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May 6, 2011

VIA E-MAIL (SCOTT.PETERSON@SSTGB.ORG)

Streamlined Sales Tax Governing Board, Inc.
Attn: Mr. Scott Peterson
4205 Hillsboro Pike, Suite 305
Nashville, Tennessee 37215

Re: Business Advisory Council Petition For Resolution and Reconsideration of Nebraska's Compliance with Sections 332 and 333 of the Streamlined Sales and Use Tax

Dear Mr. Peterson:

With this letter, our firm wishes to provide written comments to the above-referenced petition (the "Petition") on behalf of Cole Information, Inc., a client we represent (the "Taxpayer"). We agree with the Petition, and we disagree with the response submitted by the Nebraska Department of Revenue (the "Department") for the reasons set forth herein. The purpose of this letter is to illustrate the positions that, in our experience, the Department has taken and to illustrate the very real burdens imposed on taxpayers that results.

1. Nebraska's Noncompliance with the SST Definition of Tangible Personal Property is Substantial.

In the Department's response to the Petition dated May 4, 2011, it acknowledges that Nebraska's SST Agreement requires that "the effect of the state's laws, rules, regulations, and policies is substantially compliant with each of the items set forth in the Agreement." (emphasis added). Then, the Department states that the Governing Board is not allowed to inquire as to the Department's rules or regulations in determining the practical effect of these rules and regulations on Nebraska's substantial compliance.

We disagree. As is well known, one of the purposes of the SST is to "over time eliminate the burden and cost for all sellers to collect this state's sales and use tax."

NEB. REV. STAT. § 77-2712.02. This cannot be accomplished if the scope of the Governing Board's review of a state's compliance is limited to the statute if the state's regulations and policies exceed the definitional agreements of the SST Agreement. Section 905 of the SST Agreement is clear that the effect of a state's laws, rules, regulations, and policies (not just statutory provisions) are to be considered in determining substantial compliance.

2. Nebraska's Substantial Noncompliance with the SST Agreement Creates a Substantial Burden on Business.

The Department appears to argue that its substantial noncompliance does not result in a burden to businesses. We disagree.

In the case of the Taxpayer, which is still pending, the Department, after an extensive audit:

- Assessed sales tax on the digital information services provided by the Taxpayer to end users, expansively defining the services as the provision of "mailing lists"; and

- Assessed use tax on the Taxpayer for digital information purchased and used to provide its digital services, again by expansively classifying the data as "mailing lists."

When the Taxpayer asserted that imposing tax on digital mailing lists exceeded the Department's statutory authority, the Department responded that its basis for taxation was Reg. 1-080.05, a position that we believe is in direct conflict with the SST Agreement. *See* Letter from Abigail Stempson dated April 1, 2011, attached as Exhibit A. The fact that the Department is also assessing tax on intermediate transactions by expansively defining "digital mailing lists" only adds to the confusion and burden of compliance.

The administrative and monetary burden on businesses is clear. Businesses must be aware that Nebraska's statutory rule is different from its actual policy, adding unnecessary complexity to a taxpayer's efforts to comply. The burdens of Nebraska's noncompliance are more than theoretical—the burdens are very real to the Taxpayer and others similarly situated.[1]

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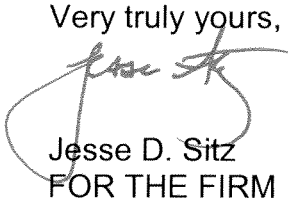
[1] The Department attempts to assert that its regulations have the same effect as statutory law. The Department fails to express the fact that an administrative agency cannot use its rulemaking power to modify, alter, or enlarge provisions of a statute which it is charged with administering. *Capitol City Tel. v. Neb. Dep't of Revenue*, 264 Neb. 515, 528 (Neb. 2002).

* * * * * *

With this letter, and on behalf of the Taxpayer, we request that the Governing Board find Nebraska to be in substantial noncompliance with its obligations under the SST Agreement. Its regulations, policies, and rules, in effect, are in direct conflict with the provisions of the SST Agreement. Because Nebraska is required to comply with "each" of the requirements under the SST Agreement, the Governing Board must find Nebraska in substantial noncompliance.

Please feel free to contact our office with any questions, and we appreciate your consideration.

Very truly yours,



Jesse D. Sitz
FOR THE FIRM

JDS/jds
Enclosure
cc: Vickie Neville
David C. Levy, Esq.
DOCS/1035248.2

Dave Heineman
Governor

STATE OF NEBRASKA
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April 1, 2011

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Re: In the Matter of the Petition of Cole Information Services, Inc. ("Petitioner") for the Redetermination of Sales and Use Taxes, Docket 2010-139-1 & 4D, NE ID # 10660100

Dear Mr. Sitz:

The Nebraska Department of Revenue ("Department") has reviewed your correspondence dated December 23, 2010, in regard to your Petition for Redetermination in the above-mentioned matter. This letter will respond to said arguments in the same order that they were made in your correspondence of December 23, 2010.

CIS's Argument: CIS's purchases and sales are not subject to sales or use tax because such purchases and sales are not digital audio works, digital audio-visual works, digital books, or digital mailing lists.

Department's Response: Petitioner questions the basis for the Department's assertion that digital mailing lists are taxable for sales and use tax purposes. Regulation 1-080.05 specifically addresses digital mailing lists and states:

> Mailing lists and prospect lists provided in the form of labels, magnetic media, diskette, electronic or any other format are taxable.

This Regulation was enacted prior to the beginning of the audit period in question. Therefore, Petitioner's purchase and sale of digital mailing lists are taxable.

CIS's Argument: CIS's purchases constitute a sale for resale.

Department's Response: Petitioner begins by citing *Neb. Rev. Stat.* §77-2701.34 which is the definition of sale for resale and is as follows:

> 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 to or integral part of other property or service.

Petitioner then specifically includes in this cite §77-2701.34(4) which is in regard to uses of digital products in a place where an admission is charged, for example, a movie theater. This subsection is inapplicable to Petitioner's factual situation and the Department does not understand what argument the Petitioner is making in regard to said subsection. If Petitioner continues to feel this subsection has a bearing on its specific situation, please provide the Department additional information.

Petitioner then contends that the Department "evidently has confused the "sale for resale" definition with the "ingredient or component part" exemption for manufacturing found at Neb. Rev. Stat. §77-2704.45." The Department is not confused. As stated in Ellen Thompson's letter of August 5, 2010, the specified digital products can be purchased tax-free as a sale for resale [§77-2701.34] when the property will be resold "as is" or when the product will become an ingredient or component part [§77-2704.45] of other property to be sold in the normal course of the purchaser's business. Ms. Thompson's letter concluded that Petitioner's digital mailing lists do not qualify as a sale for resale pursuant to §77-2701.34 or the exemption for an ingredient or component part pursuant to §77-2704.45. I agree with her conclusion.

In regard to the exemption for an ingredient or component part, if the same digital information is included in what is sold to more than one customer, it is not an ingredient or component part. Because this is Petitioner's factual situation, Petitioner's digital mailing lists do not qualify under §77-2704.45.

Furthermore, Petitioner's letter states, "A sale for resale is present where (1) a sale of property or provision of a service is made; and (2) the purchaser is using the property or service for the purpose of reselling it in the purchaser's normal course of business." What Petitioner has left out is that the property or provision of a service must be *in the form or condition in which it is purchased or as an attachment to or integral part of other property or service* (§77-2701.34). The Department's long-standing interpretation of this language is that the digital product must ultimately transfer to the customer and not be retained by the seller after the sale and therefore Petitioner's digital mailing lists do not qualify under §77-2701.34. In further support of the Department's position is *May Broadcasting Co. v. Boehm*, 241 Neb. 660, in which the court concluded that because the product a company sold to purchasers was not the same product the company bought from its distributors, the transactions between company and purchasers are not sale for resale of the product the company purchased from its distributors. Therefore, Petitioner would have to sell the same product to its clients that it bought from its distributors in order to be eligible as a sale for resale. In Petitioner's factual situation, this is not the case.

In conclusion, Petitioner must pay tax on its digital mailing lists when it purchases said products from its distributors. Furthermore, when Petitioner sells digital mailing lists, Petitioner must collect and remit sales tax when the purchaser is located in Nebraska.

If Petitioner wishes to make further arguments in regard to this matter, please do so by **April 15, 2011.** Please also feel free to call me with any comments or concerns.

FOR THE TAX COMMISSIONER

Sincerely,

Abigail M. Stempson

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