Bartel

IN THE DISTRICT COURT OF LANCASTER COUNTY, NEBRASKA

ALIANT COMMUNICATIONS CO., d/b/a ALLTEL, a Delaware Corporation.	)	CASE NO. CI00-3002
and	)	
ALIANT SYSTEMS INC. d/b/a ALLTEL, a Nebraska Corporation, Petitioners-Appellants,	)	
vs.	)	**ORDER**
NEBRASKA DEPARTMENT OF REVENUE, an Agency of the State of Nebraska,	)	
and	)	
MARY JANE EGR. Tax Commissioner,	)	
Respondents-Appellees.	)	

DEPT. OF JUSTICE
MAY 0 3 2001
STATE OF NEBRASKA

I. STATEMENT OF THE CASE

This is an appeal from the Department of Revenue ("Department") pursuant to Neb.Rev.Stat. §§ 77-27,127 (Reissue 1996) and 84-917 (Cum.Sup. 1998). On February 16, 1999, the Department issued a deficiency assessment to Aliant Communications Co. d/b/a ALLTEL ("Aliant Co."). An audit of Aliant Systems Inc. d/b/a ALLTEL ("Systems") also resulted in a deficiency assessment on November 30, 1999. On February 11, 2000, the "Petition for Redetermination" filed by Aliant Co., and the "Claim of Overpayment of Sales and Use Tax" filed by Systems, were consolidated for the purpose of hearing and decision of the common issue. A hearing on this consolidated case was held before the State Tax Commissioner, Mary Jane Egr (the "Commissioner") on May 16 and 17, 2000.

The issue tried before the Commissioner was whether Aliant Co. and Systems' receipts for installation labor services performed entirely on the "customer side" of the "demarcation point" (defined in paragraph 19 of Exhibit 35, the Stipulation of the parties) on which the Department has assessed sales tax are properly subject to sales tax as gross receipts of persons engaged as a public utility pursuant to Neb.Rev.Stat. §§ 77-2703 and 77-2702.07(2).

The Commissioner sustained the Notice of Deficiency Determination issued to Aliant Co. relating to the issue submitted for decision and denied the Claim for Overpayment of Sales and Use Tax submitted by Systems as it related to such issue submitted for decision.

II. STANDARD OF REVIEW

Pursuant to Neb.Rev.Stat. § 84-917(5)(a) (Reissue 1996), the District Court's review shall be conducted "de novo on the record of the agency."

III. STATEMENT OF FACTS

Aliant Co. is a Delaware corporation, domesticated under the laws of the State of Nebraska, with its principal offices and place of business located at 1440 M Street in Lincoln, Nebraska. During the audit period (February 1, 1995 through March 31, 1998) Aliant Co. operated as a diversified communications company that provided retail services and products, including local exchange telephone service and intrastate message toll service to residential and business customers, educational institutions and governmental agencies located in 22 contiguous counties in southeastern Nebraska. Aliant Co. also purchased telephones and resold them to its residential and business customers. Aliant Co. also provided and installed voice mail and custom calling features such as call waiting and caller ID remotely from its central office. If requested by a customer, Aliant Co. also installed facilities such as inside wiring.

Systems is a Nebraska corporation with its principal offices and place of business located at 2201 Winthrop Road in Lincoln, Nebraska. During the audit period (July 1, 1995 through June 30, 1998), Systems provided intrastate message toll telephone service through its division known as Lincoln Telephone Long Distance and later as Aliant Long Distance; provided sales and leases of telephone systems and other equipment; provided installation of and training for the operation of telephone systems and other equipment; provided service agreements related to telephone systems and other equipment; and provided telephone answering service. Systems also purchased pre-manufactured telephone systems and resold them to customers. Among the systems it sold and installed were PBX systems, Key systems, voice mail systems, call monitoring systems, facsimile machines and intercom systems. Each of these systems had a variety of features and functions, and varied in cost depending on the specific needs and requirements of the customer.

On March 1, 1983, certain aspects of telephone services became deregulated when the Nebraska Public Service Commission issued an Order which, among other things, directed that the telephone customer would thereafter be responsible for the installation, repair and maintenance of inside station wiring and for the repair and maintenance of existing station wiring. Telephone customers were also allowed to purchase their own terminal equipment from sources other than the service provider. Telephone companies were to continue to own facilities up to a "demarcation point", which is the point at which the facilities that are owned and maintained by a telephone company are connected to the inside wiring owned by and dedicated to an individual customer's use.

Aliant Co. owns the lines and equipment up to the demarcation point where a protector against electrical surges such as lightning strikes is installed. This demarcation point is the point

of connection to the customer's business or residence so that the customer may receive local exchange service and message toll telephone service. The customer owns the lines downstream from the point of demarcation. Aliant Co. is responsible for everything on its side of the demarcation point. Aliant Co. and Systems do sell and service equipment that is used on the customer's side of the demarcation point. All facilities on the customer's side of the demarcation point are deregulated, are not a part of Aliant Co.'s rate base, and the customer is responsible for everything on his or her side of the demarcation point. It is undisputed that all labor on services in question were performed on the customer's side of the demarcation point for the purposes of the issue before this Court.

All equipment and facilities on the customer's side of the demarcation point are not a part of the public utility functions of either Aliant Co. or Systems. Revenue from public utility functions does not include gross receipts derived from internet access, intercom or paging devices, none of which are within the definition of public utility services.

The Department assessed the gross receipts that Aliant Co. derived from installations, moves, equipment changes and additions. In regard to Systems, the Department assessed the gross receipts that Systems derived from installing telephone systems, equipment and wiring. The disputed items, for the purpose of this Order, relate only to the various installation services performed by Aliant Co. and Systems on the customer side of the demarcation point, and the sales tax on those charges has been stipulated to be $136,095.00 and $98,307.00, respectively.

IV. ANALYSIS

The Petitioner's position is that sales tax is appropriately imposed only with regard to labor for installation and connecting the public utility facilities up to, but not beyond, the

demarcation point. The Petitioner has argued that sales tax should not be charged for labor services on the "deregulated side" of the demarcation point. In other words, no sales tax should apply to labor associated with installation, inside wiring or wall jacks within the customer's residence or business.

A. Legislative History

The Legislative history supports the Petitioner's position insofar as it indicates the Legislature's intention to tax the labor associated with the connection of public service utilities to the residence or business but not to impose sales tax on labor charges associated with the installation, inside wiring or wall jacks within the house or business. Dial tone associated with the provision of local exchange telephone service and intrastate message toll telephone service is delivered at the demarcation point

In contrast, the Department concluded in its Order that: "Regardless of who owns the inside wiring or the terminal equipment, it is used *in conjunction with* the equipment of the telephone service provider to provide the level of telecommunications required by the customer." (Department's emphasis) (Tr. 74). On such basis, the Department found that the gross receipts from installation labor relating to such equipment are subject to sales tax pursuant to the last paragraph of Section 77-2702.07(2). This view, however, not only ignores the facts, but further ignores the legislative history of this section which explains the intended purpose of the applicable statutes.

A review of the legislative history of LB 1027 relating to the enactment of Section 77-2702.07(2) and LB 523 relating to Section 77-2702.07(2) demonstrates that in the passage of this legislation, it was the labor associated with the connection of public service utilities to the residence or business that was to be subject to sales tax—not the labor associated with installing

the inside wire or wall jacks in the house that deliver the telephone service dial tone for local and long distance service that is hooked up at the demarcation point.[1]

The principle that runs through the legislative history is that the scope of the sales tax on furnishing, installing and connecting public utility telephone communication service is limited to the connection that brings such service to the business or residence. As stipulated by the Department, this connection is effected at the demarcation point. It is stipulated that Aliant Co. and Systems have collected and remitted sales tax on such labor charges for installations up to

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[1] When Senator Vard Johnson introduced Amendment 2773 to LB 1027 on April 3, 1986, he described it as follows:

> This amendment is sort of a catchall amendment that covers a variety of areas that were brought to the Revenue Committee sometime after 1027 went to the floor. The committee has gone over virtually all of these little provisions. . . . The eighth amendment is one that sort of comes in conjunction with LB 835 but it is an extension of the sales tax to cover certain installations, connections and furnishing of tangible personal property *associated with the provision of public service utilities.*

1986 Legislative Journal at pages 11393-4 (emphasis added). A few days later, Senator Hannibal reacted to Senator Johnson's "little provisions", and the intent thereof, with the following statement:

> . . . what I need to tell you is what this bill is doing is expanding our sales tax on services and the reason why I took a particular interest in it is because I found out it is expanding the sales tax on services *for installation of all the things we hook up to houses and all the things we hook up to commercial buildings* such as water lines, sewer lines, gas lines, telephone lines, cable television lines. . . . *This is taxing the service over and above the materials that go into putting these lines in.*

1986 Legislative Journal at page 12199 (emphasis added).

> In 1987, when LB 523 was introduced to repeal the sales tax on labor associated with utility hook-ups, Senator Withem offered the following comments during floor debate:
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> The intent of the bill [LB 1027] at that time was to impose a *sales tax on utility connection fees* which was to have generated about $2 million. And, as I recall conversations with the bill afterwards, *the prime target of that tax was telephone hookups and cable television hookups.* In addition to that, there was water and electrical and gas charges added onto it. What Senator Hannibal's amendment does is it leaves in place telephone connections. It leaves in place cable TV connections . . . What will be repealed will be this particular provision of the bill which the Revenue Department has admitted is virtually unenforceable and has caused nothing but confusion . . . .

1987 Legislative Journal at page 6443 (emphasis added).

the demarcation point. All amounts sought in these cases for sales tax on installation labor are related to labor pertaining to unregulated facilities on the customer side of the demarcation point.

B. *Department of Revenue Regulations*

Regulation 065.05, on which the Department relies for these assessments, does not provide an independent basis for taxation. The Department's manager for tax formulation acknowledged that the legal basis for Regulation 065.05 is Section 77-2702.07(2), and that the scope and extent of a Department Regulation is confined to its statutory source. *See* Tr. 156:17-157:19. An administrative agency cannot use its rulemaking power to modify, alter, or enlarge provisions of statute that it is charged with administering. *See Spencer by and through Spencer v. Omaha Public School Bd.*, 252 Neb. 750, 566 N.W.2d 757 (1997) and *County Cork, Inc. v. Nebraska Liquor Control Com'n*, 250 Neb. 456, 550 N.W.2d 913 (1996).

The analysis of the law and facts set forth in the preceding sections of this Order establish that neither Section 77-2702.07(2) nor Section 77-2703 provide a basis for assessing sales tax on the gross receipts from labor services provided by Aliant Co. and Systems at issue herein. Based upon the foregoing principle, the Department cannot, through the adoption of Regulation 065.05 enlarge its power to assess sales tax.

C. *Cox Cable of Omaha v. Dept. of Revenue*

The Department tries to find support for its position in the case of *Cox Cable of Omaha v. Dept. of Revenue*, 254 Neb. 598, 578 N.W.2d 423 (1998), but such support is missing. *Cox Cable* is distinguishable from the facts of this case because in the *Cox Cable* case the labor which was subject to the tax was expended in connection with installation or connection of *regulated* facilities of a public utility that serve the customer and therefore such labor services

are subject to sales tax.[2] Indeed, the *Cox Cable* court emphasized the regulated nature of these services.[3]

Thus, Cox Cable does not provide a precedent to impose sales tax in the instant case in which the labor on which sales tax has been assessed does not relate to connection and installation of *regulated* facilities.

D. Equitable Estoppel

The Petitioner has also raised equitable estoppel. Although the Petitioner is correct that government entities may be equitably estopped under compelling circumstances, the doctrine is difficult to apply in tax situations. On September 22, 1986, Roger Hirsch, then the Deputy Tax Commissioner, wrote a "Dear Telephone Company" letter stating in relevant part:

> Charges for installing shall mean the amount charged for the assembling and placement of all components necessary to affect delivery of the service from your general delivery system (central office including local plant facilities) to the point at which the utility enters the customer's property (through but not beyond the protector).

(Exhibit 6). However, since 1993, the Department of Revenue has been issuing deficiency assessments contrary to Hirsch's letter.[4]

Assuming, without conceding that equitable estoppel could be invoked with regard to collection of taxes, which is strictly a governmental function, the change of regulation would have given notice that the policy had changed as early as 1993 when Regulation 1-065 was adopted. Thus, the Petitioner certainly has not met the burden of proof in showing that the six elements as set out in *Woodward v. City of Lincoln*, 256 Neb. 67 have been met.

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[2] As stipulated by the parties, *regulated* facilities extend only to the demarcation point and all labor at issue was performed on the customer side of the demarcation point.

[3] In the paragraph in which the Supreme Court stated its holding in *Cox Cable*, the Court uses the word "regulated" five times in connection with the description of services, the gross receipts from which are properly subject to sales tax. 254 Neb. at 604-605.

[4] In 1993, Department REG-1-065 TELEPHONE AND TELEGRAPH SERVICES, was formally amended in contravention of the Hirsch letter.

V. CONCLUSION

The weight of the evidence supports the Petitioner's argument that the gross receipts from the labor services at issue do not relate to public utility functions, nor do such receipts relate to the "connecting or installing of services" pursuant to Neb.Rev.Stat. §§ 77-2703 and 77-2702.07(2).

Therefore, the Order of the Department and Commissioner are set aside. Aliant Co. and Systems are not subject to sales tax, interest or penalty relating to the gross receipts from the installation labor charges on the customer side of the demarcation point.

Accordingly, the Department and Commissioner are directed to redetermine Aliant Co.'s deficiency for sales tax in compliance with this Order.

It is further ordered that Department and Commissioner refund to Systems all of the sales tax, interest and penalties paid to the Department relative to the installation labor charges at issue in this matter.

Dated: May 2, 2001.

BY THE COURT:

Earl J. Witthoff, District Judge

cc: Paul M. Schudel, attorney for Petitioners-Appellants
L. Jay Bartel, attorney for Respondents-Appellees