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February 7, 2007

Jay Holmquist, General Manager  
Nebraska Rural Electric Association  
P.O. Box 82048  
Lincoln, NE 68501

Re: Sales Tax on Postage

**QUESTION**

You have asked me to respond to a question raised by Don Suda of Southwest Public Power District concerning a letter he and several other managers received from Southeast Data Cooperative ("SEDC") regarding sales tax on postage in connection with billing services performed by SEDC.

**FACTS**

As I understand the facts, SEDC is printing and mailing customer bills for Southwest Public Power District ("Southwest") and several other public power districts in Nebraska ("collectively "PPDs"). The PPDs make checks made payable to the United States Post Service ("USPS") and send them to SEDC. Subsequently, SEDC deposits these checks in SEDC's USPS postage account. SEDC uses its postage permit for the postage required to send the PPDs bill to the PPDs customers. SEDC informs the PPDs the amount due for postage and the PPDs make checks payable for such amounts to the USPS, which are subsequently deposited in SEDC's account with the USPS. Arguably, since the checks are made payable to the USPS, there is no sales tax on the postage. As discussed below, the current practice of making checks payable to USPS is claimed to be subject to sales tax by the Nebraska Department of Revenue.

SEDC has informed the PPDs that it has changed its postage permit funding process to an automated ACH debit system which only allows funding (electronic transfers) directly from SEDC's bank account. It is not clear whether the change is voluntary or mandatory. Nevertheless, SEDC will no longer accept checks that are made payable to the USPS. Under the new procedure, the PPDs will be billed directly for the postage by SEDC, which makes the postage subject to sales tax in Nebraska.

Our office is presently contesting a notice of deficiency given by the Department of Revenue ("Department") to Norris Public Power District and Seward Public Power District for the failure to pay sales tax on postage. The Department has audited the sales tax records of Norris and Seward and claims that Norris and Seward should have paid sales tax on postage, in spite of the fact that checks for postage were made payable to USPS. National Information Solutions Cooperative ("NISC") is the vendor for Norris and Seward, as well as many other public power districts in Nebraska.

### **ARGUMENTS MADE TO THE STATE TAX COMMISSIONER**

The arguments that we made to the State Tax Commissioner on behalf of Norris and Seward will give you some incite into the nature of the claims presently before the Tax Commission. The cases for Norris and Seward have been fully tried and briefed and we are awaiting a decision from the Nebraska Tax Commissioner.

### **POSTAGE PAYMENTS TO THE UNITED STATES POSTAL SERVICE ARE NOT SUBJECT TO SALES OR USE TAX**

[ARGUMENTS IN NORRIS AND SEWARD OPENING BRIEF]

The Department is erroneously attempting to tax the Districts' purchases of postage. Each of the Districts uses the National Information Solutions Cooperative (hereinafter "NISC") for the printing of its monthly billing statements to consumers. Each month, the Districts write checks payable to the Unites States Postal Service (hereinafter the "USPS") for the purpose of purchasing postage with which to mail the bills. (Stipulation at ¶ 18). The checks are delivered by the Districts to NISC, who deposits them with the USPS. *Id.* The Districts' monthly invoices are put into envelopes stamped with NISC's postal permit number, and are taken by NISC to the USPS for delivery. *Id.*

The Department has determined that because the money paid by the Districts to the USPS is ultimately credited to NISC's postal account, the Districts' checks reflect payments for "delivery charges" rather than for "postage". However, the Department's position erroneously ignores the plain language of its own regulations. From the beginning of the audit period through October 1, 2003, the regulation applicable to printing and related industries provided, in relevant part, as follows:

057.02 The printer must collect tax on the total charges for printing. Neb. Admin. Code, Title 316, Ch. 1, § 057.02 (1998) (Ex's 37 & 38). The record is undisputed that the Districts do not pay NISC for postage, and thus postage is not included as part of the "total charges" for printing. (Stipulation at ¶ 18). The Districts' checks payable to the USPS constitute direct payments to the USPS for postage. Section 1-079, which was applicable through April 12, 2005, provided that:

079.01 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.**

079.02 Charges for delivery, freight, postage, shipping, or transportation that are **paid to a person other than the retailer are exempt.**

Neb. Admin. Code, Title 316, Ch. 1, § 079 (1998) (Ex's 37 & 38) (emphasis added).

While the Department has construed these payments as payments to NISC for printing charges, it is beyond dispute that NISC was legally incapable of negotiating the checks. By analogy, a lawyer or law firm would not be deemed to have received a direct payment from a client who delivers a check payable to a third party. The Department's conclusion absolutely ignores the payee of the checks issued by the Districts. To construe the checks as direct payments to NISC for printing is therefore improper.

The analysis under the revised regulations regarding printing and delivery charges leads to the same conclusion. On October 1, 2003 section 057 was revised to provide, in relevant part, that:

057.02 The printer must collect tax on the gross receipts for printing. The gross receipts are taxable whether the printer or the customer provides the materials. 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) (Ex's 38 & 39). On April 12, 2005, section 079 was revised to provide, in relevant part, that:

079.01 Charges for delivery, freight, postage, shipping, handling, crating, packing, or transportation of an item are taxable whenever the item is taxable and the charges are paid to the retailer of the item.

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079.03 Charges for delivery, freight, postage, shipping, or transportation **that are paid to a person other than the retailer are exempt.**

Neb. Admin. Code, Title 316, Ch. 1, § 079 (2005) (Ex's 38 & 39) (emphasis added). The checks issued by the Districts clearly reflect a purchase of postage by the Districts from the USPS, and therefore the transaction is nontaxable.

At the hearing on this matter, the Department admitted that the Districts would not be assessed for a sales or use tax if they had delivered stamps to NISC, rather than delivering checks made payable to the USPS for postage. (T,141:13-17). This conclusion demonstrates the arbitrary nature of the manner in which the applicable regulations are being applied. The Districts clearly intended to purchase postage directly from the USPS, as evidenced by their checks. The Department's conclusion is an example of putting form over substance.

It is also important that the current version of section 057 references the printer's "gross receipts." The Department made it clear at the hearing on this matter that it did not investigate this matter to determine whether or how the amounts attributable to postage are reflected on the books of NISC. It is undisputed, however, that NISC did not include postage charges on the invoices that reflected its charges to the Districts. (Stipulation at ¶ 18). Since the Districts' checks were made payable to the USPS and no funds for postage were ever transferred from the Districts to NISC, it is erroneous to construe the payments as part of the gross receipts of NISC. For all of the foregoing reasons, the Districts request that the Department's assessment as to postage purchased by them for the mailing of their monthly invoices be reversed and that all such amounts reflected in their respective Notices of Deficiency be voided. [END OF ARGUMENT] Our reply argument, to the Department of Revenue's position in its Brief, follows.

[ARGUMENT IN NORRIS AND SEWARD REPLY BRIEF]

The Department's position with respect to whether use tax should be paid on amounts the Districts paid to the United States Postal Service (hereinafter the USPS) ignores the undisputed facts of this case. The Department contends that *Affiliated Foods v. State*, 259 Neb. 549, 611 N.W.2d 105 (2000) dictates that use tax is due as to these amounts. However, although representing that the facts in the case at bar are "similar" to those in *Affiliated*, the Department does acknowledge that there are "some differences." It is these differences which are material, and which dictate a different outcome in this case.

In *Affiliated*, the taxpayer was essentially playing the same role as NISC in this case. The taxpayer printed advertisements for its members and mailed them through the U.S. mail. The taxpayer billed their members for postage along with other charges, but did not collect sales tax on the portions collected for postage. The court determined that the charges for postage were a cost of transportation which were subject to the Nebraska sales tax.

In *Affiliated*, the taxpayer argued that it was simply reimbursed for the cost of postage which it passed through to its members. The court stated that this argument involved a question of fact, and reviewed the lower court's order for errors appearing on the record. *Id.* at 556, 611 N.W.2d at 110-111. In reviewing the record, the court determined that there was competent evidence to support the finding that the postage was charged as part of the retail sale. *Id.* The court later succinctly stated its holding that "[w]hen the cost of transportation is paid directly to *Affiliated Foods*, it is taxable." *Id.* at 558-559, 611 N.W.2d at 112.

With respect to the Districts, it is undisputed that the postage charges were not invoiced by NISC. It is further undisputed that the Districts paid for the postage by writing checks payable to the USPS. Thus, unlike *Affiliated*, the postage was not paid to NISC. At best, NISC was requesting pre-purchases of postage by facilitating direct payments from the Districts to the USPS. The Districts did not deliver money to NISC, but rather, delivered postage. In other words, the money went directly from the Districts to the USPS and the postage was then

delivered by the USPS directly to NISC. For these reasons, *Affiliated* is distinguishable and the amounts paid directly from the Districts to the USPS are not subject to Nebraska sales or use tax.

The Districts request that the Department's assessment as to postage purchased by them for the mailing of their monthly invoices be reversed and that all such amounts reflected in their respective Notices of Deficiency be voided. [END OF ARGUMENTS]

The arguments made in the briefs referred to above are to no avail if SEDC will no longer accept deposits made payable to the USPS. It is quite clear under Nebraska law (Section 1-079), that unless payment is made to a person other than the retailer (SEDC or NISC are retailers) the charges for delivery are subject to sales tax. From reading SEDC's letter, it is not clear whether the change in the funding process was voluntarily or mandatory. In any event, the change will subject the postage to sales tax.

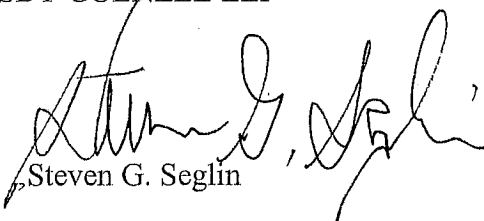
### CONCLUSION

If SEDC changes its funding mechanism to an automated ACH debit system which only allows funding (electronic transfers) directly from SEDC's bank account, and ends up billing Southwest and the other PPDs for the postage, it is clear this direct billing by SEDC under the current state of the Nebraska law will subject the transaction to sales tax. The only way around paying the tax is to change the law, or for Southwest and the other PPDs to mail the bills themselves, or establish their own account with the USPS and figures out some way that SEDC can access it.

Very truly yours,

CROSBY GUENZEL LLP

By

  
Steven G. Seglin

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