IN THE DISTRICT COURT OF LANCASTER COUNTY, NEBRASKA

NORRIS PUBLIC POWER DISTRICT, Public Corporation and Political Subdivision of the State of Nebraska Plaintiff, vs. STATE OF NEBRASKA, NEBRASKA DEPARTMENT OF REVENUE and DOUGLAS A. EWALD, TAX COMMISSIONER OF THE STATE OF NEBRASKA Defendants.	)	CI 07-837 ORDER

SEWARD COUNTY RURAL PUBLIC, POWER DISTRICT, a Public Corporation and Political Subdivision of the State of Nebraska Plaintiff, vs. STATE OF NEBRASKA, NEBRASKA DEPARTMENT OF REVENUE and DOUGLAS A. EWALD, TAX COMMISSIONER OF THE STATE OF NEBRASKA Defendants.	)	CI 07-1069 ORDER

THIS MATTER COMES before the court on May 23, 2007. Tom Jeffers and Steven Seglin appeared on behalf of Plaintiffs. L. Jay Bartel appeared on behalf of Defendants. Arguments were heard, evidence was adduced, and the case was submitted on briefs. The court, being fully informed, now hereby finds and orders as follows:

BACKGROUND

Plaintiff, Norris Public Power District (Norris) is a public corporation and political subdivision of the State of Nebraska organized and created pursuant to NEB. REV. STAT. §§ 70-601 to 70-681 (Reissue 2003 and Cum. Supp. 2004) with its principal office located in Beatrice, Gage County, Nebraska. Norris is engaged in the business of the transmission and distribution of electric power at wholesale and retail to customers located in all or part of a five county area within Nebraska, where it sells electric power to customers at retail.

Plaintiff, Seward County Rural Public Power District (Seward) is a public corporation and political subdivision of the State of Nebraska organized and created pursuant to Neb. Rev. Stat. §§ 70-601 to 70-681 (2003 and Cum. Supp. 2004) with its principal office in Seward, Seward County, Nebraska. Seward is engaged in the business of the transmission and distribution of electric power at retail to customers located in all or part of a five county area within Nebraska, where it sells electric power to customers at retail. Seward and the municipalities it serves operated under Nebraska Public Power District (NPPD) contracts until January 1, 2004.

Defendant Nebraska Department of Revenue is a department of State government, established pursuant to NEB. REV. STAT. § 77-360 (2003). Defendant

Douglas A. Ewald is the duly acting and qualified Tax Commissioner of the State of Nebraska. In July 2005, the Department commenced an audit of Seward. In August of 2005, the Department commenced an audit of Norris. Both audits included an examination of sales tax records and returns.

On December 30, 2005, the Department issued to Norris a Notice of Deficiency Determination for sales and consumer's use taxes for the periods July 1, 2002 through June 30, 2005. On the same date, the Department issued to Seward a Notice of Deficiency Determination for sales and consumer's use taxes for the periods June 1, 2002 through May 31, 2005. Norris and Seward timely protested the Notice of Deficiency Determination, by filing a petition for determination. The Commissioner entered his order affirming the determinations on February 23, 2007.

There are four tax determinations the Districts now appeal.

I. Sales Tax on Lease Fees and Gross Revenue Tax

Norris and Seward (collectively referred to as "the Districts") have entered into agreements with villages and cities (Municipalities) in the State. The Districts have agreed to provide customers residing within the Municipalities with electric power at retail and to pay the Municipalities with which it contracts a lease fee. Lease fees are collected under two types of agreements. Under the Distribution System Lease Agreements the lease fee is based on a percentage of gross revenues from sales of electric power to customers within the Municipalities. Under the Professional Retail Operations Agreements, the lease fee is based on a percentage of the District's adjusted retail revenues from sales of electric power to customers within the Municipalities.

Norris itemized the lease fee on the billing statement sent to each of its customers residing within a Municipality. Norris then paid the fee collected to each Municipality based on the agreement between the District and the particular municipality. The lease fee was not set out as a separate line item charge on the bills Seward sent to its customers.

In addition to the lease fee, pursuant to **NEB. REV. STAT.** § 70-651.03 (Reissue 2003), the Districts are required to pay to the county treasurer of the county in which any municipality the Districts serve is located, a gross revenue tax of five percent of the gross revenue derived from retail sales of electricity within those municipalities. (Gross Revenue Tax). The billing statement sent by Norris to its customers included a separate line item charge for Gross Revenue Tax. A separate line item charge did not appear on the bill Seward sent to its municipal customers. Seward's internal documents, however, identified the Gross Revenue Tax it charged to its customers.

The Districts normally did not collect sales tax on lease fees and Gross Revenue Tax. The one exception during the audit period was when certain monies transferred from Nebraska Public Power District to Districts for service, the Districts collected and remitted to the Department sales taxes on lease fees and Gross Revenue Taxes for those municipalities transferred to the Districts. The Districts have not included the Gross Revenue Tax collected from their municipal customers in calculating the lease fees.

The Department has assessed sales taxes on the lease fees and Gross Revenue Tax reimbursement the Districts received from their customers. The Plaintiffs are contesting the assessments. on the ground that these charges are not subject to

sales tax under Nebraska law.

II. Use Taxes on Postage

During the audit period National Information Solutions Cooperative (NISC) printed customer billing statements for the Plaintiffs, sorted, folded and stuffed the billing statements into envelopes stamped with NISC's postal permit number. NISC transported the billing statements to the United States Postal Service (USPS) for delivery. The postage for mailing the billing statements was paid from a postage account NISC had with USPS.

The Districts initially funded this postage account by sending NISC a check made payable to the USPS. NISC delivered the checks to USPS and the amount was credited to NICS's postage account. After the initial deposit was made, the practice was for NISC to notify the Districts of the number of billing statements and the amount of postage required. The Districts then drew a check to cover the amount, payable to the USPS and sent it to NISC. NISC delivered the check to USPS and it was credited to NISC's postal account. The bills were then mailed out under the NISC postal account number.

NISC did not include postage charges on the invoices it sent the Districts. The Department assessed a use tax on the postage to mail the billing statements.

III. Support Fees

In 1989, NISC[1] entered into a licensing agreement with Norris to provide a computer attached processing system, which consisted of engineering, accounting and

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[1] Formerly known as Central Area Data Processing Corporation.

billing software. Norris agreed to pay a monthly service and support fee for programming, member services and operational support. Norris paid tax on the monthly service fees, but not on the monthly support fees. The Department assessed the use tax on the support fees.

IV. Magazine

Each month Norris customers received the District's monthly magazine, the Norris Electric News. Norris provided each new customer who signed up for electric service with a welcome letter and a Customer Guide that addressed the Norris Electric News. The cost for the Norris Electric News Magazine was not invoiced separately on the customer's energy bill. Sales tax was collected by Norris and remitted to the Department. However, there was no sales or use tax paid to the printer of the magazine. The Department has assessed a use tax on the transaction between Norris and the printer.

STANDARD OF REVIEW

Any final action of the Tax Commissioner may be appealed to the district court for Lancaster County under the Administrative Procedure Act. NEB. REV. STAT. § 77-27,127 (Reissue 2003). Under the Administrative Procedure Act, the court reviews the Commissioner's final decision without a jury de novo on the record of the agency. **Neb. Rev. Stat. § 84-917(5)(a)** (Reissue 2003). ***Stejskal v. Dep't of Admin. Servs.***, 266 Neb. 346, 350, 665 N.W.2d 576, 581 (2003). Deference is accorded to an agency's interpretation of its own regulations unless plainly erroneous or inconsistent. ***Sunrise County Manor v. Nebraska Dep't of Social Servs.***, 246 Neb. 726, 736, 523 N.W.2d

499, 504 (1994). A rebuttable presumption of validity attaches to the actions of administrative agencies and the burden of proof rests with the party challenging the agency's action. ***Trackwell v. Nebraska Dep't of Admin. Servs.***, 8 Neb.App. 233, 239 (1999).

ANALYSIS

Plaintiffs appeal the Commissioners determination on each of the issues described above.

Sales Tax on Lease Fees and Gross Revenue Tax

Plaintiffs contend that lease fees and Gross Revenue Tax revenue which the received from their customers are not subject to the sales tax assessed by the Department. Plaintiffs provide two arguments to support their position. First, Plaintiffs' assert that the lease fees and the Gross Revenue Tax are not subject to taxation because the Districts are required to collect those costs from their customers making a sales tax a tax on a tax. Second, the statutory and regulatory definition of gross receipts for tax purposes includes only the cost of power, not any other services.

Plaintiffs assert that neither the lease fees nor the Gross Revenue Tax are included as income on the Districts' books. In part due to that practice, according to the Plaintiffs, the "amounts collected and remitted for the Lease Fees and the Gross Revenue Tax are treated the same as the amounts generally collected from customers for sales tax." (Plaintiff's Brief, 4). Plaintiffs argue that the lease fees, per the signed agreements, and Gross Revenue Tax are to be collected from the individual customers. As such, Plaintiffs contend, the Districts "merely act as conduits between the Municipalities they serve at retail and the electric customers residing within those

Municipalities . . ." (Plaintiffs Brief, p. 5). Plaintiffs conclude therefore, that the lease fees and the Gross Revenue Tax act like a sales tax. To impose a tax on them would be to tax a tax.

Defendants counter that the lease fees and Gross Revenue Tax are expenses of the seller and as such are costs of doing business subject to taxation. The court finds the Defendants' argument persuasive. The Districts are not required to separately charge their customers either for the lease fees or the Gross Revenue Tax.

The statutes place the burden of paying the Gross Revenue Tax on the Districts. **NEB. REV. STAT.** § 70-651.03 does not require the customer to pay a Gross Revenue Tax. Likewise, there is no requirement that the Districts recover the Gross Revenue Tax from its customers. In contrast, other tax burdens, such as sales and use taxes are specified to be collected from the consumer. **NEB. REV. STAT.** § 77-2703(1)(a) (Reissue 2003). Where the statute plainly places the incident of the tax upon the District, the government cannot collect the tax from the consumer. *See* ***Gurley v. Rhoden***, 421 U.S. 200, 205-206 (1975).

Additionally, Plaintiffs argue the Gross Revenue Tax is the same as the sales tax and taxing the Gross Revenue Tax would be a tax upon a tax. The Gross Revenue Tax is not the same as sales tax. "The distinction between a gross-receipts tax and a sales tax is that the latter essentially is a transactional tax on the consumer of goods and services separately stated and collected from the purchaser by the seller, while a gross-receipts tax is a tax on the business activity of the seller." **58 A.L.R.5th 187** (West 2006) (citing Hartman, Federal Limitations on State and Local Taxation § 8.1 (Lawyers

Cooperative Publishing, 1981)). Neither the statutory language nor the legal interpretation of a gross receipts taxes support Plaintiffs' position that to subject the Gross Revenue Tax to taxation creates a tax upon a tax.

Plaintiffs also rely on the Lease Agreements between themselves and the Municipalities to support their position that the burden is on the consumer and therefore the Districts should not be subject to taxation on the lease fees. However, the agreements do nothing to bolster that argument. An example of an agreement with Seward states,

> The gross retail electric revenues received during the term of this Agreement from sales to customers purchasing electricity from the Distribution system shall be adjusted to eliminate (I) any bad debt charge-offs associated with such sales, (ii) revenues from tax-supported agencies receiving a discount (e.g. equal to thirty-three and one-third percent (33 1/3 %) on the effective date hereof, based on the SCPPD current cost of services on the effective date thereof), and (iii) any revenue associated with application of production cost and similar adjustments. During the initial fifteen (15) years this Agreement is in effect, an amount equal to twelve percent (12%) of the retail revenue as so adjusted, as determined by SCPPD records, shall be paid by SCPPD to the Village. The formula for calculating the lease payment to the Village, as described above, shall be implemented and become effective at the beginning of the calendar quarter immediately following the effective date of this Agreement. Such lease payments shall be made on a quarterly basis.

(Ex.5: Tab 14, pg 5). A sample agreement with Norris indicates, "Where the District has an agreement to pay the municipality a percentage of the customer's retail revenue, such percentage will be added to each customer's bill before application of a fuel and production cost adjustment." (Ex.5, Tab 17, p1). While the Norris agreement at least indicates the customer may be billed for the lease fee, it does not change the character

of the revenue derived from the billing.

The Lease fees and the Gross Revenue Tax are both costs of doing business incurred by the Districts. Costs of doing business, like cost of machinery, equipment, or even transportation are included in the cost of the product or service. ***Pepsi Cola Bottling Co. v. Peters***, 189 Neb. 271, 275, 202 N.W.2d 582, 584 (1972). In sum, all the Districts have done here is to elect to itemize on the billing statement to the customer some of the expenses the District intends to pay with the money received from the customer. The Districts could just as easily choose to disclose what portion of the customer's payment will be used to pay the salary of the Chief Executive Officer. This disclosure does not change the character of the revenue generated by the customer's payment for sales tax purposes.

Next, both the Plaintiff and the Defendant assert that the definition of gross receipts is critical to determining the taxation issue with regard to the Gross Revenue Tax. Defendants urge the court to use the general gross receipts definition whereby gross receipts means the total amount of the sale, lease or rental price, as the case may be, of the retail sales of retailers. **NEB. REV. STAT.** § 77-2701.16(7) (Cum. Supp. 2006). However, Plaintiffs contend that gross receipts for a public utility means "[i]n the furnishing of gas, electricity, sewer, and water service . . . the gross income received from the furnishing of such services upon billings or statements rendered to consumers for such utility services." **NEB. REV. STAT.** §§ 77-2701.16(2)(c) and 77-2701.16(8)(c) (Reissue 2003) and (Cum.Supp. 2006).

Defendants rely on the more general definition, in part because that definition is based on sales price, a concept which is statutorily defined.

> Sales price applies to the measure subject to sales tax and means the total amount of consideration, including cash, credit, property, and services, for which personal property or services are sold, leased, or rented, valued in money, whether received in money or otherwise, without any deduction for the following: . . . all taxes imposed on the seller, and any other expense of the seller.

NEB. REV. STAT. § 77-2701.35 (Reissue 2003). Defendants urge the court to focus on the more general definition because it appears as if the statute specifically indicates that gross revenue should always be taxed.

In contrast, Plaintiffs' focus on the more specific public utility definition of gross receipts. Plaintiffs' seem to suggest, with no authority to support the interpretation, that the statute intends gross revenue to reflect only the amount collected for the sale of power. Plaintiffs contend the definition does not include any other monies collected for charges billed to the customers for costs attendant to the power. Further, Plaintiffs argue that the current Department regulations are substantially similar to the statute and provide that gross receipts include the "gross revenue received from furnishing . . .electricity." (Plaintiffs' Brief, p. 7). However, the Department regulation actually reads, gross receipts include the "gross revenue received from furnishing gas, electricity, sewer and water *services*. **NEB. ADMIN. CODE**, Title 316, Ch. 1, § 007.01C (2005) (emphasis added).

Regardless of which definition is used, the regulations and statutes include the language of furnishing electricity *services*.[2] Use of the term "services" does not restrict

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[2] Grammatically, there might be an interesting discussion that the statute, §77-2701.16(2)(c) and 77-2701.16(8)(c) include commas after the word "sewer." This would suggest that the word "services" modifies only "water" rather than the string which precedes the comma. If "services" is to modify the entire string, the Department's administrative rule which does not use a comma after "sewer" is the more correct

gross revenue to only the charge for power. In ***Omaha Pub. Power Dist. v. Nebraska Dep't of Revenue***, the court discussed generating and distributing electricity as components of providing electricity service when determining whether electricity could be considered tangible personal property. 248 Neb. 518, 522, 537 N.W.2d 312, 316 (1995). Providing, or in this case furnishing, electricity services is broader than just one element of cost.

In discerning the meaning of a statute, a court must determine and give effect to the purpose and intent of the Legislature as ascertained from the entire language of the statute considered in its plain, ordinary, and popular sense. ***Capitol City Tel. v. Neb. Dep't of Revenue***, 264 Neb. 515, 528, 650 N.W.2d 467, 478 (2002). In ***Capitol City*** the court found that the utility was subject to sales tax where the statutory language was broadly worded. If the Legislature had intended to tax only the gross receipts attributable to the generation and distribution of electricity rather than all the costs associated with "furnishing" it, it could have so stated. *See* ***Capitol City Tel.*** @ 529, 650 N.W.2d @ 479. The Legislature's use of broader language reflects that it intended the scope of the tax to extend beyond the mere generation and distribution of electricity to all the services provided by the utility. ***Id.***

The imposition of sales tax on the portion of the gross receipts of the Districts which are used to pay the lease fees and the Gross Revenue Tax is not a tax upon a tax. The statutory language regarding gross receipts does not exclude the amount the

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grammatically. However, the meaning of the statute is made clear when it goes on (in spite of the errant comma) to then refer to "such utility services." The court is to give effect to the intended meaning of the statute. The Department's administrative rule appears to do that.

Districts pay for the lease fees and the Gross Revenue Tax. The sales tax assessment by the Commissioner is proper in this regard.

Postage

Plaintiffs argue the postage paid for billing customers is not subject to taxation. Plaintiffs assert NISC prints the bills but that Plaintiffs pay the postage directly to the United States Postal Service. At the beginning of the audit period, Department regulations provided that charges for delivery, freight, postage, shipping, or transportation of an item are taxable whenever the item is taxable and the charges for delivery are paid to the retailer of the item. **NEB. ADMIN. CODE**, Title 316, Ch. 1, § 079.01 (1998). It also provided that charges for delivery, freight, postage, shipping, or transportation that are paid to a person other than the retailer are exempt. ***Id.*** @ 079.02. The regulations were revised in 2005 and now provide that charges for delivery, postage, or shipping paid to a printer *or* paid directly to the U.S. Postal Service or a common carrier on behalf of the printer *are taxable*. **NEB. ADMIN. CODE**, Title 316, Ch. 1, § 057.02 (2005) (emphasis added).

The record indicates that while the checks were written to USPS, they were deposited in the NISC account. Moreover, the mailings were sent out using the NISC postal account. (Plaintiffs' brief, p. 19). In effect Plaintiffs were paying NISC to use NISC's postage account and permit number. Plaintiffs argue that NISC may not have been legally able to negotiate the check. However, it is clear that while in form the payment was made to USPS, in substance it was a payment to NISC for postage and the use of NISC's postal account and permit number. "It is not the function of the law to

exalt form over substance." ***Mid City Bank, Inc. v. Douglas County Bd. of Equalization***, 260 Neb. 282, 288, 616 N.W.2d 341, 346 (2000). Based on these facts, postage paid during the audit period as described above is subject to taxation and the Commissioner's determination is affirmed.

Support Fees

Norris has an agreement with NISC to provide software licensing and program support. The agreement includes support services which are not specific to the software licensing and programming. Where NISC services are specifically related to software licensing and programming fees, Norris has paid taxes. Where the services are related to telephone, educational, and technical hardware support as well as training and web conferencing services, Norris has not paid taxes. Norris argues while software services are taxable the other support services NISC offers are not.

Regulations relevant at the commencement of the audit period indicate that gross receipts from furnishing software is taxable, but that charges for customer training that are not a mandatory part of the sale, lease or rental of software are exempt as are charges for consultants who only provide generalized advice and who do not provide any software or modifications to software. See **NEB. ADMIN. CODE.**, title 316, Ch. 1, §§ 088.01 - 088.03. (1998). Changes were made to portions of the regulations in 2003. Of importance is § 088.02 which now provides that charges for customer training are taxable whenever paid to the retailer of the software and charges paid to a person other than the retailer of the software are exempt. **NEB. ADMIN. CODE.**, title 316, Ch. 1, §§ 088.02 (2005). Plaintiffs argue that under either articulation of the regulation, the

charges for customer support services were exempt.

The Department points out, however that its regulations provide that gross receipts of companies selling intellectual property includes the total amount of the sale without deduction for any mandatory charge required to be paid in the purchase of an item subject to tax. Neb. Dept. of Rev. Regulation 1-007K(6). Defendants urge the court to consider the support fees as mandatory to the agreement for software services. Defendants cite the agreement which states that in exchange for the software license granted in the agreement, Norris agrees to pay the system support fees outlined in an attachment to the agreement.

The Department asserts that the service and support fees are inseparable. The court does not agree with Defendants' interpretation. The agreement in fact separates and details how each support item is calculated, independent of the other fees. (E5, Tab 21, p. 9). Because nothing in the record indicates that the support fees are in fact mandatory or cannot be separated from the service fees, the Department's determination should be overturned.

Norris Electric News Magazine

Norris contends the purchase of the Magazine from the printer was not taxable. According to Norris, the purchase of the Magazine from the printer was a sale for resale. Sale for resale means a sale of property or provision of a service to any purchaser who is purchasing such property or service for the purpose of reselling it in the normal course of his or her business, either in the form or condition in which it is purchased or as an attachment or integral part of other property or service. **NEB. REV. STAT.** § 77-2701.3 (Cum. Supp. 2006). Norris asserts that they purchase the Magazine

as part of their normal course of business and that the Magazine is resold in the condition in which it is purchased. Norris further notes that the Magazine includes a statement indicating the purchase price of the Magazine is thirty-five cents. Customers can also cancel this subscription.

The Department argues that Norris's customers do not reasonably know they are subscribing to the Magazine. Additionally, Department asserts that Norris does not specify this charge on the bill and that the "subscription rate" is included in and treated as part of the general cost of providing electricity services. Norris has historically not made a distinction between the subscription price and the rest of the energy bill for taxation purposes according to Defendants. When the audit period commenced, the relevant statute provided that gross receipts from the sale, by subscription, of any magazine issued at average intervals not exceeding once each month were exempt from sales tax. **NEB. REV. STAT.** § 77-2704.22 (Reissue 1996). Despite this, Norris collected sales tax on the subscriptions because they were included in the retail cost of the electricity as billed to customers. That exemption expired in October 2002, during the audit period. At that point Norris should have and did collect sales tax on the subscription. Defendants assert, however, and Norris does not dispute, that Norris applied for and received exemptions for certain qualifying customers. For those customers, Norris still should have collected sales tax on the subscriptions but failed to do so.[3] Defendants argue that Norris did not treat the subscription rate as such for

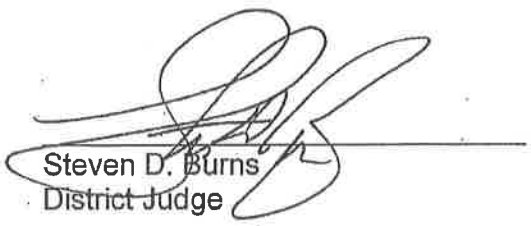
[3] It appears from the briefs that this issue is raised only for the purpose of showing that Norris acted inconsistently with its claim that the transaction between it and the printer was tax-exempt, rather than as an additional claim by the Department of past due taxes.

taxation purposes and should not now be able to do so.

The parties appear to agree that the telling tale on this issue is whether Norris acted consistently with its claim of exemption due to resale. Even though the defendant has picked at various points, in the end Norris' conduct is consistent with their position. First, Norris acquired the magazine from the printer claiming an exemption from sales tax because the magazine was intended to be resold. Second, they placed a price on the sale of the magazine. Third, Norris collected a sales tax from their customers on the sale of the magazine.[4] Finally, Norris remitted the sales tax to the Department. The decision of the Commissioner should be reversed and set aside on this issue.

IT IS THEREFORE HEREBY ORDERED AND ADJUDGED that the Tax Commissioner's February 23, 2007, determinations that the Districts owe tax for lease fees and Gross Revenue Tax received from their customers and for payments made for postage are affirmed. The Tax Commissioner's February 23, 2007, determination that the magazine and the support fees are subject to taxation is reversed and set aside. A mandate is to issue accordingly.

Dated: September 4, 2007



Steven D. Burns
District Judge

[4] It appears from the evidence that Norris may have collected a sales tax for some period of time when the tax was not due, but there is no claim for a refund of that tax and that issue is not before the court.