BEFORE THE ISSUES RESOLUTION COMMITTEE
STREAMLINED SALES TAX GOVERNING BOARD

In the Matter of Substantial Compliance of the State of Nebraska

Decision No. 2011-1

Presiding:
R. Bruce Johnson, Chair
Kathy Lawson
Michael Eschelbach
Robert Thompson

Appearances:
For the Business Advisory Council: Fred Nicely

For the State of Nebraska: Tom Gillaspie, Manager, Legal Services, Nebraska Department of Revenue

STATEMENT OF THE CASE
This matter came before the Issues Resolution Committee for a Hearing pursuant to Section 1002.B. of the Streamlined Sales Tax Agreement ("the Agreement"). On December 13, 2010, pursuant to a properly listed agenda item, the Compliance Review and Interpretations Committee ("CRIC") presented a report to the Governing Board of its annual review of states’ compliance with the Agreement. CRIC did not make a recommendation that Nebraska be found out of compliance. Mr. Fred Nicely moved to find Nebraska out of compliance on the issue of how Nebraska treats electronic mailing lists. The motion failed on a roll call vote of full member states with Oklahoma and Washington voting yes, fifteen

1 Mr. Gillaspie is a member of the Issue Resolution Committee. He recused himself from deliberations on this matter and appears only as a representative of the State of Nebraska.
states voting no, and Indiana and North Dakota absent. By Petition dated February 11, 2011, Meredith Garwood, President of the Business Advisory Council ("the BAC"), filed a Petition for Resolution and Reconsideration of the Governing Board action of not finding Nebraska out of compliance with the Agreement. Scott Peterson, Executive Director of the Governing Board, published the Petition on the Governing Board website and requested public comment as required by Rule 1001.B. A hearing was held on May 17, 2011. Fred Nicely represented the Business Advisory Council. Tom Gillaspie, Manager, Legal Services, Nebraska Department of Revenue, represented the State of Nebraska. Written comments were received from Jesse Sitz, Esq., BairdHolm, Attorneys at Law, on behalf of his client, Cole Information, Inc. Oral comments were taken from Mark Nebergall, President, Softec.

**ISSUE PRESENTED**

The BAC alleges that Nebraska is not in compliance with the Agreement because it taxes electronic mailing lists and prospect lists ("Lists") as tangible personal property in violation of Section 333 of the Streamlined Sales and Use Tax Agreement ("the Agreement").

**APPLICABLE AGREEMENT PROVISIONS**

Section 332 of the Agreement provides, in part, as follows:

**Section 332: SPECIFIED DIGITAL PRODUCTS**

A. A member state shall not include "specified digital products", "digital audio-visual works", "digital audio works" or "digital books" within its definition of "ancillary services", "computer software", "telecommunication services" or "tangible property." This restriction shall apply regardless of whether the "specified digital product" is sold to a purchaser who is an end user or with less than the right of permanent use granted by the seller or use which is conditioned upon continued payment from the purchaser. Until January 1, 2010, the exclusion of "specified digital products" from the definition of "tangible personal property" shall have no implication on the classification of products "transferred electronically" which are not included within the definition of "specified digital products" as being included in, or excluded from, the definition of "tangible personal property."
B. For purpose of Section 327(C) and the taxability matrix, “Digital Audio-Visual Works”, “Digital Audio Works”, and “Digital Books” are separate definitions.

C. If a state imposes a sales or use tax on products “transferred electronically” separately from its imposition of tax on “tangible personal property”, that state will not be required to use the terms “specified digital products”, “digital audio visual works”, “digital audio works”, or “digital books”, or enact an additional or separate sales or use tax levy on any “specified digital product.”

D.

1. A statute imposing a tax on “specified digital products,” “digital audio-visual works,” “digital audio works” or “digital books” and, after January 1, 2010, on any other product “transferred electronically” shall be construed as only imposing the tax on a sale to a purchaser who is an end user unless the statute specifically imposes and separately enumerates the tax on a sale to a purchaser who is not an end user. For purposes of this paragraph, an “end user” includes any person other than a person who receives by contract a product “transferred electronically” for further commercial broadcast, rebroadcast, transmission, retransmission, licensing, relicensing, distribution, redistribution or exhibition of the product, in whole or in part, to another person or persons.

2. A statute imposing a tax on “specified digital products,” “digital audio-visual works,” “digital audio works” or “digital books” and, after January 1, 2010, on any other product “transferred electronically” shall be construed as only imposing tax on a sale with the right of permanent use granted by the seller unless the statute specifically imposes and separately enumerates the tax on a sale with the right of less than permanent use granted by the seller. For purposes of this paragraph “permanent” means perpetual or for an indefinite or unspecified length of time. A right of permanent use shall be presumed to have been granted unless the agreement between the seller and the purchaser specifies or the circumstances surrounding the transaction suggest or indicate that the right to use terminates on the occurrence of a condition subsequent.

3. A statute imposing a tax on “specified digital products,” “digital audio-visual works,” “digital audio works” or “digital books” and, after January 1, 2010, on any other product “transferred electronically” shall be construed as only imposing tax on a sale which is not conditioned upon continued payment from the purchaser unless the statute specifically imposes and separately enumerates the tax on a sale which is conditioned upon continued payment from the purchaser.

4. A member state which imposes a sales or use tax on the sale of a product “transferred electronically” to a person other than [an] end user or
on a sale with the right of less than permanent use granted by the seller or which is conditioned upon continued payment from the purchaser shall so indicate in its taxability matrix in a format approved by the Governing Board.

E. Nothing in this section or the definition of “specified digital products” shall limit a state’s right to impose a sales or use tax or exempt from sales or use tax any products or services that are outside the definition of “specified digital products.”

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I. For purposes of this section, the term “transferred electronically” means obtained by the purchaser by means other than tangible storage media.

Section 333 of the Agreement provides as follows:

**Section 333: USE OF SPECIFIED DIGITAL PRODUCTS**
A member state shall not include any product transferred electronically in its definition of “tangible personal property.” “Ancillary services”, “computer software”, and “telecommunication services” shall be excluded from the term “products transferred electronically.” For purposes of this section, the term “transferred electronically” means obtained by the purchaser by means other than tangible storage media.

Section 805 of the Agreement provides as follows:

**Section 805: COMPLIANCE**
A state is in compliance with the Agreement if the effect of the state’s laws, rules, regulations, and policies is substantially compliant with each of the requirements set forth in the Agreement.

Section 1103 of the Agreement provides as follows:

**Section 1103: LIMITED BINDING AND BENEFICIAL EFFECT**
A. This Agreement binds and inures only to the benefit of the member states. No person, other than a member state, is an intended beneficiary of this Agreement. Any benefit to a person other than a state is established by the laws of the member states and not by the terms of this Agreement.

B. Consistent with subsection (A), no person shall have any cause of action or defense under the Agreement or by virtue of a member state's approval of the Agreement. No person may challenge, in any action brought under any provision of law, any action or inaction by any department, agency, or other instrumentality of any member state, or any political subdivision of a member state on the ground that the action or inaction is inconsistent with the Agreement.
C. No law of a member state, or the application thereof, may be declared invalid as to any 1 person or circumstance on the ground that the provision or application is inconsistent 2 with the Agreement.

The following definitions are contained in Appendix C, Part II of the Agreement:

“Delivered electronically” means delivered to the purchaser by means other than tangible storage media.

Specified digital products” means electronically transferred:

“Digital Audio-Visual Works” which means a series of related images which, when shown in succession, impart an impression of motion, together with accompanying sounds, if any,

“Digital Audio Works” which means works that result from the fixation of a series of musical, spoken, or other sounds, including ringtones, and

“Digital Books” which means works that are generally recognized in the ordinary and usual sense as “books”.

For purposes of the definition of “digital audio works”, “ringtones” means digitized sound files that are downloaded onto a device and that may be used to alert the customer with respect to a communication.

For purposes of the definitions of “specified digital products”, “transferred electronically” means obtained by the purchaser by means other than tangible storage media.

BACKGROUND

Section 327 of the Agreement requires member states to utilize common definitions that are set out in the Library of Definitions. Appendix C, Part I, “Administrative Definitions,” defines “tangible personal property” as “personal property that can be seen, weighed, measured, felt, or touched, or that is in any other manner perceptible to the senses. ‘Tangible personal property’ includes electricity, water, gas, steam, and prewritten computer software.”

At the time the Agreement was drafted, there was a general understanding by the Implementing States that states with substantially similar statutory definitions of tangible

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2 There is no allegation that Nebraska’s definition of “tangible personal property” is materially different than the Agreement definition.
personal property had judicial decisions that interpreted the language differently, particularly with regard to computer software. Specifically, some courts interpreted the definition to include computer software and others did not. Accordingly, the states and representatives of the business community embarked on a lengthy effort to bring some clarity to this area by crafting a definition of “digital goods” or “digital equivalents” of tangible personal property. That effort was ultimately unsuccessful.

The parties were successful, however, in crafting a definition of “specified digital goods,” which was limited to electronically transferred “digital audio-visual works.” “digital audio works,” “and “digital books.” Each specified digital good was also defined. On September 20, 2007, these definitions were enacted into Agreement Appendix C, Part II. At the same time, Sections 332 and 333 of the Agreement were enacted. (These amendments will be sometimes referred to collectively as “the 2007 Amendments.”

Prior to the 2007 Amendments, two hypothetical member states, both using the Agreement definition of tangible personal property—and neither with any specific additional provisions in their statutes—could take different positions on the taxability of digital goods. A seller of digital books, for example, relying solely on a state’s statutes, could not know whether such books were taxable in a member state.

The 2007 Amendments were enacted to alleviate this problem. After the 2007 Amendments, a state had several choices. It could explicitly tax all “specified digital goods.” It could tax one or more of the “specified digital goods” and not the other ones. Or, it could explicitly tax certain “property delivered electronically,” which, presumably would include “specified digital goods” as well as similar property as the state might define it. What was no longer available, however, was the option for the state to tax digital goods solely by virtue of a judicial decision defining tangible personal property to include such goods. It would be necessary for a state to have a specific imposition provision that would put taxpayers on notice of the tax. The language chosen to effectuate this last limitation was primarily the language of Section 333 which provides: “A member state shall not include any product transferred electronically in its definition of ‘tangible personal property.’”
**NEBRASKA LAW**

Nebraska has, at all relevant times, imposed a sales and use tax on certain transfers of tangible personal property. See Neb. Rev. Stat. §77-2703(1). Nebraska does not generally impose a sales tax on services or on sales of intangible property. In 1992, the Nebraska Supreme Court, in *May Broadcasting Co. v. Boehm*, 490 N.W.2d 203 (Neb. 1992), upheld a use tax on the taxpayer’s storage and use of syndicated television programming. Much of the programming was transferred to the taxpayer on film or videotape. Other programming was delivered by satellite. The Court held (490 N.W.2d at 207) that the method of delivery did not alter the use tax consequences:

> A transmission by satellite is the transmission of a tangible thing—an electronic signal. The mere fact that the signals may be received and stored shows that a tangible thing is in issue. The concept of physically storing an intangible thing is beyond comprehension. We hold that the method of transmission does not affect the applicability of the Nebraska use tax.

Almost four years later, the Nebraska Supreme Court decided an income tax case, *American Business Information, Inc. v. Egr*, 650 N.W.2d 251 (Neb. 2002). In that case, the Department of Revenue had argued that the sale of prospect lists, whether transferred by paper, index card, diskettes, magnetic tapes, CD-ROM’s, or electronically by computer communications over telephone lines “was the sale of intangible information, and that the physical medium which conveyed that information was merely incidental or inconsequential to the transaction.” 650 N.W. 2d at 256. The Court disagreed, holding that the products sold by ABI constituted tangible personal property. While noting that *May* was not dispositive, because it was a sales tax case, the Court cited with approval the language cited above, and concluded that “ABI’s delivery of online data electronically over telephone lines ‘is the transmission of a tangible thing.’” 650 N.W. 2d at 257.

In response to *American Business Information*, the Department amended Sales and Use Tax Regulation 1-080.05 to provide that “[m]ailing lists and prospect lists provided in the form of labels, magnetic media, diskette, electronic or any other format are taxable.”

Apparently in response to the 2007 Amendments, the Nebraska legislature amended Neb. Rev. Stat. §77-2703(1) to impose a tax on “the gross receipts from the sale of products

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3 The prior version of Regulation 1-080.05 had provided that mailing lists “on magnetic media or in an electronic format are not taxable.”
transferred electronically as described in subsection (9) of section 77-7-2701.16.”

Subsection (9) provides as follows:

(9) Gross receipts includes the retail sale of digital audio works, digital audiovisual works, digital codes, and digital books delivered electronically if the products are taxable when delivered on tangible storage media. A sale includes the transfer of a permanent right to use, the transfer of a right of use that terminates on some condition, and the transfer of a right to use conditioned upon the receipt of continued payments.

The statute does not affirmatively address “electronic mailing lists.”

It appears that Nebraska has properly complied with the 2007 Amendments as far as taxing “specified digital goods” is concerned. The BAC agrees that Nebraska’s taxation of those goods is in substantial compliance with Sections 332, 333, and other relevant sections of the Agreement. “Electronic mailing lists,” however, are not specified digital goods. Nor are they digital audio works, digital audiovisual works, digital codes, or digital books.

The gravamen of the BAC’s complaint is that the Department of Revenue’s regulation taxing electronic mailing lists must be premised on the legal theory that electronic mailing lists are tangible personal property, as held in American Business Information Co. Otherwise, there is no statutory support for the regulation. Thus, the BAC claims the rule violates Sections 332 and 333 of the Agreement by “includ[ing] any product transferred electronically [i.e., mailing lists] in its definition of ‘tangible personal property.’”

DISCUSSION

Pursuant to Section 805 of the Agreement, “[a] state is in compliance with the Agreement if the effect of the state’s laws, rules, regulations, and policies is substantially compliant with each of the requirements set forth in the Agreement.”

The BAC argues that Nebraska is not in compliance with the Agreement because it relies on “rules [and] regulations” to impose a tax on electronically delivered Lists. In the BAC’s view, the only statutory authority for such a regulation is Nebraska’s statutory provision imposing a tax on tangible personal property. Thus, BAC argues that Nebraska is clearly including a product transferred electronically, i.e., the Lists, in its definition of tangible personal property in violation of Section 333. The BAC further argues that this places a burden on businesses because the protections of Section 332 do not apply. These
protector protections require a tax on products transferred electronically to be limited to a tax on end users, on the transfer of a permanent right to the property, and on transfers not conditioned on future payments, “unless the statute specifically imposes and separately enumerates the tax on such products.” Section 332.D.1-3.

Nebraska argues, on the other hand, that it substantially complies with the 2007 Amendments. Those amendments collectively require a state that chooses to tax products transferred electronically to do so explicitly. It could not do so implicitly by relying on an expansive definition of tangible personal property. The BAC concedes that Nebraska could impose this tax by statute. In Nebraska’s view, whether the imposition of the tax is explicitly in the statute or in a rule or regulation is one for the state to decide. Finally, Nebraska argues that the protections of Section 332 do apply, because Nebraska Rev. Stat. §77-27-2712.03(2) states that Nebraska will comply with all the provisions of the Agreement. This statute requires the Department to provide those protections to the Lists explicitly taxed in the Regulation.

Technical Compliance. We agree with the Department of Revenue. A state is in compliance if “the effect of the state’s laws, rules, regulations, and policies is substantially compliant. . . .” Nebraska’s regulation is presumptively valid. See Swift & Co. v. Nebraska Department of Revenue, 278 Neb. 763 (2009), cited in Nebraska’s response. Whether a particular provision should be in statute or rule is a decision that should be left to the state. Until a rule or regulation is declared invalid by the courts, this Committee must consider it a valid expression of state law.

It is clear that the Agreement requires a state that wishes to tax goods transferred electronically to do so explicitly with a provision that addresses such goods. Nebraska has done so in statute for “specified digital goods.” It does so in regulation for Lists. Thus, the provisions of Section 333 are satisfied.

Burden. Our views on the meaning of “substantial compliance” were set out in our recommendation in In the Matter of the Substantial Compliance of the State of Nevada (IRC Dec. 2010-1). In that recommendation, we stated “[s]ubstantial compliance does not mean

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4 Because we have found no technical violation, it is theoretically unnecessary for us to address the “burden” argument. Our decision, however, is only a recommendation. We recognize that the Governing Board may disagree. Accordingly, we have set out our view on the taxpayers’ burden for the benefit of the Governing Board in its deliberations.
exact compliance. It is sufficient under the Agreement that ‘the effect of all of the states’s laws, rules, regulations, and policies is substantially compliant. . . . ‘ We believe the ‘effect’ must be the effect on the taxpayers of the state. When this standard was originally debated by the Governing Board, there was significant discussion surrounding the term ‘substantially.’ It is clear, for example, that a state may use its own statutory conventions and format in drafting definitions and other provisions of the Agreement, even though the effect of the provisions must be uniform. Stylistic differences generally do not impact a taxpayer nor increase its burden of compliance. Thus, a state may depart from the exact terms of the Agreement if it does not increase the burden on any taxpayer or the burden is de minimus.\(^5\) We note further that the mere imposition of a tax, though clearly a burden on any taxpayer, is not enough. The taxpayer must show some burden that it incurs by virtue of a violation of the Agreement that it would not have incurred if the Agreement had been followed.

In this case, we believe that Nebraska is substantially compliant with the 2007 Amendments. The Lists are taxed by virtue of a regulation. The BAC alleges they should be taxed by virtue of a statute. We fail to see how this difference imposes an additional burden on a taxpayer. The BAC alleges that the protections of Section 332 are not provided to sales of electronically delivered Lists. Nebraska alleges that those protections are available. We have no reason to disbelieve the representations of the state unless and until the BAC can demonstrate that a taxpayer has not been allowed those protections.

We are aware, through public comment, that these issues are currently the subject of administrative proceedings in which a taxpayer alleges, inter alia, that Reg. 1.080.05 exceeds the Department’s authority and that the Department is seeking to tax sales other than sales to end users. We, of course, express no opinion on the merits of this litigation. A final decision in that case, whether by the Department or a Nebraska court, may shed additional light on these issues.

\(^5\) Although the Governing Board adopted our recommendation, it was not asked to adopt the report *per se*. Accordingly, we do not assert that our interpretation of substantial compliance has been explicitly adopted or approved by the Governing Board.
RECOMMENDATION

We believe that Nebraska, at the time of the Governing Board meeting was substantially compliant with Section 332 and 333 of the Agreement, as mandated by Section 805. Pursuant to Article X of the Agreement, and the rules promulgated thereunder, we recommend that the Governing Board find that Nebraska is substantially compliant with the Agreement, and that it notify the petitioner, the Business Advisory Council, and the appropriate Nebraska authorities of its decision.

Signed in counterparts on the date indicated.

R. Bruce Johnson                  Michael Escalbach
July 13, 2011                     July __, 2011

Kathy Lawson                      Robert Thompson
July __, 2011                      July __, 2011
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We believe that Nebraska, at the time of the Governing Board meeting was substantially compliant with Section 332 and 333 of the Agreement, as mandated by Section 805. Pursuant to Article X of the Agreement, and the rules promulgated thereunder, we recommend that the Governing Board find that Nebraska is substantially compliant with the Agreement, and that it notify the petitioner, the Business Advisory Council, and the appropriate Nebraska authorities of its decision.

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R. Bruce Johnson
July ___, 2011

Michael Eschelbach
July 11, 2011

Kathy Lawson
July ___, 2011

Robert Thompson
July ___, 2011
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July __, 2011

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July 12, 2011
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R. Bruce Johnson
July __, 2011

Michael Eshelbach
July __, 2011

Kathy Lawson
July 14, 2011

Robert Thompson
July __, 2011