPPLIER FOR TOBACCO PRODUCTS BROUGHT INTO MINNESOTA.**

McLane concedes that, under either version of Section 297F.01, subdivision 23, the relevant price is a price list price. *See* McLane Br. at 10 (conceding that 2002 statutory term "established price" refers to a "price list"); *id.* at 20 (conceding that first sentence of 2003 statute states that tax should be "the price stated on the price list"). The remaining statutory construction issue here, and before the Tax Court, thus rests on a single question: whose price list sets the tax? Here, McLane's arguments deviate from the plain and unambiguous statutory language.

McLane's statutory construction argument is premised on the notion that the language encompasses only one price: the manufacturer's price, regardless of whether McLane pays that price. *See* McLane Br. at 25 (arguing that it is "irrelevant" that McLane "cannot purchase tobacco products at the prices charged by" manufacturer). But

the plain language of the statute makes the price that McLane pays the only relevant price, because it sets the tax on the price charged by a “for which manufacturer *or a person* sells a tobacco product to a distributor.” *See* Minn. Stat. § 297F.01, subd. 23 (2002, 2004) (emphasis added). McLane thus pursues a statutory construction that deliberately ignores, eliminates, and narrows the plain language of “or person.” Further, there is no sound statutory construction principle that supports construing that plain language to set Minnesota’s tobacco tax, and McLane’s tax liability, on the price charged in a transaction to which McLane is not a party. The Tax Court correctly recognized that McLane’s approach was improper as a matter of law.

**A. The Tax Court Correctly Applied The Principles of Statutory Construction That Mandate Adherence to the Plain And Unambiguous Language.**

“No room for judicial construction exists when the statute speaks for itself.” *Comm’r of Revenue v. Richardson*, 302 N.W.2d 23, 26 (Minn. 1981). Thus, the “most basic” rule of statutory construction requires the Court to apply the plain language of the statute. *See Green Giant Co. v. Comm’r of Revenue*, 534 N.W.2d 710, 712 (Minn. 1995) (holding that where “statutory language is clear and unambiguous, courts must give effect to its plain meaning”). The corollary to this rule requires the Court to construe those plain words so that all provisions of the statute are effective and none are rendered superfluous. *See Willmus v. Comm’r of Revenue*, 371 N.W.2d 210, 213 (Minn. 1985) (noting “statute is to be construed as a whole so as to harmonize and give effect to all of its parts.”); *see also* Minn. Stat. § 645.16 (2006) (words should be construed to give

effect to all portions of statute). Finally, the Court should keep in mind the entirety of Minnesota's tobacco tax statutes. *See, e.g., Am. Family Ins. Group v. Schroedl*, 616 N.W.2d 273, 281 (Minn. 2000) (noting that court should "read and construe a statute as a whole and must interpret each section in light of the surrounding sections to avoid conflicting interpretations.").

McLane avoids these principles with determination. Instead, McLane chastises the Tax Court for considering the transactions by which McLane can or cannot purchase tobacco products, assumes the Tax Court labored under a confusion that "blighted" its analysis, and blames that court for taking a "tortuous analytic path along which it made errors at nearly every point." *See* McLane Br. at 9-11, 24.

McLane's attacks divert attention from the plain language of the statute, which was the guiding path for the Tax Court's analysis. Simply by allowing the statutory language to speak for itself, *see Richardson*, 302 N.W.2d 26, this Court can confirm that the Tax Court reached the correct construction.

**B. The Plain Language Of The Statute Sets The Tax On The Price McLane Pays To Its Supplier.**

It was undisputed below that McLane is the tax liable distributor. This is because when McLane purchases tobacco products from its suppliers, McLane "brings or causes [those products] to be brought" into Minnesota for sale. *See* Minn. Stat. §§ 297F.01, subd. 20 (defining "tobacco products distributor"); 297F.05, subd. 3(1) (defining taxable activity as "brings or causes to be brought"); *see also* DeMeules Aff. Exh. 5, Gilliam Depo. at 128 (R.A.76). The Washington appellate court reached the same conclusion

under virtually identical statutory language. *See McLane Co., Inc. v. Washington State Dep't of Revenue*, 19 P.3d 1119, 1121 (Wash. Ct. App. 2005) (rejecting McLane's argument that "brings or causes to be brought" language defines tax liable distributor by ownership of products when entering state). Thus, the only question below was which price sets the tax: the price McLane pays, or the price that someone else pays before selling those products to McLane.

The plain language of the statute, in both versions at issue here, answers this question in abundantly clear terms. Minnesota has long defined the taxable price in the alternative, as *either* the manufacturer's price, *or* a person's price for which the taxable products are sold. *See* Minn. Stat. § 297F.01, subd. 23 (2006). Further, "person" is defined broadly as "any entity engaged in the sale of cigarettes or tobacco products." Minn. Stat. § 297F.01, subd. 12 (2006). Similarly, "sale" is defined as a "transfer, exchange, or barter, . . . and *includes all sales made by any person.*" *Id.*, subd. 16 (emphasis added). It was undisputed below that McLane's suppliers are not manufacturers. The only logical conclusion then is that those suppliers are "persons" who make "sales" to McLane. When the relevant statutory definitions are considered together, the conclusion is unmistakable. The price that McLane pays its suppliers is unambiguously within the plain language of subdivision 23.

Further, the plain language does not support McLane's argument that "or person" has no broader meaning than "manufacturer." *See* McLane Br. at 13-17. To reach this conclusion, McLane argues that the addition of "or person" was "not intended to change the law," it was merely a clarification. *Id.* at 14. McLane is wrong for several reasons.

First, the plain language of the statute defeats McLane's argument; thus, the Court need not reach the legislative history to reject that construction. The disjunctive "or" confirms that *either* a manufacturer's price, *or* a person's price, is a wholesale sales price. *See, e.g., Am. Family Ins. Group*, 616 N.W.2d at 281 (noting that "or" in challenged statute conveyed that both of the listed acts were prohibited); *State v. Rossow*, 247 N.W.2d 398, 400 (Minn. 1976) (use of "or" in statute conveys that evidence is admissible on either of two separate grounds identified).

Second, "person" cannot be equated with "manufacturer" because "person" encompasses a much broader range of possibilities than does "manufacturer." *Compare* Minn. Stat. § 297F.01, subd. 12 (defining person as "any entity engaged in" selling products) *with* Minn. Stat. § 297F.01, subd. 10 (defining manufacturer as person who "produces and sells" products). In short, McLane's statutory construction argument requires the Court to ignore the word "or" while it also narrows "person" to mean someone who "produces" tobacco products. This is an impermissible construction. *See Willmus*, 371 N.W.2d at 213 (noting "statute is to be construed as a whole so as to harmonize and give effect to all of its parts"); *see also* Minn. Stat. § 645.16 (words should be construed to give effect to all provisions).

The Colorado Court of Appeals, faced with similar statutory language, rejected McLane's attempt to equate the statutory term "supplier" with "manufacturer." *See McLane Western, Inc. v. Dep't of Revenue*, 126 P.3d 211 (Colo. Ct. App. 2005). Like Minnesota, Colorado defined "list price" as one of two prices, that charged by a "manufacturer or supplier." *Id.* at 214. As it does here, McLane urged the Colorado

court to ignore the statutory language “or supplier” arguing that “it need not reach the term ‘supplier’ as the facts establish an earlier qualifying sale between a manufacturer and distributor.” *Id.* at 217-18. The Colorado court rejected McLane’s argument, finding that “the presence of the term ‘supplier’ in the statutory definition of ‘manufacturer’s list price’ necessarily imposes the tax on the price McLane paid” its supplier. *Id.* at 218. Further, the court noted that McLane purchased tobacco products from a supplier, not a manufacturer. *Id.*

The same analysis applies here. McLane purchases its tobacco products from a “person,” not a “manufacturer” when it purchases from either Conwood Sales or UST Sales. The mere presence of the term “person” in Minnesota’s statutory definition of the taxable “wholesale sales price” requires that the tax be imposed on the price McLane pays to that “person.”

Third, even if the legislative history behind the amendment to add “or person” was relevant in light of the unambiguous language, that history defeats McLane’s argument. In 1999, when the statute was amended to include “or person,” the change was made so the tax “includes the established prices (excluding discounts) *set by sellers other than manufacturers*. Present law refers only to purchases from a manufacturer.” *See* Bill Comparison Summary of H.F. 2420/S.F. 1276 at 26 (House Research, Senate Counsel, Senate Tax Staff) (May 5, 1999) (Exh. B, Supp’l DeMeules Aff., filed Oct. 19, 2007).<sup>8</sup> The clarification on which McLane relies expressly refers to “sellers other than

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<sup>8</sup> A copy of this Summary is available at [www.house.leg.state.mn.us/hrd/billsummary](http://www.house.leg.state.mn.us/hrd/billsummary).

manufacturers.” In short, if as McLane argues, the 1999 legislative history is relevant to the construction of the otherwise plain and unambiguous statutory language, that history confirms that McLane’s argument is simply wrong.

Fourth, that history demonstrates that McLane’s proposed construction is completely wrong because it violates, rather than upholds, legislative intent. *See* McLane Br. at 10 (arguing that “Legislature has always intended for the base of the tax to remain fixed and certain as the manufacturer’s price.”); *see also* Minn. Stat. § 645.16 (“The object of all interpretation and construction of laws is to ascertain and effectuate the intention of the legislature.”). This legislative history also makes clear that even if “or person” could be considered ambiguous, the legislative intent eliminates that ambiguity. *See American Express Ry. Co. v. Holm*, 169 Minn. 323, 325, 211 N.W. 467, 467 (1926) (noting that doubts are only resolved in taxpayer’s favor where “statute is capable of two constructions and the intent of the Legislature is in doubt”).

Fifth, nothing in the statutory language supports the construction that a person’s price is the same as the “manufacturer’s established price” as McLane argues. *See* McLane Br. at 10 (arguing that “or person” in statute “merely explains that tobacco products may be sold by suppliers who are not manufacturers at the same manufacturer’s established price.”). The undisputed facts before the Tax Court demonstrated that McLane’s suppliers (who are “persons”) sold products to McLane at the prices listed on the suppliers’ price lists -- not at the price charged by a manufacturer. *See, e.g.,* DeMeules Aff., Exhs. 22-25 (R.A.85-93). And, the undisputed facts demonstrated that the manufacturer’s price was not available to McLane. DeMeules Aff. Exh. 5, Gilliam

Depo. at 118-19, 123-24 (R.A.74-75). Thus, from the standpoint of both the plain and unambiguous language and the undisputed facts, there were no sales “by suppliers who are not manufacturers at the same manufacturer’s established price.”

Finally, there is no ambiguity in the 2002 statutory term, “established price” that requires a narrow construction of “or person.” The only court that has defined “established price” in a similar tobacco tax statute refused to limit that term in the manner that McLane proposes here. *See United States Tobacco Sales & Marketing, Inc. v. State of Washington*, 982 P.2d 652 (Wash. Ct. App. 1999).<sup>9</sup> There, the court began with the same definition of “establish” that McLane uses. *Compare id.* at 939, with McLane’s Br. at 9 (both using Webster’s definition). The Washington appellate court then held that an established price “*reflects the fair market value of the products*” because the price is one that is available to all customers. *Id.* at 940 (emphasis added). In the case of affiliated entities, however, “which, in effect, are obligated to buy and sell from each other, the ‘established price’ must be based upon the fair market value *rather than the manufacturer’s price to its affiliate.*” *Id.* (emphasis added); *see also id.* at 942 (“because Tobacco Manufacturing sells exclusively to an affiliate, its selling price does not

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<sup>9</sup> The Washington statutory language at issue in the UST litigation was: “the established price for which a manufacturer sells a tobacco product to a distributor, exclusive of any discount or other reduction.” *Id.* at 655 (quoting Wash. Rev. Code 82.26.010(7)). Thus, Minnesota’s statute is broader than Washington’s, because Minnesota imposes the tax on the established price charged by a “manufacturer *or person*,” *See McLane Company, Inc.*, 19 P.3d at 1123 (noting that earlier UST litigation established that statutory language imposed tax on manufacturer’s established price, not supplier’s established price).

necessarily reflect fair market value”). Ultimately, the Washington appellate court defined an “established price” as “the price a completely unaffiliated entity would have had to pay to purchase [tobacco products] from Tobacco Manufacturing[.]” *United States Tobacco Sales & Marketing Company, Inc. v. State of Washington*, 115 P.3d 1080, 1085 (Wash. Ct. App. 2005).

There was no evidence below — McLane offered none — to demonstrate that the prices the manufacturers charged their affiliated sales organization are prices that “a completely unaffiliated entity would have had to pay to purchase” those same products. In fact, the evidence was to the contrary. McLane admitted that it is unaffiliated with UST Manufacturing and that it cannot buy tobacco products at the price UST Sales pays for those products. Mr. Tamaro’s statement that UST Manufacturing’s price is “designed” to meet the IRS’s transfer pricing regulations does not change McLane’s admission. *See Tamaro Aff.*, ¶ 16 (A.80). Even the experts in the Washington litigation acknowledged that an established price required a fair market value price higher than that charged the affiliate sales organization. *See United States Tobacco Sales & Marketing*, 115 P.3d at 1081 (Sales paid .625/can), *id.* at 1082 (expert’s fair market value price was .68-.72/can). Nevertheless, the Washington court was “not convinced that [this] range . . . truly reflects the fair market value of the [tobacco products] sold by Tobacco Manufacturing in 1992.” *Id.* at 1085.

McLane purchased tobacco products from a “person” — UST Sales or Conwood Sales — at either an “established price” or “the price stated on the price list in effect at the time” of that person’s sale to McLane. Because the Tax Court properly construed the

plain and unambiguous language, because McLane's arguments ignore that language, and because the Tax Court's construction is consistent with the Legislature's expressly stated intent, this Court should affirm the Tax Court's Order.

**C. The Tax Court Correctly Applied The Same Statutory Construction Principles To The Current Statutory Language.**

In 2003, the Legislature made two relevant changes to Section 297F.01, subdivision 23. First, the term "established price" was changed to "the price stated on the price list in effect at the time of sale for which a manufacturer or person" sells the taxable product. Minn. Stat. § 297F.01, subd. 23 (2004). Second, a sentence was added at the end of the subdivision: "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." *Id.*

As with its construction of "or person," McLane takes these statutory amendments to mean only one thing: the tobacco tax is imposed only on the manufacturer's price list price. *See* McLane Br. at 20 (arguing that "regardless of who sells the tobacco products," the price is that charged by the manufacturer). And, as with its previous construction arguments, McLane reaches this result only by re-writing the statutory language to eliminate that which does not fit its preferred construction.

It was undisputed below that McLane's suppliers have prices stated on "a price list" that is "in effect at the time of sale" to McLane. *DeMeules Aff.*, Exh. 5 at Gilliam Depo. at 125 (R.A.76). Further, it was undisputed that UST Sales and Conwood Sales distribute price lists to "all customers" that have effective dates and that notify the

customer that prices can change at any time. *See DeMeules Aff.*, Exhs. 22-25 (R.A.85-93). Finally, McLane admitted below that the UST and Conwood manufacturers do not sell tobacco products to McLane, and that the manufacturer's price is not "available" to McLane. *See DeMeules Aff.* Exh. 5, Gilliam Depo. at 81, 118-19, 123-24 (R.A.65, 74-75); *DeMeules Aff.* Exh. 4, Koch Depo. at 39-42 (R.A.30-31).

These undisputed facts remove McLane from the narrow exception stated in the last sentence of the subdivision and leave it squarely within the first sentence. That is, the plain and unambiguous statutory language is applicable to McLane's purchases from its suppliers, at the prices charged by those suppliers. *See Minn. Stat. § 297F.01*, subd. 23 ("price stated on the price list in effect at the time of sale for which a . . . person sells a tobacco product to a distributor"). The only time the definition contemplates using a manufacturer's price *to the exclusion* of any other price is where the manufacturer's price is a "price at which tobacco products are made available for sale to *all distributors on an ongoing basis.*" *Id.* (emphasis added). To construe this language in the manner McLane suggests would require the Court to ignore the clause "at which tobacco products are made available for sale to all distributors on an ongoing basis," an impermissible approach to statutory construction. *See Willmus*, 371 N.W.2d at 213; *see also Gale v. Comm'r of Taxation*, 228 Minn. 345, 349, 37 N.W.2d 711, 715 (1949) (holding that "statute should be so construed that, if it can be prevented, no clause, word, or sentence will be superfluous, void, or insignificant.").

Further, the current version of this definition expressly *excludes* the manufacturer's price as the defined "wholesale sales price" for purposes of computing

McLane's tax liability. The defined price is, as noted, the price "stated on the price list" and "exclusive of any discount, promotional offer, or other reduction." Minn. Stat. § 297F.01, subd. 23 (2006) (emphasis added). To base McLane's tax liability on a price that McLane did not pay (and which is lower than the price McLane did pay) would result in a "reduction" or "discount" in the price stated on the price list. Such a result ignores this unambiguous statutory language.

In addition, the Tax Court's construction preserved the flexibility necessary for applying the statute regardless of the special prices tobacco manufacturers make available only to their affiliated sales companies. Indeed, the Tax Court correctly applied statutory construction principles to ensure that all terms in the statute were preserved. Thus, the court began by "first determine[ing] the sales at issue," Order at 11 (A.52), and finding that only the transaction between McLane and its supplier was the relevant sale. This initial step fulfilled the express legislative intent to impose on the price charged by whomever sells the tobacco products to the Minnesota distributor. Next, the Tax Court recognized that the sales entity's price cannot fit within the language of the last sentence because the sales entity is not a "manufacturer." *Id.* at 12 (A.53). Finally, the Tax Court found that only the sales entity's price was available to "all distributors on an on-going basis," and therefore it was not a discounted or reduced price. *Id.* at 13 (A.53).

The Tax Court's construction was proper as a matter of law because it was consistent with the undisputed facts, it preserved the plain and unambiguous language and all terms of the statute, and it fulfilled the Legislature's intent. McLane's challenge to that construction therefore fails as a matter of law.

### **III. McLANE'S COMMERCE CLAUSE CHALLENGE FAILS AS A MATTER OF LAW.**

McLane alleges that, by construing the definition of “wholesale sales price” to encompass the price that McLane pays for its tobacco product purchases, Minnesota improperly discriminates between in-state and out-of-state commerce. McLane’s strained argument has been rejected by every court that has considered it, including the United States Supreme Court. *See McLane Western, Inc. v. Colorado Dep’t of Revenue*, 549 U.S. 810, 127 S.Ct. 42 (2006) (denying McLane’s Petition for Certiorari). The same result should be reached here.

#### **A. Legal Principles for Commerce Clause Analysis.**

Minnesota’s tobacco tax statutes are presumed constitutional. *See Westling v. County of Mille Lacs*, 581 N.W.2d 815, 819 (Minn. 1998) (citation omitted). “States have wide latitude to establish taxation schemes and a taxpayer challenging the constitutionality of a statute bears a heavy burden.” *Mayo Collaborative Servs., Inc. v. Comm’r of Revenue*, 698 N.W.2d 408, 412 (Minn. 2005) (rejecting Commerce Clause challenge to health care tax) *cert. denied*, 546 U.S. 1171, 126 S.Ct. 1334 (2006). The taxpayer must prove “beyond a reasonable doubt” that the statute violates a constitutional right. *See Westling*, 581 N.W.2d at 819. Further, the Court’s review of taxation statutes is inherently deferential because taxation is a legislative function exercised with broad power. *See Metro Sports Facilities Comm’n v. County of Hennepin*, 478 N.W.2d 487, 489 (Minn. 1991); *Guillams v. Comm’r of Revenue*, 299 N.W.2d 138, 142 (Minn. 1980).

The Commerce Clause is an affirmative grant to Congress of the power to “regulate Commerce with foreign Nations, and among the several States.” U.S. CONST. art. I, § 8, cl. 3; *Fulton Corp. v. Faulkner*, 516 U.S. 325, 330 (1996). Even when Congress has not exercised this power, the dormant Commerce Clause has long been understood to prohibit state legislation that is inimical to interstate commerce. See *Oklahoma Tax Comm’n v. Jefferson Lines, Inc.*, 514 U.S. 175, 179-80 (1995). The dormant Commerce Clause “prohibits economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.” *Fulton*, 516 U.S. at 330 (internal quotation marks omitted); see also *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 273 (1988) (challenged measure must be “designed to benefit in-state economic interests by burdening out-of-state competitors”). The Commerce Clause’s “fundamental command” is that “a State may not tax a transaction . . . more heavily when it crosses state lines than when it occurs entirely within the State.” *Associated Indus., Inc. v. Lohman*, 511 U.S. 641, 647 (1994); see also *Mayo Collaborative Servs., Inc.*, 698 N.W.2d at 412 (“A state tax discriminates against interstate commerce if it gives differential treatment to in-state and out-of-state economic interests that benefits the former and burdens the latter.”) (citations, quotations omitted). In assessing the constitutionality of state tax schemes under the dormant Commerce Clause, the Supreme Court has adopted a four-part test:

[A] state tax . . . will not survive Commerce Clause scrutiny if the taxpayer demonstrates that the tax (1) applies to an activity lacking a substantial nexus to the taxing State; (2) is not fairly apportioned; (3) discriminates against interstate commerce; or (4) is not fairly related to the services provided by the State.

*Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). McLane’s challenge is limited to the third factor, the anti-discrimination prong. “The term ‘discrimination’ in the dormant Commerce Clause context means differential treatment of in-state and out-of-state interest that benefits the former and burdens the latter.” *Chapman*, 651 N.W.2d at 834 (citing *Oregon Waste Sys. Inc. v. Dep’t of Env’tl. Quality*, 511 U.S. 93, 99, 114 S.Ct. 1345, 1350 (1994)).

**B. Minnesota Imposes A Uniform Tax Rate On A Defined Set Of Activities. McLane’s “Shifting Tax Base” Theory Is Therefore Misplaced.**

McLane argues that, because the price of some tobacco products increases as those products move through some distribution chains, Minnesota’s tobacco tax is an impermissible “shifting tax base.” The possible disparity that McLane claims results from the higher tax that *might* be owed by an in-state distributor who buys through a hypothetical multi-tier distribution network, versus the lower tax that out-of-state distributors *might* owe on purchases made in a single tier distribution network. *See* McLane Br. at 33-35. McLane’s argument is flawed because it relies heavily, if not exclusively, on hypothetical scenarios. *See id.* at 38. The United States Supreme Court’s Commerce Clause jurisprudence, however, does not rest on speculation. *See Associated Indus. of Missouri v. Lohman*, 511 U.S. 641, 654, 114 S. Ct. 1815, 1824 (1994) (noting that Court has “never deemed a hypothetical possibility of favoritism to constitution discrimination” for Commerce Clause purposes).

Minnesota imposes a uniform tax rate — 35% — on a uniform tax base — the “wholesale sales price” — when certain taxable activities occur. *See* Minn. Stat. § 297F.05, subd. 3 (2006). The thrust of McLane’s Commerce Clause challenge is that discrimination in tax burden can only be avoided if McLane’s tax liability is based on a transaction that occurs outside of Minnesota and to which McLane is not a party. Nothing in Commerce Clause jurisprudence dictates this result.

“In examining whether a state enactment violates the ‘dormant’ aspect of the Commerce Clause, courts must first determine if the regulation provides ‘differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.’ Non-discriminatory state laws that have only an incidental effect upon interstate commerce will be considered valid unless ‘the burden imposed on such commerce is clearly excessive in relation to putative local benefits.’” *Eby-Brown Co., LLC v. Wisc. Dep’t of Agriculture*, 295 F.3d 749, 756 (7<sup>th</sup> Cir. 2002) (addressing tobacco products distributor’s challenge to cigarette unfair sales act) (citations omitted).

There is no differential treatment in Minnesota’s tobacco tax because it applies equally to in-state and out-of-state distributors. In particular, there is no differential treatment that benefits in-state interests at the expense of out-of-state interests. Indeed, as the Colorado Court of Appeals pointed out in responding to McLane Western’s Commerce Clause challenge to Colorado’s similar tobacco tax, this structure *discourages* out-of-state entities from moving into Minnesota, because doing so could make such entities the tax liable distributor. *See McLane Western, Inc.*, 126 P.3d at 216 (“neither Manufacturing or Sales is encouraged to move into the state because they might well

become the taxable distributor.”). Similarly, nothing in Minnesota’s tobacco tax statutes distinguishes between in-state and out-of state distributors such that distributors are compelled to move operations into Minnesota in order to lower their Minnesota tobacco tax liability. *See, e.g., Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 400-01, 104 S. Ct. 1856, 1865 ( 1984) (noting that New York tax provides a “positive incentive for increased business activity” in state, while penalizing increases in activity outside of state).

McLane’s complaint, notwithstanding its protests to the contrary, *see* McLane Br. at 48, rests in the fact that its Minnesota tobacco tax liability is higher on its purchases from a manufacturer’s affiliated sales entity than on its purchases direct from a manufacturer. This result, however, is a function of the organization model chosen by some of McLane’s suppliers — not Minnesota’s tobacco tax structure. In fact, although McLane argues that there is no support in the record for the pricing structure used by its distributors, McLane submitted the variance in pricing (e.g., “inter-company pricing”) between the affiliated UST and Conwood entities to demonstrate how McLane’s tax liability increased based on the sales entities’ prices. *See* Gilliam Aff., Exhs. 1-2 (A.72-77).

Moreover, no reported decision has invalidated a tax statute under the Commerce Clause because the tax was imposed on the price the tax liable party paid for the items purchased, rather than a price that tax liable party did not pay. Indeed, courts have rejected the notion that a Commerce Clause violation occurs with the *possibility* of a lower tax liability based on a price that is not available to the taxpayer in a transaction to

which the taxpayer is not a party. *See, e.g., McLane Western, Inc.*, 126 P.3d at 215-17; *see also Eby-Brown Co., LLC*, 295 F.3d at 757 (rejecting Commerce Clause challenge, noting that the “fact that doing business in Wisconsin has become more difficult for Eby-Brown does not mean the Act violates the principles of interstate commerce.”); *Kansas Tobacco Candy Dist. & Vendors, Inc. v. McDonald*, 519 P.2d 1110, 1115 (Kan. 1974) (rejecting Commerce Clause challenge and noting that “all purchases without discrimination are taxed equally at an equal and constant tax rate of ten percent”).

The Supreme Court’s decision in *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 83 S.Ct. 1201 (1963) does not change this conclusion. In *Halliburton*, the taxpayer manufactured and assembled oil well servicing equipment in Oklahoma. *Id.* at 66, 83 S.Ct. at 1202. That equipment was not sold to a third party, but was assigned to a field location for the taxpayer’s use, including in some instances, field locations in Louisiana. *Id.* The State of Louisiana imposed, and the taxpayer paid, use tax on the oil well equipment. *Id.* at 67, 83 S.Ct. at 1202. The tax on the equipment manufactured in Oklahoma was based on the total manufacturing and assembly cost, including labor and shop overhead. *Id.* If, however, the taxpayer had manufactured and assembled that same equipment in Louisiana, the tax would have been computed *without* considering the labor and shop overhead costs. *Id.* at 67, 83 S.Ct. at 1203. Because Louisiana’s tax discriminated against the out-of-state manufacturer-user by pressuring it to move into Louisiana (and therefore avoid the labor and shop overhead costs of the tax), the tax violated the Commerce Clause. *See id.* at 72, 83 S.Ct. at 1205 (noting that tax is

discriminatory where it “encourages an out-of-state operator to become a resident in order to compete on equal terms.”).

*Halliburton* therefore represents a consistent application of the rule that in-state businesses cannot be preferentially treated by denying a tax benefit to out-of-state businesses, where the out-of-state business’ tax rate changes based on out-of-state activities. Further, in this respect, the *Halliburton* decision is no different from the decisions in *I.M. Darnell & Sons Co. v. City of Memphis*, 208 U.S. 113, 28 S. Ct. 247 (1908), and *Walling v. Michigan*, 116 U.S. 446, 6 S.Ct. 454 (1886), which McLane cites. Both decisions invalidated a tax because it was imposed on out-of-state parties and not on equally situated in-state taxpayers. See *I.M. Darnell & Sons*, 208 U.S. at 116, 28 S. Ct. at 248 (logs removed from property within state were exempt from tax); *Walling*, 116 U.S. at 458, 6 S. Ct. at 459 (no similar tax imposed on in-state liquor manufacturer).<sup>10</sup>

The decisions that have rejected Commerce Clause challenges to tobacco taxes have, similarly to these decisions, recognized there is a distinction between preferential tax treatment of in-state taxpayers, as opposed to tax liability based on supplier business models. The Colorado Court of Appeals, for example, recognized that the competitive disadvantage resulting from pricing differences does not translate to a Commerce Clause violation. That court acknowledged that “the tax base will be higher the later in the

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<sup>10</sup> The *I.M. Darnell & Sons* and *Walling* decisions are of limited value since both appear to apply the “come to rest” test that was abandoned when the Supreme Court adopted the four-factor test in *Complete Auto*. See *D.H. Holmes Co. Ltd v. McNamara*, 486 U.S. 24, 31, 108 S.Ct. 1619, 1623 (1988) (noting that “come to rest” test makes “little difference” after *Complete Auto*).

distribution network the product is taxed,” but disagreed “with McLane Western’s conclusion that this fact renders the tax unconstitutional under the Commerce Clause.”

*Id.* at 215. As the appellate court stated:

The tax is imposed on an activity within the state, the sale and distribution of OTP, not on the product or the distribution network. The fact that the tax base calculated on the price paid by the taxable distributor may place the product at a competitive disadvantage in the marketplace because the higher tax is added to the price does not, in our view, render the tax unconstitutional under the Commerce Clause. All taxable distributors of OTP are taxed at the same rate and on a tax base determined in the same fashion.

*Id.* at 216; *cf. Chapman*, 651 N.W.2d at 834 (noting that statute denied exemption for contributions to out-of-state charities, and therefore facially discriminated by affording preference to in-state activities).<sup>11</sup>

Here, Minnesota’s consistent tax rate is imposed only on the activities that result in tax liability. Minnesota’s tobacco tax does not tax “commerce itself,” and is applied equally to all distributors.<sup>12</sup> McLane’s preference to pay less tax because its suppliers

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<sup>11</sup> The *Chapman* Court found the challenged statute facially discriminatory. 651 N.W.2d at 834. McLane’s Commerce Clause challenge, in contrast, rests on the novel theory that, despite the neutral statutory language, in-state distributors are treated detrimentally compared to out-of-state distributors.

<sup>12</sup> McLane’s suggestion that the Commissioner has treated distributors different is misplaced. *See* McLane Br. at 39, n.11. McLane refers to the tax imposed on incidental sample distributions. Thus, if UST Sales purchased tobacco products from UST Manufacturing to use as sample products, — that is, UST Sales did not re-sell those products but distributed them in Minnesota as samples — Minnesota’s tobacco tax is calculated and paid on the price UST Sales paid UST Manufacturing. *See* DeMeules Aff. Exh. 5, Gilliam Depo. at 78-79 (acknowledging that Sales brought sample products into Minnesota and did not re-sell those products) (R.A.64); *see also* DeMeules Aff., Exh. 17 (Mar. 13, 1997 letter) (tax basis for samples should be purchase price from manufacturer) (R.A.81).

increased their prices in a corporate reorganization does not demonstrate a Commerce Clause violation, particularly “beyond a reasonable doubt.”

Nor can McLane show a Commerce Clause violation by hypothesizing about each transaction through which tobacco products might move. *See* McLane Br. at 37-38. The United States Supreme Court has “never deemed a hypothetical possibility of favoritism to constitute discrimination that transgresses constitutional commands. . . . we have repeatedly focused our Commerce Clause analysis on whether a challenged scheme is discriminatory in effect.” *Associated Indus. of Missouri v. Lohman*, 511 U.S. 641, 654, 114 S.Ct. 1815, 1824 (1994) (citations omitted).

McLane, however, seeks to create an “effect” by focusing solely on the price charged by a manufacturer in a transaction to which McLane is not a party. *See* McLane Br. at 36. As the State of Colorado pointed out in opposing McLane’s Petition for Certiorari to the United States Supreme Court: “Basing a taxpayer’s burden on an ancillary transaction that does not involve the taxpayer would be novel in the area of transactional and excise taxes. Nothing in the Commerce Clause or this Court’s precedent requires or justifies such a strange result.” Brief of Respondents In Opposition to Petition For Writ of Certiorari at 4, *McLane Western, Inc. v. Colorado Dep’t of Revenue*, No. 05-1294 (U.S., June 4, 2006) reported at 2006 Westlaw 1621795. The only relevant transaction — in which McLane pays a higher tax on its purchases from UST Sales or Conwood Sales — results from a corporate reorganization decision, not Minnesota’s tax.

McLane rejects this reality, relying instead on the analysis provided by Professor Hellerstein, who represented McLane before the United States Supreme Court. See McLane Br. at 44-45; see also Petition For Writ of Certiorari, *McLane Western, Inc. v. Colorado Dep't of Revenue*, No. 05-1294 (U.S., Apr. 7, 2006), reported at 2006 Westlaw 937513. Thus, while Professor Hellerstein may find the Colorado court's opinion "troublesome," he presented that view to the Supreme Court, and that Court did not find that Colorado's application of the high Court's Commerce Clause jurisprudence warranted further review.

Finally, McLane's distinction of the decision in *Kansas Tobacco-Candy Distributors & Vendors, Inc. v. McDonald*, 519 P.2d 1110 (Kan. 1974) is unavailing. While the Kansas Supreme Court found the taxpayer's Commerce Clause challenge to be "obscure," it recognized that tobacco products were "taxed equally at an equal and constant tax rate of ten percent," and therefore the tax was not discriminatory. *Id.* at 1115. The same is true of Minnesota's tobacco tax: regardless of the price list price paid, all tobacco products are taxed at an equal and constant rate of 35% of that price. See Minn. Stat. § 297F.05, subd. 3; see also *Kansas Tobacco-Candy Distributors & Vendors, Inc.*, 519 P.2d at 1114 (noting that a tax does not discriminate simply because "some retailers pay a higher wholesale price than others for the same goods.").

### **C. McLane's Remaining Arguments Are Unavailing.**

McLane chastises the Tax Court for failing to "look for discrimination," for "conceiv[ing] of some ways" in which the statute could be constitutional, and for

engaging in a “shallow analysis.” See *McLane Br.* at 41-42 & 49. McLane’s attacks ignore the Tax Court’s actual holding and the guidance provided by controlling Commerce Clause jurisprudence.

First, McLane’s arguments are an undisguised effort to shift its burden of proof to the Tax Court. McLane, however, not the Tax Court, bore the “heavy burden” of establishing its constitutional challenge “beyond a reasonable doubt.” See *Mayo Collaborative Servs., Inc.*, 698 N.W.2d at 412; *Walker*, 642 N.W.2d at 751. The Tax Court correctly presumed that Minnesota’s tobacco tax is constitutional, and then cautiously evaluated McLane’s challenges to that constitutionality. See *Walker*, 642 N.W.2d at 750 (noting that allegations of unconstitutionality must be approached with “extreme caution”).

The Supreme Court’s decision in *Best v. Maxwell*, 311 U.S. 454, 61 S.Ct. 334 (1940), on which McLane relies for its argument to require a court to search for discrimination, does not diminish McLane’s burden of proof. There, the Court was faced with a statute that facially discriminated against out-of-state retailers. See *id.* at 455, 61 S.Ct. at 335, n.1 (imposing tax on anyone “not being a regular merchant in North Carolina”). As the Court pointed out, interstate commerce “could hardly survive in so hostile an environment.” *Id.* at 456, 61 S.Ct. at 335; see also *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 195, 114 S.Ct. 2205, 2212 (1994) (noting that “avowed purpose and undisputed effect” of challenged statute was to enable in-state producers to compete against out-of-state farmers). In contrast here, recognizing the presumptive constitutionality of Minnesota’s tobacco tax and McLane’s heavy burden of proof, the

Tax Court (and other courts before it) correctly found McLane failed to meet its burden because Minnesota's tobacco tax, with its uniform rate and uniform base, does not discriminate against or burden interstate commerce. *See* Order at 16 (A.57).

Second, McLane complains that the Tax Court erroneously focused on the taxable distributor, rather than the taxable tobacco products. *See* McLane Br. at 43. The Tax Court could not so err, however, because the statute expressly imposes the tobacco tax on the products and on distributors. *See* Minn. Stat. § 297F.05, subd. 3 (tax is imposed "on all tobacco products in this state *and upon any person engaged in business as a distributor*") (emphasis added). Further, the Tax Court in fact considered McLane's argument about the taxable products, which of course, are sold by distributors. *See* Order at 15 (A.56) (stating McLane's argument as, "each layer in the distribution network marks up the price, and thus, *the tax imposed on the product* will be higher for those selling later in the distribution network") (emphasis added). In short, the Tax Court did not create the artificial distinction between the taxable tobacco products and the taxable distributors that move those products that McLane claims occurred.

Third, McLane argues that the Tax Court erred in stating that the "tax is imposed only on in-state activity." *See* McLane Br. at 46. The Tax Court actually held, however, that the "ultimate increase" in McLane's taxes "is not caused by any action of the State of Minnesota; it is due to the change in pricing by McLane's supplier." Order at 16 (A.57). The Tax Court's reasoning was thus *consistent with* the Supreme Court's decision in *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 101 S.Ct. 2946 (1981). In that case, which McLane cites, the Court upheld a tax statute against a Commerce Clause

challenge, finding that the tax was computed at the same rate, regardless of the ultimate destination of the products. *Id.* at 618, 101 S.Ct. at 2954; *see also id.* at 619, 101 S.Ct. at 2954 (“there is no real discrimination in this case; the tax burden is borne according to the amount of coal consumed and not according to any distinction between in-state and out-of-state consumers.”)

Finally, McLane argues the Tax Court erred by focusing on the tax rate, rather than the tax base, citing *Halliburton*, 373 U.S. at 70, 83 S.Ct. at 1204. *See* McLane Br. at 47. Whether the focus is the tax rate or the tax base, the ultimate question remains whether McLane succeeded in showing beyond a reasonable doubt “discrimination in the dormant Commerce Clause context mean[ing] differential treatment of in-state and out-of-state interest *that benefits the former and burdens the latter.*” *Chapman*, 651 N.W.2d at 834 (emphasis added, citation omitted). This preferential treatment of the in-state taxpayer was a critical element to the *Halliburton* Court’s decision. *See* 373 U.S. at 70, 83 S.Ct. at 1204 (“The inequality of Louisiana’s tax burden between in-state and out-of-state manufacturer-users is admitted.”).<sup>13</sup>

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<sup>13</sup> McLane errs when it distinguishes the tax statutes in *Kansas Tobacco-Candy Distrib. & Vendors, Inc.*, 519 P.2d 1110; and in *McLane Co.*, 19 P.3d 1119, as based on “a fixed and certain tax base.” *See* McLane Br. at 47. n.14. The tobacco tax in those cases, as in Minnesota and many other states, was imposed “at the rate of 10% of the wholesale sales price” at the time the distributor “brings or causes to be brought into this state from without tobacco products for sale.” *See Kansas Tobacco-Candy*, 519 P.2d at 1114; *see also McLane Co.*, 19 P.3d at 1121, 1123 (tax imposed on any person who “brings or causes to be brought into this state from without this state, tobacco products” noting that “statute sets the amount of the tax at the fair market price of the product when the manufacturer sells it to the distributor”).

McLane simply could not demonstrate that Minnesota discriminates in its taxation of any tobacco products distributors because the tobacco tax is applied consistently and at the same rate to all distributors. The Tax Court therefore correctly concluded that McLane's constitutional challenge failed as a matter of law, thus warranting summary judgment in the Commissioner's favor.

### CONCLUSION

For all the reasons stated above, the Commissioner respectfully requests that this Court affirm the Tax Court's Order granting the Commissioner's Motion for Partial Summary Judgment.

Dated: November 17, 2008

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## CERTIFICATE OF COMPLIANCE

The undersigned, Rita Coyle DeMeules, hereby certifies pursuant to Minn. R. Civ. App. P. 132.01, subd. 3(c), that the word count of the attached Brief of Respondent Commissioner of Revenue is 9, 630 words. The Brief complies with the typeface requirements of the rule and was prepared and the word count was made, using Microsoft Word 2003.

Dated: November 7, 2008

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