COPY

IN THE DISTRICT COURT OF LANCASTER COUNTY, NEBRASKA

FARMERS COOPERATIVE, a cooperative corporation organized under the laws of the State of Nebraska,	**CASE NO. CI 13-2325**
Petitioner,	
vs.	**ORDER**
STATE OF NEBRASKA, NEBRASKA DEPARTMENT OF REVENUE, and DOUGLAS A. EWALD, TAX COMMISSIONER OF THE STATE OF NEBRASKA,	
Respondents.	

This matter came on for hearing on the merits on November 7, 2013, on the appeal of the Petitioner Farmers Cooperative (the "Cooperative"), from the May 30, 2013 decision of Douglas A. Ewald, Tax Commissioner of the State of Nebraska, denying Petitioner's requests for redetermination of certain sales and use taxes assessed by the Nebraska Department of Revenue (the "Department"). Thomas E. Jeffers appeared for Petitioner. Assistant Attorney General L. Jay Bartel appeared for Respondents. The transcript and bill of exceptions, Volumes I and II, were filed with the court on July 25, 2013. Arguments were heard, and the matter was submitted. Being fully advised in the premises, the court now finds and orders as follows.

FACTS

A. The Cooperative's Business Activities

The Cooperative is a farmer-owned cooperative that was organized as a corporation in

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1917. (138:13–25).[1] Headquartered in Dorchester, Nebraska, the Cooperative operates from facilities in 40 communities and provides and sells a variety of products and services through its Grain, Agronomy, Feed, and Petroleum Divisions/Departments. (138:20–140:13; Ex. 29). The Cooperative's Grain Division operates numerous elevators and facilities and handles approximately 60 million bushels of corn, soybeans, wheat, milo, and specialty grains annually. (Ex. 29, p.3). The grains, which are purchased from farmers/producers through contracts with them, are stored and accumulated until sold to large companies or in the international markets. (164:18–165:12). The product is transported by rail or truck from the elevator or facility. (Ex. 29, p.3).

The Cooperative's Agronomy Division operates several elevators and has a distribution system from which anhydrous ammonia, dry fertilizer, liquid fertilizer, farm chemicals, ag-lime, chemical applications, seeds, and other products are sold to farmers to facilitate the growing of crops. (140:3–6; 146:4–8; Ex. 29, p.5). The division also provides services such as fertilizer and chemical applications. (169:12–171:6). The Agronomy Division also provides and sells a complete portfolio of seed products including corn, milo, wheat, soybean, alfalfa, sunflowers, hybrids, and pasture grass that are initially purchased from companies such as Monsanto, Syngenta, Dow, and DeKalb. (28:8–23; 37:22–40:7; Ex. 29, pp.6–7). The Cooperative takes raw grain and through the use of specialized seed treatment equipment, chemicals are added to the grains which impart unique characteristics on the seeds to protect them from fungus and insects. (28:8–23). Each of the Cooperative's seed plants consists of a seed treater, conveyors to move grain in and out of a seed treater, bins in which seed is stored, and storage tanks for various chemicals that are used to treat seeds. (34:1–20). The Cooperative does not use any of the equipment at its seed plants for purposes other than manufacturing or treating seeds. (33:17–25; 35:11–36:1). Once seeds are treated with these chemicals, the chemicals cannot be removed or extracted from the grain kernels. (28:24–29:23; 35:8–10). Seeds are sold in bulk and delivered to a location designated by the farmer/purchaser or are picked up at the Cooperative.

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[1] The bill of exceptions was filed with the court on July 25, 2013. Volume I of the bill of exceptions contains the record from the proceedings before the hearing officer (pages 1–227), and Volume II contains Exhibits 1–17, 21–25, 27–29, and 34–36, which were received by the hearing officer. All references to the bill of exceptions will be cited to the relevant page and line number or exhibit number.

(40:4–42:25). The Cooperative generated millions of dollars of revenue from its seed plants each year during the audit period. (36:12–18).

The Cooperative's Feed Division processes grain into feed and provides services to customers from five feed mills. (53:2–9; 56:8–11). The conversion process consists generally of taking raw materials such as corn, milo, oats, or other grains, grinding and rolling the grains, and mixing the result with vitamins, trace minerals, liquids, choice white grease, liquid molasses, and other ingredients. (53:18–55:6). The resulting grain-sourced feed, particularly chicken and cattle feed, may go through a process from which pellets or cubes are created. (55:6–11). The division's largest product, volume wise, is poultry feed, followed by swine, beef, and dairy feed. (53:7–14). While the Cooperative manufactures some custom feed recipes for bagged sales, most of the feed is produced and sold in bulk and delivered by the Cooperative via its own semi-trailer trucks to a producer/customer's feedlot or other feeding facility. (67:19–68:25; 92:9–93:6). Only 750 tons of the 180–200 thousand tons made annually during the audit period are sold as bagged feed. (68:2–10; 71:2–15). The Cooperative generated millions of dollars of revenue from its manufactured feed during the audit period. (71:16–72:6).

None of the Cooperative's feed manufacturing equipment is used for purposes other than manufacturing feed, and such equipment is physically separate from other operations. (55:17–24). The Cooperative does not own livestock, and does not use any of the feed it manufactures for its own purposes. (56:2–7). The Nebraska Department of Agriculture regulates feed manufacturing, and each of the Cooperative's feed mills is required to be, and is, registered with the Department of Agriculture for feed manufacturing purposes. (107:9–108:13). The Feed Division also furnishes nutritional services, production consulting, profit/loss projections, production close-out information, forage testing, ration balancing/analysis, and other services. (Ex. 29, p.8).

The Cooperative's Petroleum/TBA [Tires, Batteries and Accessories] Division sells and delivers bulk propane, fuel, lubricants, and oil, and provides 24-hour on-farm tire service. (125:4–13; Ex. 29, p.10). The division also sells and installs new and used tires at several locations. (113:5–17; 125:14–128:8). Additionally, it sells batteries, oil filters, brakes, and other accessories, and provides an array of other automotive services including, but not limited

to, front end alignments, muffler work, oil changes, lubrications, and junk and scrap tire disposal. (113:18–114:11; 125:17–24).

When a customer chooses to have tires removed and/or left at a service center which are at the end of their service life and/or are damaged beyond repair, that customer is charged a tire disposal fee which compensates the Cooperative for its costs associated with disposing of such tires. (114:17–115:7; 118:8–20). If the customer takes his or her old tires, the customer is not charged a tire disposal fee. *Id.* When a customer has tires removed which are still usable, the customer can either take them or receive a rebate or credit toward the purchase of new tires, but a disposal fee is not charged. (116:7–117:2). The fee charged to customers for tire disposal services are based upon the size of the tires being disposed, with the fees generally increasing as the tire size increases. (115:8–20). Customers do not have to buy anything in order to utilize the Cooperative's tire disposal services. (117:3–16). Some customers bring in scrap tires for disposal without purchasing any new or used tires, and in such instances the only charge is for tire disposal. (117:17–118:7). In these instances, the same schedule of disposal fees is applicable. *Id.*

B. The Department's Deficiency Assessment and the Cooperative's Petition for Redetermination

Following an audit of the books and records of the Cooperative, the Department issued a Notice of Deficiency Determination to the Cooperative for the periods June 1, 2007, through May 31, 2010, that reflected assessments of sales, consumer's use, and withholding taxes, interest, and penalties totaling $65,343. (Ex. 2, p.2). The Cooperative filed a Petition for Redetermination of the deficiency assessment. (T10–13).[2] The Cooperative claimed the Department erroneously assessed use tax on its purchases of machinery and equipment, and additional amounts paid for the maintenance, service, and repair of such machinery and equipment, contending the purchases involved items that qualified as exempt manufacturing machinery and equipment. (T11, 31–34). The Cooperative also protested the Department's determination that tire disposal charges made to its customers in connection with a taxable

[2] A certified copy of the official transcript of the proceedings below was prepared by the Department and was filed with the court on July 25, 2013. All references to the official transcript will be cited as "T__" followed by the corresponding page number.

purchase of related tangible personal property were subject to sales tax, contending the disposal charges were for nontaxable services. (T10–11, 34–35). The Cooperative also challenged the Department's assessment of use tax on charges the Cooperative paid for what it characterized as payments related to "consulting and training services" in connection with a computerized scale interface system. (T35–36).

C. Tax Commissioner's Order Denying the Cooperative's Petition for Redetermination

Following a hearing, the Tax Commissioner entered an order denying the Cooperative's Petition for Redetermination. (T47–56). The Tax Commissioner determined that: (1) The Cooperative's purchases of machinery and equipment used to manufacture feed and seed, as well as repair or replacement parts for such machinery and equipment, were not exempt manufacturing machinery or equipment under NEB. REV. STAT. § 77-2704.22 (Reissue 2009) because, while the machinery and equipment was used in manufacturing feed and seed, the Cooperative was not "a person engaged in the business of manufacturing" within the meaning of NEB. REV. STAT. § 77-2701.47(1); (2) Tire disposal charges made by the Cooperative in connection with the sale of tires or related items of tangible personal property were costs or expenses associated with the sale of tangible personal property and charges necessary to complete the sale and, thus, part of the sales price as defined in NEB. REV. STAT. § 77-2701.35(l) included in gross receipts subject to sales tax; and (3) Payments by the Cooperative to the retailer of software were for training and, thus, were taxable under NEB. REV. STAT. § 77-2701.16(4)(c) and 316 NAC § 1-088.02.

The Cooperative appealed the Tax Commissioner's decision to this court on June 25, 2013.

STANDARD OF REVIEW

This is an appeal pursuant to NEB. REV. STAT. §§ 77-27,127, 77-27,128 (Reissue 2009), and 84-917 (Cum. Supp. 2012). When reviewing the final decision of an administrative agency, the district court conducts the review without a jury de novo on the record of the agency. NEB. REV. STAT. § 84-917(5)(a) (Cum. Supp. 2012); *Betterman v. State of Neb. Dep't of Motor Vehicles*, 273 Neb. 178, 191, 728 N.W.2d 570, 584 (2007). In a review de novo on the record, the district court is required to make independent factual determinations based upon the record,

and the court reaches its own independent conclusions with respect to the matters at issue. *Schwarting v. Nebraska Liquor Control Comm'n*, 271 Neb. 346, 351, 711 N.W.2d 556, 561 (2006). To the extent the interpretation of statutes and regulations is involved, questions of law are presented, in connection with which an appellate court has an obligation to reach an independent conclusion irrespective of the decision made below, according deference to an agency's interpretation of its own regulations, unless plainly erroneous or inconsistent. *Utelcom, Inc. v. Egr*, 264 Neb. 1004, 1007, 653 N.W.2d 846, 850 (2002). The district court may affirm, reverse, or modify the decision of the agency or remand the case for further proceedings. NEB. REV. STAT. § 84-917(6)(b).

ANALYSIS

The Cooperative disputes the Department's assessment of sales and use tax with respect to several items contained in the Deficiency Notice, (Ex. 2), which items can be separated into three basic categories:

1. Manufacturing Machinery and Equipment Exemption
2. Tire Disposal Fees
3. Computer Software Certification Expenses.

The Cooperative asserts that the Tax Commissioner erred as a matter of law when he concluded that each of these contested items or transactions is taxable and denied the Cooperative's Petition for Redetermination. The court will address each of these categories in turn.

I. Manufacturing Machinery and Equipment Exemption

The Department assessed numerous items which the Cooperative maintains were not subject to tax under the exemption for manufacturing machinery and equipment. The Department concluded that the Cooperative did not qualify for the manufacturing exemption because it was not a person "engaged in the business of manufacturing" under the definitions utilized by the Department at the time of the audit. *See* 316 NAC § 1-107.02; Revenue Rulings 1-05-1, 1-08-2, & 1-11-1; (Ex. 34–36).

One claiming an exemption from taxation must establish entitlement to the exemption. *Omaha Public Power Dist. v. Nebraska Dep't of Revenue*, 248 Neb. 518, 520, 537 N.W.2d 312, 314 (1995). "[T]ax exemption provisions are to be strictly construed, and their operation will not

be extended by construction." *Metropolitan Utilities Dist. v. Balka*, 252 Neb. 172, 176, 560 N.W.2d 795, 799 (1997). "Property which is claimed to be exempt must clearly come within the provision granting exemption from taxation." *Bridgeport Ethanol, LLC v. Neb. Dep't of Revenue*, 284 Neb. 291, 297, 818 N.W.2d 600, 605 (2012).

Nebraska law provides that "[s]ales and use taxes shall not be imposed on the gross receipts from the sale, lease, or rental and on the storage, use, or other consumption in this state of manufacturing machinery and equipment" nor shall such taxes be imposed on "the sale of installation, repair, and maintenance services performed on or with respect to manufacturing machinery and equipment." NEB. REV. STAT. § 77-2704.22 (Reissue 2009). "Manufacturing means an action or series of actions performed upon tangible personal property, either by hand or machine, which results in that tangible personal property being reduced or transformed into a different state, quality, form, property, or thing." NEB. REV. STAT. § 77-2701.46. "Manufacturing machinery and equipment" is defined as "any machinery or equipment purchased, leased, or rented by a person engaged in the business of manufacturing for use in manufacturing," and includes, but is not limited to "[m]achinery or equipment for use in manufacturing to produce, fabricate, assemble, process, finish, refine, or package tangible personal property." NEB. REV. STAT. § 77-2701.47(1). Thus, machinery and equipment used to manufacture tangible personal property must meet two criteria to be eligible for exemption: (1) The purchaser must be a person engaged in the business of manufacturing; and (2) The machinery and equipment must be used in manufacturing.

The evidence is clear, and the Department has not denied, that the seed and feed treatment and production activities constitute manufacturing for purposes of the law and that the equipment at issue is used solely in such manufacturing activities. (T50). The dispute in this case boils down to the meaning of "a person engaged in the business of manufacturing" as that term is used in NEB. REV. STAT. § 77-2701.47(1). The Department has issued regulations and revenue rulings regarding the manufacturing machinery and equipment exemption, which define "manufacturer" as:

> a person who is *primarily* engaged in the business of manufacturing. Persons are *primarily* engaged in the business of manufacturing if more of their total annual revenues are derived from the sales of products they manufacture and sell as tangible personal property . . . than from any other commercial activity.

316 NAC § 1-107.02 (2011) (emphasis added). The Department first adopted this definition in Revenue Ruling 1-08-2, with an effective date of July 1, 2008. (203:3–18; Ex. 35).

Under this "revenue test" established by the Department, the manufacturing machine and equipment exemption is limited to persons or businesses that derive more of their total annual revenues from manufacturing than from any other source. (Ex. 36). The evidence clearly demonstrates that the Cooperative does not derive more of its revenue from manufacturing than any other commercial activity. (Ex. 3; 141:9–22; 144:15–145:3). Because the Cooperative does not meet the "revenue test," the Department has concluded, and the Tax Commissioner agreed, that the Cooperative's expenditures relating to manufacturing machinery and equipment are not exempt from sales and use tax under NEB. REV. STAT. § 77-2704.22. The Cooperative argues, though, the Department's interpretation of "engaged in the business of manufacturing" impermissibly restricts, modifies, and alters the manufacturing machinery and equipment exemption in contravention of the plain language of the statute and the Legislature's purpose behind the exemption.

Nebraska's revenue statutes provide a definition of "manufacturing," NEB. REV. STAT. § 77-2701.46, as well as more specific definitions of what machinery qualifies as "manufacturing machinery and equipment." NEB. REV. STAT. § 77-2701.47. The statutes also provide a definition of "business." NEB. REV. STAT. § 77-2701.07. However, the statutes do not separately define "person engaged in the business of manufacturing" or "manufacturer." *See* NEB. REV. STAT. §§ 77-2701.46 and 77-2701.47(1). The Department has adopted its own definition of those terms through its revenue rulings and regulation adopted three years after the statutory exemption was enacted. 316 NAC § 1-107.02; Revenue Rulings 1-08-2 & 1-11-1; (Ex. 35–36).

In the absence of anything to the contrary, statutory language is to be given its plain and ordinary meaning, and a court will not resort to interpretation to ascertain the meaning of statutory words which are plain, direct and unambiguous. *Bridgeport Ethanol LLC v. Neb. Dep't of Rev.*, 284 Neb. at 296, 818 N.W.2d at 605. The words "the business of manufacturing" are not ambiguous and the plain meaning is readily ascertainable. Prior to enactment of the manufacturing machinery and equipment exemption, the Legislature had previously defined

"business" as "any activity engaged in by any person or caused to be engaged in by him or her with the object of gain, benefit, or advantage, either direct or indirect." NEB. REV. STAT. § 77-2701.07.[3] "In enacting a statute, the Legislature must be presumed to have knowledge of all previous legislation upon the subject. The Legislature is also presumed to know the language used in its statutes . . . ." *Alisha C. v. Jeremy C.*, 283 Neb. 340, 354, 808 N.W.2d 875, 886 (2012). Applying the statutory definitions of "business" and "manufacturing" for purposes of the manufacturing machinery and equipment exemption, a person is "engaged in the business of manufacturing" if the person engages in manufacturing "with the object of gain, benefit, or advantage." NEB. REV. STAT. § 77-2701.07. Under this definition, the Cooperative is plainly engaged in the business of manufacturing for purposes of the manufacturing machinery and equipment exemption. The evidence demonstrates that the Cooperative's annual revenues from its seed and feed manufacturing ranged from over $15 million to over $45 million during the audit period. (Ex. 3; 143:21–145:3).

The Department's central argument in support of its administrative interpretation of the manufacturing machinery and equipment exemption is that the Legislature's "[u]se of the definite article 'the' preceding the phrase 'business of manufacturing,' as opposed to the indefinite articles 'a' or 'any' or the phrase 'engaged in manufacturing,' demonstrates a legislative intent to limit the exemption to those persons whose most important or primary business activity is manufacturing." (Respondents' Brief at 11). The Department relies on a definition of "the" as "[i]ndicating the most approved, most desirable, most conspicuous or most important of its kind." (*Id.* (citing Century Dictionary online, (http://www.global-language.com/CENTURY)). However, "the" is also "used to refer to things or people that are common in daily life" or "used as a function word before a singular noun to indicate that the noun is to be understood generically." Merriam Webster Online Dictionary (http://www.merriam-webster.com/dictionary/the).

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[3] Neither the Cooperative nor the Department brought this statutory definition to the court's attention. The Legislature's definition of "business" appears to have been overlooked in the proceedings before the Tax Commissioner as well. (T47–56).

Given the various definitions of "the," the court is not persuaded that the Legislature intended to limit the exemption as the Department contends. Indeed, under the Department's reasoning, the Department would have been equally justified in limiting the exemption to a person *exclusively* or *only* engaged in manufacturing as opposed to just primarily. By placing such emphasis on "the," the Department is attempting to make the phrase "the business of manufacturing" a term of art. The Legislature, however, chose not to separately define "the business of manufacturing." If the Legislature had intended to limit the exemption as the Department suggests, the Legislature could have easily written the statute as requiring a person to be "primarily engaged in the business of manufacturing."[4] Nothing in the relevant statutes indicates that the exemption requires a person to be primarily engaged in manufacturing. Rather, the plain statutory language demonstrates that the Legislature intended to make the exemption available for machinery and equipment used in manufacturing by a person who engages in manufacturing for gain or, in other words, profit. *See* NEB. REV. STAT. §§ 77-2701.07, 77-2701.46, & 77-2701.47.

Even if the court were to consider the statute ambiguous and open to construction, the Department's restrictive definition of "manufacturer" in 316 NAC § 1-107(2), and its similar construction of what it means to be engaged in manufacturing in Revenue Ruling 1-08-2, would not serve the Legislature's purposes behind the manufacturing machinery and equipment exemption. In *Concrete Industries Inc. v. Neb. Dep't of Revenue*, 277 Neb. 897, 902–03, 766 N.W.2d 103, 108 (2009), the Court recognized two specific legislative purposes behind the enactment of the exemption:

> This exemption was enacted by the Legislature in 2005 for two primary reasons. The first reason was to try to provide smaller businesses with some of the tax advantages that had been conferred on larger businesses by the Employment and Investment Growth Act, commonly known as L.B. 775. The second reason

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[4] Indeed, the Legislature has limited other tax exemption definitions by restrictively defining the person that can use the exemption. *See, e.g.*, NEB. REV. STAT. § 77-2701.24(4) (defining "occasional sale" to include "a sale by an organization created exclusively for religious purposes" which is exempt from tax under NEB. REV. STAT. § 77-2404.48); NEB. REV. STAT. § 77-2704.12(1) (providing "[s]ales and use taxes shall not be imposed on the gross receipts from the sale, lease, or rental of and the storage, use, or other consumption in this state of purchases by (a) any nonprofit organization created exclusively for religious purposes").

was to eliminate some of the "double taxation" that occurred when sales or use taxes were charged for items that were then taxed again as tangible personal property subject to property taxes.

The legislative history of LB 312, which is included in the record as Exhibit 1, clearly shows that the purpose of the newly enacted statutory language was to extend the benefits of the exemption to smaller businesses, with a particular focus on rural areas, and to allow "anyone who has a purchase of machinery or equipment" to avoid paying both personal property tax and sales tax on manufacturing machinery. *Floor Debate on LB 312*, 99th Leg., Reg. Sess., at 5425–27 (May 9, 2005) (statements of Senator Baker); *see also Id.* at 5329–32, 5342–44; (Ex. 1, pp.2–5, 7–9, 12–13). The "revenue test" adopted by the Department in 316 NAC § 1-107.02 ignores both of the primary purposes behind the Legislature's enactment of the exemption by shifting the focus from the use of the equipment to the nature of the revenues and business of the taxpayer. Where the Legislature's intent with the exemption was to extend tax advantages to smaller businesses and eliminate some of the double taxation which occurs in connection with manufacturing equipment (which occurs regardless of the nature of the revenues of a business), the Department's construction in this matter serves to thwart that intent by making the availability of those tax advantages contingent on whether the business meets the Department's unduly restrictive revenue test.

Not only has the Cooperative purchased manufacturing equipment and machinery, but it also pays property taxes on all equipment utilized in manufacturing seed and feed. (218:9–18). Unlike the originally enacted statutes, the Department's "revenue test" results in "double taxation" in connection with the Cooperative's feed and seed equipment and for all businesses unable to demonstrate a majority of revenues are derived from manufacturing—the exact result the exemption in NEB REV. STAT. § 77-2704.22(1) was meant to prevent. Clearly, the Department's revenue test defies the intent of the Legislature, as expressed in *Concrete Industries* and Exhibit 1.

It is true "that the Legislature has the power to authorize an administrative or executive department to make rules and regulations to carry out an expressed legislative purpose, or for the complete operation and enforcement of a law within designated limitations." *Swift and Co. v. Neb. Dep't of Revenue*, 278 Neb. 763, 767, 773 N.W.2d 381, 385 (2009). Likewise, "although

construction of a statute by a department charged with enforcing it is not controlling, considerable weight will be given to such a construction." *Capitol City Telephone v. Neb. Dep't of Revenue*, 264 Neb. 515, 527, 650 N.W.2d 467, 477 (2002). However, "a rule of deferring to agency interpretations does not apply when the agency's regulation contravenes the plain language of its governing statutes." *Project Extra Mile v. Neb. Liquor Control Comm'n*, 283 Neb. 379, 395, 810 N.W.2d 149, 163 (2012). "An administrative agency may not employ its rulemaking power to modify, alter, or enlarge provisions of a statute which it is charged with administering." *Brunk v. Neb. State Racing Comm'n*, 270 Neb. 186, 193, 700 N.W.2d 594, 601 (2005). By restricting the manufacturing machinery and equipment exemption to only those persons or businesses primarily engaged in the business of manufacturing, the Department has impermissibly and arbitrarily done exactly that. The Department has significantly and materially modified the statutory exemption it was charged with administering.

The plain language of NEB. REV. STAT. § 77-2701.47(1), defining the "manufacturing machinery and equipment" subject to exemption under NEB. REV. STAT. § 77-2704.22(1), limits the exemption to manufacturing machinery or equipment purchased "by a person engaged in the business of manufacturing for use in manufacturing." The evidence clearly demonstrates that the Cooperative qualifies as "a person engaged in the business of manufacturing" within the plain meaning of the manufacturing machinery and equipment exemption. Accordingly, the court finds that the Tax Commissioner erred in upholding the Department's assessment of sales and use taxes, penalty, and interest relating to payments for the exempt manufacturing machinery and equipment listed in the Deficiency Notice and disputed by the Cooperative. (Ex. 2 at Schedule 22B: Lines 2, 10, & 19; Schedule 23A: Lines 1, 2, 4, 7–14, 16–18; Schedule 23B, p.2); *see also* (Ex. 5–17).

II. Tire Disposal Fees

The Cooperative disputes the Department's assessment of all tire disposal fees listed in the Deficiency Notice, (Ex. 2), including those identified on Schedule 13Aa, Lines 53–212; Schedule 13Ba, Lines 118–694; and all assessments relating to tire disposal fees included on Schedules 13C and 13D. (Ex. 2); *see also* (Ex. 4, 27–28). Exhibits 4, 27, and 28 include summaries of invoices, as well as actual invoices to customers. Due to the number of

transactions at issue, the record does not include each and every invoice relating to tire disposal services assessed by the Department. However, in addition to spreadsheet summaries that were received in evidence as Exhibits 27–28, Exhibit 4 consists of 24 invoices that were included in the Department's assessment. As to the specific charges included on the Department's schedules, the Cooperative does not dispute that such charges reflect fees charged to customers for tire disposal services and further, does not dispute that it did not collect or remit sales taxes in relation to such charges.

The Department assessed sales tax on untaxed tire disposal charges identified on the same invoices/receipts that also included and accompanied a sale of tangible personal property, primarily tires. (199:9–21; Ex. 4, 27–28). The Department did not assess sales tax on transactions in which the Cooperative accepted scrap tires for disposal without an accompanying purchase of new or used tires. The Cooperative asserts that the tire disposal fees at issue are not properly treated as taxable gross receipts from the sale of goods and that such fees were paid in exchange for nontaxable services. Upon review of the record and the relevant statutes and regulations, the court concludes that the Tax Commissioner properly determined that the tire disposal charges made by the Cooperative in connection with the sale of tires or related items of tangible personal property were costs or expenses associated with the sale of the tangible personal property and charges necessary to complete the sale. Thus, the tire disposal fees were part of the sales price as defined in NEB. REV. STAT. § 77-2701.35 (Reissue 2009) and properly included in gross receipts subject to sales tax.

Nebraska "impose[s] a tax . . . upon the gross receipts from all sales of tangible personal property sold at retail in this state." NEB. REV. STAT. § 77-2703(1) (Cum. Supp. 2012).[5] "Retail sale or sale at retail means any sale . . . for any purpose other than for resale, sublease, or subrent." NEB. REV. STAT. § 77-2701.31 (Reissue 2009). "Sale" is defined to mean "any transfer of title or possession . . . exchange, barter, lease, or rental . . . in any manner or by any means, of property for a consideration or the provision of service for a consideration." NEB. REV. STAT. §77-2701.33(1) (Reissue 2009). "For the purpose of the proper administration of the

[5] Citations to the Nebraska Revised Statutes refer to the current iteration of each statute. The operative language for purposes of this appeal are unaffected by any amendments during the relevant time period.

provisions of the Nebraska Revenue Act of 1967 and to prevent evasion of the retail sales tax, it shall be presumed that all gross receipts are subject to the tax until the contrary is established." NEB. REV. STAT. § 77-2703(1)(f). The seller has "the burden of proving that a sale of property is not a sale at retail." *Id.*

"Gross receipts means the total amount of the sale or lease or rental price, as the case may be, of the retail sales of retailers." NEB. REV. STAT. § 77-2701.16(1) (Supp. 2013). NEB. REV. STAT. § 77-2701.35(1) (Reissue 2009) provides:

> (1) 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:
>
> (a) The seller's cost of the property sold;
>
> (b) The cost of materials used, the cost of labor or service, interest, losses, all costs of transportation to the seller, all taxes imposed on the seller, and any other expense of the seller;
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> (c) Charges by the seller for any services necessary to complete the sale;
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> (d) Delivery charges; and
>
> (e) Installation charges.

"In the absence of anything to the contrary, statutory language is to be given its plain and ordinary meaning," and a "court will not resort to interpretation to ascertain the meaning of statutory words that are plain, direct, and unambiguous." *Japp v. Papio-Missouri River Natural Res. Dist.*, 271 Neb. 968, 973, 716 N.W.2d 707, 711 (2006). The plain language of the relevant statutes provides that "gross receipts" subject to sales tax includes "the total amount of consideration . . . for which personal property . . . [is] sold" without deduction for the cost of materials, labor or service, "any other expense of the seller," or any "[c]harges . . . for any services necessary to complete the sale." NEB. REV. STAT. §§ 77-2701.16(1) & 77-2701.35(1)(b),(c). The tire disposal charge is a cost or expense associated with the Cooperative's sale of taxable tangible personal property, i.e., tires, as the charge is imposed to cover expenses incurred by the Cooperative in disposing of junk and scrap tires. The tire disposal charges are structured as an integral part of the retail sale of tangible personal property, a tire or tires (or, in limited cases, a tube), and are properly included in taxable gross receipts,

along with other costs passed on to the purchaser, whether imbedded in the price of the article sold or separately itemized, as was done by the Cooperative on its sales invoices. (Ex. 4).

Tire disposal, with respect to each transaction assessed, also constituted a charge by the Cooperative, i.e. the seller, for a service necessary to complete the sale within the meaning of NEB. REV. STAT. § 77-2701.35(l)(c). The charge imposes an obligation on the purchaser to pay for the service provided by the Cooperative pursuant to the sale/purchase of the tire. It is included within the definition of gross receipts as a charge required to be paid in connection with the purchase of property subject to tax. *See* 316 NAC § 1-007.01T ("Gross receipts includes . . . [t]he total amount of the sale without deduction for . . . [a]ny charge required to be paid in connection with the purchase, lease, or rental of property subject to tax."). While a purchaser may opt not to incur the charge by taking the junk or scrap tires away on their own, if they elect to leave the tires with the Cooperative, they must pay the tire disposal charge, and it is a necessary part of the sale transaction.

The Cooperative argues the tire disposal charge is not subject to sales tax because it is a charge for the performance of a non-taxable service. The Cooperative further argues that the tire disposal charge is not taxable because the disposal charge is not a mandatory charge in conjunction with the taxable sale of new or used tires, tubes, or bolts, and the disposal charge is not required or necessary to complete the sale since the customer elects whether or not to leave a junk tire for disposal.

In support of its claim, the Cooperative notes that a customer may dispose of scrap tires without purchasing a tire. In that case, the customer is charged for tire disposal, but there is no sale or charge for a tire. The Cooperative also notes that a purchaser can opt to retain his or her used scrap or junk tire or tires, in which case no disposal charge is imposed. These transactions are not at issue, however, and were not assessed for obvious reasons. In the first instance, the tire disposal charge was not associated with a taxable sale of a tire or other item. In the second instance, no service was provided in connection with a taxable sale, and, as a result, no charge for tire disposal was included on the invoice with the tire sale. The only relevant transactions are those in which the customer elects to leave a tire for the Cooperative to dispose of in conjunction with a related taxable sale.

The Cooperative attempts to demonstrate that the tire disposal fee is not a necessary charge to complete a sale by pointing out that the Department could not explain how the fee was necessary when the transaction at issue did not involve the sale of a tire. The Cooperative points to evidence relating to two of the invoices included in Exhibit 4. (Ex. 4, pp. 1–2). Each of those invoices involved a transaction where the customer brought in his own tire, had the Cooperative change it for him, and the Cooperative disposed of the old tire for the customer. (119:19–121:10). Each customer also purchased a tube and, in one case, bolts. *Id.* While there was no purchase of a tire in these two cases, the customers did purchase "tubes" or inner-tubes made for tires and had the Cooperative change out an old tire for a new one provided by the customers. It is not unreasonable, then, to view the purchase of the tube as related to the tire change and consequent disposal of the old tire. Since "all gross receipts are subject to the tax until the contrary is established," NEB. REV. STAT. § 77-2703(1)(f), the court is not convinced that the evidence regarding these two transactions out of the hundreds included in the record demonstrate that the tire disposal fee is a completely separate charge for a nontaxable service unrelated to the taxable sales involved.

Furthermore, the Cooperative's position overlooks the fact that sales tax is on the transaction called the sale. *See* 316 NAC § 1-001.02 (Sales tax "is not upon the article sold, but upon the transaction called the sale."). The transactions assessed by the Department were based on invoices reflecting a charge for a sale of a tire, tube, or bolts, as well as a charge for tire disposal. (Ex. 4). The purchaser was required to pay the amounts the Cooperative listed on the invoice, including charges for tires or tubes and tire disposal, in order to complete the sale of the tire or tube. Stated another way, the charges were required to be paid in connection with the purchase of property subject to tax (a tire or tube). *See* 316 N.A.C. § 1-007.01T.

The court finds the recent district court decision in *Enterprise Rent-A-Car Co.-Midwest, LLC v. Nebraska Dep't of Revenue*, Case No. CI 11-3101 (District Court of Lancaster County, Nebraska (Nov. 5, 2012)) ["*Enterprise*"], persuasive. *Enterprise* involved the issue of whether certain optional charges associated with the lease or rental of motor vehicles were part of the "gross receipts" subject to sales tax. The charges involved were collision damage waiver ["CDW"] and refueling charges. Under the rental agreement, if a customer opted to pay the

CDW charge, Enterprise waived the customer's responsibility to pay for any damage to the vehicle. If a customer declined the CDW, the customer was responsible for any damage to the vehicle. *Id.* at 2-3. Regarding refueling, a customer could pre-pay a charge based on the fuel level of the vehicle at the time of rental. Customers electing this option were not charged for fuel upon the return of the vehicle regardless of fuel level. Alternatively, customers could opt to choose whether to refuel the vehicle prior to its return, or not refuel, in which case the customer would be required to pay Enterprise a refueling charge upon return if the tank level was lower than when the motor vehicle was rented. *Id.* at 3. The Department assessed sales tax on the CDW and refueling charges. Enterprise contended the charges were not part of taxable "gross receipts" for lease or rental of its motor vehicles because customers had the option not to pay either charge, and, therefore, the charges were not "necessary" for rental of the motor vehicle and were "separable from the rental of the vehicle." *Id.* at 5.

The district court rejected Enterprise's argument, observing that "sales price" was "defined broadly" and included "charges for delivery, installation and 'any other expense of the seller' when computing the sales price subject to sales tax." *Id.* at 7. The court noted this broad definition indicated that "the Legislature intended to include all consideration paid for the sale or rental of tangible personal property, including those items incidental to the actual transfer of the property." *Id.* The court continued by stating:

> This reading of the sales tax statutes finds support in the Nebraska Supreme Court's decision in *Omaha Public Power Dist. v. Nebraska State Tax Comm'r*, 210 Neb. 309, 314 N.W.2d 246 (1982). In that case, Omaha Public Power District (OPPD) was assessed a sales and use tax deficiency on management fees and loss reimbursement payments paid by OPPD to a food service provider, Saga, with whom OPPD contracted to provide food service on OPPD's premises to its employees. The district court found the management fees and loss reimbursement payments by OPPD to Saga constituted part of the gross receipts of Saga's food sales and that such payments were subject to sales tax, affirming the Tax Commissioner's order assessing a deficiency. The Supreme Court reversed, finding instead that the management fees and subsidies were paid for services rendered (not for the sale of tangible personal property) and as such were not subject to sales tax. In so finding, the Court adopted the rationale of an Illinois court finding that such payments were not taxable because "the payments by the employer could not be traced to any specific sale . . . . [and] the evidence showed no basis for relating any portion of the fixed fee or guaranty payment to

> any individual sale as part of the selling price." *Id.* at 315, 314 N.W.2d at 249 (citing *Chet's Vending Serv. v. Department of Rev.*, 374 N.E.2d 468 (Ill. 1978)).
>
> Unlike the management fees and loss reimbursement payments in *Omaha Public Power District, supra*, the Damage Waiver and refueling charges paid by Enterprise customers selecting those options can be traced readily to individual lease transactions. The Court's reasoning in *Omaha Public Power District* indicates that—where charges or fees can be linked to individual sales or lease transactions—those charges should be included in the "gross receipts" from such transactions and subject to sales tax.

Id. at 7–8.

Here, like the CDW and refueling charges in *Enterprise*, the tire disposal fees are associated with and linked to individual transactions involving a taxable sale of a tire or tube. Consistent with the decision in *Enterprise,* the tire disposal fees are part of the total consideration paid by the purchaser traceable to these sales transactions and are thus, subject to sales tax.

Finally, the Cooperative incorrectly asserts that the tire disposal charges are not taxable because charges for tire disposal are not among the list of taxable services in NEB. REV. STAT. § 77-2701.16(4)(a)–(h). Obviously, tire disposal charges are not specifically listed among the services whose gross receipts are subject to tax in § 77-2701.16(4), and the Department did not assess tax on the tire disposal fees on this basis.

As explained above, the measure of taxable "gross receipts" is dependent on the definition of "sales price." *See* NEB. REV. STAT. §§ 77-2701.16(1), 77-2701.35(1). "Sales price" means "the total amount of consideration . . . for which personal property . . . [is] sold," including services. NEB. REV. STAT. § 77-2701.35(1). The definition of "sales price" has always included the total amount of consideration transferred in exchange for tangible personal property, including service costs or expenses of the seller. *Compare* NEB. REV. STAT. § 77-2702.17(1) (Cum. Supp. 2002) *with* NEB. REV. STAT. § 77-2701.35 (Reissue 2003). However, the definition of "gross receipts" has not always included taxable services. The tax imposed by NEB. REV. STAT. § 77-2703(1) on the provision of services defined in subsection (4) of NEB. REV. STAT. § 77-2701.16 was not enacted until 2002. *Compare* NEB. REV. STAT. §§ 77-2702.07(4) (Cum. Supp. 2002) & 77-2701.16(4) (Reissue 2003) *with* NEB. REV. STAT. § 77-2702.07 (Reissue 1996). *See also* NEB. REV. STAT. § 77-2703(1) (Cum. Supp. 2002). This demonstrates that the

services described in paragraph (1) of NEB. REV. STAT. § 77-2701.35 refer to services that are part of a sale of tangible personal property. If this was not the case, the portion of the statute referencing the "total amount of consideration, including . . . services," would have no meaning, as the services enumerated as part of "gross receipts" in NEB. REV. STAT. § 77-2701.16(4) are taxable regardless of whether or not they are part of a sale of tangible personal property.

The charges for tire disposal are taxable as a part of the sales price of the tires and tubes sold by the Cooperative, either as an "expense" of the seller under NEB. REV. STAT. § 77-2701.35(1)(b) or as "[c]harges by the seller for any services necessary to complete the sale" under NEB. REV. STAT. § 77-2701.35(1)(c). Accordingly, the court concludes the Tax Commissioner correctly upheld the assessment of sales tax on the Cooperative's tire disposal charges.

III. Computer Software Certification Expenses

Lastly, the Cooperative disputes the Department's assessment of use tax on certain costs relating to the Cooperative's computerized scale interface system. The Cooperative uses a scale interface system at a number of its elevator facilities known as the oneWeigh system which it purchased from John Deere Agri Services ("Agri Services"). (147:24–148:5). The oneWeigh system utilizes software known as "AGRIS" which the Cooperative also purchased from Agri Services. (158:8–16). In the past, the Cooperative paid Agri Services to install software. (148:14–19; 181:6–17). In 2008, the Cooperative paid Agri Services to train its employees and certify them to install the software and updates to the oneWeigh system. (148:12–149:1). The training and certification ensured that the Cooperative could purchase computer software licenses from Agri Services, including upgrades, but would not have to pay Agri Services to install new software. (147:16–149:24; 157:21–159:11; 181:3–183:12). The Department assessed use tax on the cost of the training services.

Sales tax is imposed on "the gross receipts from the provision of services defined in subsection (4) of section 77-2701.16." NEB. REV. STAT. § 77-2703(1). "A use tax is hereby imposed . . . on any transaction the gross receipts of which are subject to tax under subsection (1) of [§ 77-2703]. NEB. REV. STAT. § 77-2703(2). NEB. REV. STAT. § 77-2701.16(4)(c) provides that gross receipts for providing a service includes "[t]he gross income received for computer software training." A Department regulation provides that gross receipts includes the "gross

revenue received from computer software training provided by the retailer that sold the software." 316 NAC § 1-007.01K. The Department's regulations further provide: "Charges for customer training are taxable whenever paid to the retailer of the software. Charges for training that are paid to a person other than the retailer of the software are exempt." 316 NAC § 1-088.02.

In the instant case, Agri Services was the retailer of the oneWeigh computer software it had sold to, and which was being utilized by, the Cooperative at existing elevator locations. (180:3–6). The charges assessed were for training provided by Agri Services to employees of the Cooperative on the installation of the AGRIS software and anticipated future computer software purchases to be used with the oneWeigh system. (148:12–149:1). As the Department and Tax Commissioner concluded, the charges for this computer software training are taxable because they were paid by the Cooperative to Agri Services, the retailer of the oneWeigh computer system and the AGRIS software and, thus, constitute gross income received for computer software training under NEB. REV. STAT. § 77-2701.16(4)(c).

The Cooperative argues that NEB. REV. STAT. § 77-2701.16(4)(c) and the Department's regulations pertaining to the taxability of computer software training, 316 NAC §§ 1-007.01K & 1-088.02, do not apply because the charges by Agri Services were not directly related to any software purchase and were not charges to train employees on the operation of software. The Cooperative also maintains the charges did not result in the transfer of software as the Cooperative already was utilizing the AGRIS computer software and oneWeigh system. By its plain terms, NEB. REV. STAT. § 77-2701.16(4)(c) broadly encompasses within gross receipts the "gross income received for computer software training." This language includes any income derived from computer software training, without any of the limitations suggested by the Cooperative. There is no language that requires the income be derived from training only on the operation of software (installation training and certification were provided here), or that the training be directly related to any software purchase or transfer of software (although the training in this case related to previously purchased software that was being utilized at existing Cooperative elevator locations, which is analogous to training on software updates). Indeed, the purpose of the training was to save installation costs relating to future use of the software or upgrades. (148:12–149:24; 181:3–182:20).

As the Tax Commissioner noted, the Department's regulations provide that "'[c]harges for customer training are taxable *whenever* paid to the retailer of the software. Charges for training that are paid to a person other than the retailer of the software are exempt." (T55) (quoting 316 NAC § 1-088.02) (emphasis in original). The use of the word "whenever" in this regulation makes it clear that the tax is due whether or not the software and the training services are purchased at the same time. The Department properly assessed use tax on the amount that the Cooperative paid Agri Services, its software provider for the oneWeigh system, for training and certifying the Cooperative's employees on certain aspects of its computer programs. Accordingly, the court finds the Tax Commissioner properly denied the Cooperative's protest of the assessment of these computer software training charges.

IV. Conclusion

Upon examination of the entire record, the court finds that the Tax Commissioner correctly upheld the Department's assessment of sales and use tax with respect to the tire disposal fees and computer software certification expenses. However, the Tax Commissioner erroneously determined that the Cooperative's purchases of machinery and equipment used to manufacture feed and seed, as well as repair or replacement parts for such machinery and equipment, were not exempt manufacturing machinery or equipment under NEB. REV. STAT. § 77-2704.22. The Cooperative clearly qualifies as "a person engaged in the business of manufacturing" within the plain meaning of the exemption. *See* NEB. REV. STAT. § 77-2701.47(1). The Tax Commissioner's decision upholding the Department's assessment of a use tax, penalty, and interest relating to payments for the exempt manufacturing machinery and equipment listed in the Deficiency Notice is, thus, reversed. (Ex. 2 at Schedule 22B: Lines 2, 10, & 19; Schedule 23A: Lines 1, 2, 4, 7–14, 16–18; Schedule 23B, p.2); *see also* (Ex. 5–17).

IT IS, THEREFORE, ORDERED, ADJUDGED, AND DECREED that the Tax Commissioner's final decision dated May 30, 2013, upholding the Department's sales and use tax deficiency assessment issued to the Cooperative is hereby reversed in part, and affirmed in part in accordance with this opinion.

DATED this 4 day of March, 2014.

BY THE COURT:

Jodi L. Nelson
District Court Judge

cc *Thomas E. Jeffers, Attorney for Petitioner*
Assistant Attorney General L. Jay Bartel, Attorney for Respondents