

IN THE DISTRICT COURT OF LANCASTER COUNTY, NEBRASKA

VALPAK OF OMAHA, LLC,) Case Number CI 13-1001
)
Petitioner,)
)
v.)
) **ORDER**
)
NEBRASKA DEPARTMENT OF)
REVENUE, DOUGLAS A. EWALD,)
NEBRASKA TAX COMMISSIONER and)
the STATE OF NEBRASKA,)
)
Respondents.)

This is an appeal from a final decision of Douglas A. Ewald, Tax Commissioner (the Tax Commissioner) rendered on February 19, 2013.¹ This appeal relates to a January 2, 2008, Notice of Deficiency Determination and Assessment sent by the Nebraska Department of Revenue, Compliance Division (the Compliance Division), to Valpak of Omaha, LLC (Valpak) in the amount of \$218,513.58, covering October 1, 2004, through October 31, 2007; a July 2, 2009, Notice of Deficiency Determination and Assessment sent by the Compliance Division to Valpak in the amount of \$55,075.94, covering December 1, 2008, through May 31, 2009; and a February 10, 2012, Notice of Deficiency Determination and Assessment sent by the Compliance Division to Valpak in the amount of \$236,550.94, covering November 1, 2007, through November 30, 2008, and June 1, 2009, through December 31, 2009 (collectively the Deficiency Assessments). Valpak filed a petition for redetermination with

¹ The appeal is brought pursuant to NEB. REV. STAT. §§ 77-27,127 and 77-27,128 (Reissue 2009) and NEB. REV. STAT. § 84-817 (Cum. Supp. 2012).

DEPARTMENT OF JUSTICE
JAN 16 2014
STATE OF NEBRASKA

respect to each deficiency assessment. Hearing on the petitions for redetermination was consolidated and heard by Hearing Officer Berger on August 10, 2012. By his order of February 19, 2013, the Tax Commissioner, except for the period of October 1, 2004, through February 28, 2005, denied the petitions for redetermination. This appeal followed.

BACKGROUND

Except for prior to its organization on March 3, 2005, Valpak, a Nebraska limited liability company, was, at all relevant times, engaged in business in the State of Nebraska. Valpak is a franchisee of Val-Pak Direct Marketing Systems, Inc. (Val-Pak Direct)², a company based in Largo, Florida, pursuant to a Franchise Agreement dated October 12, 2004 (the Franchise Agreement).³

Val-Pak Direct is in the business of printing, publishing and distributing cooperative direct mail advertising, a method of advertising in which advertisements from multiple businesses are included in a single envelope for mailing. The envelopes contain advertising inserts and are mailed to multiple homes using a system called “Neighborhood Trade Areas” (NTA). An NTA is a logical group of approximately 10,000 addresses based on income demographics, purchase behaviors, proximity to retail shopping locations, traffic patterns and postal carrier routes. Under the Franchise Agreement, Valpak is granted “a right, license and obligation”, in part, “to sell, and place orders for distribution of advertising, Advertising Inserts, or other products and/or services offered by [Val-Pak Direct], to be placed in VALPAK ® Envelopes [(the Envelopes with advertising inserts)] to be distributed within . . .” a designated territory. Valpak’s territory includes Cass, Washington, Douglas and Sarpy Counties in Nebraska and Pottawattamie County in Iowa.

² Val-Pak Direct was purchased by Cox Enterprises, Inc. and is referred to during the hearing of August 10, 2012, as Cox; however, I will use Val-Pak Direct in this order.

³ The Franchise Agreement was entered into between Val-Pak Direct and Scott Farkas and Mary P. Rogers-Farkas on October 12, 2004, and, for purposes of this case, was assigned to Valpak.

Valpak and interested advertisers, who are mainly located in the Omaha and Council Bluffs metropolitan areas, enter into Participation Agreements (a Participation Agreement), which specify the amount and type of advertising being purchased by an advertiser. A Participation Agreement involving cooperative direct mail services specifies the NTA which an advertiser wishes to target and the frequency an advertiser wishes to include an insert in the Envelopes with advertising inserts. Under a Participation Agreement, Valpak agrees to provide “assistance in planning and preparation of rough copy, proof, printing, insertion, addressing, postage, envelopes, and mailing distribution” as specified in a Participation Agreement and that it is liable for “the timely production and distribution” of the Envelopes with advertising inserts. Although an advertiser is required to approve final copy, a Participation Agreement provides that Valpak has the right to copyright advertisements in its name, “is the owner of all rights and privileges” relating to the advertisements and must provide approval prior to the publication of the advertisements.

Once a draft advertisement message has been agreed upon, the advertiser makes final payment to Valpak, which, in turn, submits the advertisement to Val-Pak Direct as an “Insertion Order”, a final transmission of the advertising message to Val-Pak Direct. Upon receipt of an Insertion Order, Val-Pak Direct is responsible for printing the advertising message and envelopes, the collating and inserting of the advertising messages into envelopes and the labeling and direct mailing of the Envelopes, with advertising inserts. The Envelopes with advertising inserts are then mailed by Val-Pak Direct to the intended recipients (e.g., potential customers of Valpak’s advertisers) through the U.S. Postal Service. Valpak does not obtain physical possession of the materials consumed by Val-Pak Direct in the making of the Envelopes with advertising inserts; the materials that become part of the Envelopes with advertising inserts prior to the creation of the Envelopes with advertising inserts; or the Envelopes with advertising inserts once they are printed by Val-Pak Direct.

As previously noted, Valpak was provided with the Deficiency Assessments, which related to the use tax due for tax periods between 2004 and 2009. The Deficiency

Assessments were based on Valpak's failure to remit use tax on its purchases and use of advertising materials from Val-Pak Direct distributed in Nebraska. Valpak timely filed petitions for redetermination for the Deficiency Assessments. Hearing on the petitions was consolidated.

Prior to hearing, Valpak filed a motion requesting Hearing Officer Berger recuse herself or, in the alternative, that the Tax Commissioner remove Hearing Officer Berger and appoint an alternate hearing officer. After a hearing on the motion⁴, an order was issued by Hearing Officer Berger denying the motion.⁵

The hearing on Valpak's petitions for redetermination was held on August 10, 2012. Following the hearing, the Tax Commissioner issued his order of February 19, 2013, which, except for the period of October 1, 2004, through February 28, 2005, denied the petitions for redetermination. This appeal followed.

For purposes of this appeal, the parties stipulated that

- (1) the amounts paid to Valpak by its advertisers, enable those advertisers to both the services and advertising inserts at issue, are not subject to Nebraska sales tax⁶ and
- (2) the issue raised by this appeal is "whether Valpak must pay the Nebraska use tax which was assessed to" it by the Deficiency Assessments.⁷

STANDARD OF REVIEW

As previously noted, this is an appeal brought under the Nebraska Administrative Procedure Act.⁸ Under the Administrative Procedure Act, a review of the Tax Commissioner's order of February 19, 2013, is to be conducted without a jury de novo on the

⁴ Exhibit 16 contains a copy of Valpak's motion and the evidence presented in support of its motion and Exhibit 17 contains the Tax Commissioner's response.

⁵ *Transcript*, p. 361.

⁶ Exhibit 1, ¶28.

⁷ Exhibit 20, page 3 ("Issue").

⁸ NEB. REV. STAT. §§ 84-901 through -920 (Reissue 2008, as amended).

record presented to Hearing Officer Berger.⁹ “. . . [A] rebuttable presumption of validity attaches to the actions of administrative agencies.”¹⁰ In attacking the action of an administrative agency, “[t]he burden of proof rests with the party challenging the agency’s action.”¹¹

DISCUSSION

1. Recusal: In a nutshell, Valpak argues that Hearing Officer Berger should have recused herself from this case due to her affiliation with the Nebraska Appleseed Center for Law in the Public Interest (Appleseed) as a staff attorney and a member of its Advisory Board at the time of her hearing of this case, because a reasonable person would have questioned her impartiality under an objective standard of reasonableness. This challenge must be addressed prior to addressing the merits of the decision of the Tax Commissioner.

Pursuant to the Nebraska Revised Code of Judicial Conduct¹², “[a] judge may engage in extrajudicial activities, except as prohibited by law or this Code. However, when engaging in extrajudicial activities, a judge shall not . . . (C) participate in activities that would appear to a reasonable person to undermine the judge’s independence, integrity, or impartiality . . .”¹³ “An adjudicator should recuse himself or herself when a litigant demonstrates that a reasonable person who knew the circumstances of the case would question the adjudicator’s impartiality under an objective standard of reasonableness, even

⁹ NEB. REV. STAT. § 84-917 (5)(a) (Cum. Supp. 2012).

¹⁰ *Norwest Corp. v. State*, 253 Neb. 574, 583, 571 N.W.2d 628, 634 (1997). *See also, Upper Big Blue NRD v. State*, 276 Neb. 612, 756 N.W.2d 145 (2008)(deference is accorded to an agency’s interpretation of its own regulations, unless plainly erroneous or inconsistent).

¹¹ *Dillard Dept. Stores v. Polinsky*, 247 Neb. 821, 825, 530 N.W.2d 637, 641 (1995) (citations omitted)..

¹² Although it is true that NEB. REV. CODE OF JUDICIAL CONDUCT, Application (1)(A), does not refer to hearing officers, the Nebraska Supreme Court had held that, “[b]y extension”, the Revised Code of Judicial Conduct applies to administrative hearing officers. *Urwiller v. Neth*, 263 Neb. 429, 434, 640 N.W.2d 417, 423 (2002).

¹³ NEB. REV. CODE OF JUDICIAL CONDUCT § 5-303.1. Concomitant rules are found at 316 NEB. ADMIN. CODE, § 33-077 and 350 NEB. ADMIN. CODE. § 90-006, which provide, *inter alia*, when a person may *not* serve as a hearing officer.

though no actual bias or prejudice is shown.”¹⁴ “A party seeking to disqualify an adjudicator on the basis of bias or prejudice bears the heavy burden of overcoming the presumption of impartiality.”¹⁵

In discussing recusal, the Nebraska Supreme Court has recently stated:

The Nebraska Revised Code of Judicial Conduct requires that ‘[a] judge shall hear and decide matters assigned to the judge, except when disqualification is required . . .’ The code goes on to state that ‘[a] judge shall disqualify himself or herself in any proceeding in which the judge’s impartiality might reasonably be questioned . . .’ We have previously stated that a trial judge should recuse himself or herself when a litigant demonstrates that a reasonable person who knew the circumstances of the case would question the judge’s impartiality under an objective standard of reasonableness, even though no actual bias or prejudice is shown.[¹⁶]

Valpak does not allege actual bias or prejudice on the part of Hearing Officer Berger. Instead, it argues that a reasonable person who knew the circumstances of the case would question her impartiality under an objective standard of reasonableness.¹⁷

In its motion, Valpak alleged that Appleseed “. . . is a politically active organization which has on a number of occasions publicly expressed views on, and has attempted to influence Nebraska’s tax policy.” Valpak argues that Hearing Officer Berger should have recused herself, due to her serving as a staff attorney and a member of Appleseed’s Advisory Board. In support of its position, Valpak has argued:

¹⁴ *Urwiller*, 263 Neb. at 435, 640 N.W.2d at 423 (citations omitted).

¹⁵ *Id.* (citations omitted).

¹⁶ *Blaser v. County of Madison*, 285 Neb. 290, 299-300, 826 N.W.2d 554, 562 (2013) (citations omitted).

¹⁷ *See, State v. Kofoed*, 283 Neb. 767, 797, 817 N.W.2d 225, 247 (2012) (absent a showing of actual bias or prejudice, a litigant must demonstrate that a reasonable person who knew the circumstances of the case would question the [adjudicator’s] impartiality under an objective standard of reasonableness) (footnotes omitted). *See also, Mooney v. Gordon Memorial Hosp. Dist.*, 268 Neb. 273, 280, 682 N.W.2d 253, 259 (2004) (an adjudicator should recuse himself or herself when a litigant demonstrates that a reasonable person who knew the circumstances of the case would question the adjudicator’s impartiality under an objective standard of reasonableness, even though no actual bias or prejudice is shown) (citations omitted).

. . . It simply was not appropriate for [Hearing Officer Berger] to be presiding over this Nebraska tax case. The reasonable *potential* for questions regarding [Hearing Officer Berger's] bias or impartiality was too great.

. . . While [Hearing Officer Berger] served as Hearing Officer, and the ultimate decision was issued by the Tax Commissioner, [Hearing Officer Berger] still took a critical role in the hearing process. . . . While it is *possible* that the Commissioner independently reviewed the factual record and the legal arguments, it is also *possible* that the Commissioner simply reviewed [Hearing Officer Berger's] recommended order and adopted it as his own (with little understanding of the underlying facts or legal arguments which [Hearing Officer Berger] failed to highlight). *Even if* the Commissioner independently reviewed the factual record and the legal arguments, and then independently wrote an order, [Hearing Officer Berger's] recommended order *likely* impacted his opinion in this case. So [Hearing Officer Berger's] opinion was *likely* highly regarded by the Commissioner . . .¹⁸

As the Nebraska Supreme Court has stated, “[a]dministrative adjudicators serve with a presumption of honesty and integrity . . . [and] . . . , [w]ithout a showing to the contrary, state administrators are assumed to be persons of conscience, capable of judging a particular controversy on the basis of its own circumstances.”¹⁹ I do not find that suppositions, speculations, what ifs or possibilities meet the burden required for a judge or other adjudicator to be required to recuse herself or himself.

I have reviewed the evidence presented in support of Valpak's motion and considered its arguments and find, under an objective standard of reasonableness, that no basis exists for concluding that a reasonable person who knew the circumstances of this case would question the impartiality of Hearing Officer Berger. As a result, there was no basis for her to have recused herself. I agree with the Tax Commissioner that no nexus exists between the myriad of issues addressed by Appleseed and the very narrow, although complex, issues presented in this case.

¹⁸ Valpak's initial brief, at 76 and 77 (emphases added).

¹⁹ *Fleming v. Civil Serv. Comm'n*, 280 Neb. 1014, 1024-25, 792 N.W.2d 871, 880-01 (2011) (citations omitted).

2. Use Tax: Valpak appeals the Tax Commissioner’s order of February 19, 2013, determining that its payments to Val-Pak Direct for the Envelopes with advertising inserts distributed to Nebraska households were subject to Nebraska use tax. Valpak argues it never owned, possessed or consumed any property produced by Val-Pak Direct and, as a result, the Tax Commissioner incorrectly assessed a use tax on payments it made to Val-Pak Direct.

The imposition of a use tax is governed by the Nebraska Revenue Act of 1967 (the Act)²⁰ and the rules and regulations promulgated by the Department of Revenue (the Department)²¹. The Tax Commissioner found that Valpak was subject to the use tax because it was an advertising agency within the Department’s regulations and/or because Valpak’s purchase and use of advertising materials distributed in Nebraska constituted a use of property subject to Nebraska’s consumer’s use tax.

Nebraska law provides for the imposition of a tax “. . . upon the gross receipts from all sales of tangible personal property sold at retail in this state”²² In addition, it imposes a use tax

. . . on the storage, use, or other consumption in this state of property purchased, leased, or rented from any retailer and on any transaction the gross receipts of which are subject to tax under subsection (1) of this section on or after June 1, 1967, for storage, use, or other consumption in this state at the rate set as provided in subsection (1) of this section on the sales price of the property or, in the case of leases or rentals, of the lease or rental prices.[²³]

With respect to a use tax, the regulations of the Department provide that “[t]he consumer’s use tax is imposed upon the storage, use, distribution, or other consumption of any tangible personal property and on any intangible property or services the gross receipts of which are

²⁰ NEB. REV. STAT. §§ 77-2701 to 77-27,135.01 and 77-27,228 to 77-27,236 (Reissue 2009, as amended).

²¹ “Agency regulations properly adopted and filed with the Secretary of State Nebraska have the effect of statutory law.” *Swift & Co. v. Nebraska Dept. of Rev.*, 278 Neb. 763, 767, 773 N.W.2d 381, 385 (2009).

²² NEB. REV. STAT. § 77-2703(1) (Cum. Supp. 2012).

²³ NEB. REV. STAT. § 77-2703(2) (Cum. Supp. 2012).

included in the measure of the sales tax under section 77-2703(1). The consumer's use tax applies when the sales tax has not been paid. . . ."²⁴

Generally speaking, "use" is defined as "the exercise of any right or power over property incident to the ownership or possession of that property, . . ."²⁵ "Purchase" is defined to include "any transfer of title or possession, exchange, barter, lease, or rental, conditional or otherwise, in any manner or by any means, of property for a consideration . . ."²⁶ "Property" is defined to mean "all tangible and intangible property that is subject to tax under subsection (1) of section 77-2703 and all rights, licenses, and franchises that are subject to tax under such subsection."²⁷ According to the Department's regulations,

. . . [i]t is presumed that any property or services sold, leased, or rented by any person for delivery in this state is sold, leased, or rented for storage, use, distribution, or other consumption in this state until the contrary is established. The burden of proving that any property or services delivered in this state is delivered for a purpose other than storage, use, distribution, or other consumption in this state is on the person who purchases, leases, or rents the property or services.[²⁸]

Each side points to the case of *Val-Pak of Omaha, Inc. v. Dept. of Revenue (Val-Pak)*²⁹. Valpak argues that the holding is not applicable to the facts of this case, while the Tax Commissioner argues that it is. In *Val-Pak*, the Nebraska Supreme Court addressed the question of whether the purchase and use of advertising materials distributed in Nebraska by

²⁴ 316 NEB. ADMIN. CODE, § 1-002.02. As noted in footnote 6, the parties have stipulated that the services and advertising inserts at issue in this case are not subject to Nebraska sales tax.

²⁵ NEB. REV. STAT. § 77-2701.42 (Reissue 2009).

²⁶ NEB. REV. STAT. § 77-2701.28 (Reissue 2009).

²⁷ NEB. REV. STAT. § 77-2701.27 (Reissue 2009).

²⁸ 316 NEB. ADMIN. CODE, § 1-002.02.

²⁹ 249 Neb. 776, 545 N.W.2d 447 (1996).

Val-Pak of Omaha³⁰ was subject to Nebraska’s use tax. In *Val-Pak*, Val-Pak of Omaha conceded it acted as an advertising agency under the Department’s advertising and advertising agencies regulations and provided services to its customers. As a result, based upon the regulations in effect at that time, the *Val-Pak* court found that Val-Pak of Omaha was “the ultimate consumer of all materials and services purchased by it and used in providing that service . . . [and] . . . is therefore liable for payment of the applicable use tax on its cost of providing that service regardless of its relationship to its customer.”³¹ Even though the Department’s advertising and advertising agencies regulations have changed since *Val-Pak* was decided, the Tax Commissioner argues Valpak is an advertising agent and owes a use tax under the existing regulations. On the other hand, Valpak argues it is not an advertising agent under the existing regulations and, even if found to be an advertising agent, it does not owe any use tax.

a. Advertising Agency: The following are the applicable Department regulations relating to advertising and advertising agencies³²:

056.01 An advertising agency performs advertising services and develops advertising materials for its clients.

056.02 The taxation of purchases by and sales of an advertising agency depend upon the written agreement between the agency and the client. The client and the agency may agree on two different provisions that affect taxation.

056.02A The client can designate the agency to operate as an agent of the client for purchases.

056.02A(1) If the client does not designate the agency to operate as their agent, the advertising agency must operate as a retailer under paragraph 056.05 of this regulation for that client.

³⁰ Valpak is not related to or in any way affiliated with Val-Pak of Omaha.

³¹ *Id.* at 781, 545 N.W.2d at 450.

³² 316 NEB. ADMIN. CODE. § 1-056, et seq.

056.05 This section of this regulation applies when the client has not designated the advertising agency as its agent for tax purposes. The agency must operate as a retailer and the agency is presumed to be the owner of all advertising materials not transferred to the client.

056.05A The agency must pay tax on labor or creative talent purchased from third-parties for the development or production of the ideas or for work on advertising materials. The agency may purchase from third-parties the labor used directly on the actual final product for resale.

056.05A(1) The agency must pay tax on the total amount paid to third-party artists, photographers, printers, and music producers for drawings, pictures, photographs, audio or video tapes, or for the right to use their work. The entire amount is taxable even if it is itemized as consulting, modeling fees, studio rental, or copyright license.

056.05A(2) The agency will not pay tax on salaries to its employees or fees paid to models, musicians, or voice talent hired by the agency.

056.05B The agency must pay tax on all purchases of equipment, supplies, and tools for the development or production of ideas for either advertising services or advertising materials. Items used by the agency include computers, computer software, typewriters, paper supplies, photographs, chemicals, and drawing or printing materials.

056.05C An advertising agency must pay tax on all purchases of advertising materials, except the agency will not pay tax on advertising materials that will be transferred to the client or to a customer or potential customer of the client. The materials to be transferred can be purchased for resale.

056.05C(1) Advertising materials include all types of printed material, audio tapes, video tapes, signs, posters, pictures, drawings, computer

graphics, computer music, paste-ups,
mechanicals, or other artwork.

Unlike in *Val-Pak*, Valpak does not concede it is an advertising agency. In fact, it specifically denies it is. As noted, “[a]n advertising agency performs advertising services and develops advertising materials for its clients.”³³ Under the terms of the Franchise Agreement, Valpak is granted, in part, the “right, license and obligation . . . (1) to sell, and place orders for distribution of advertising, Advertising Inserts, or other products and/or services offered by [Val-Pak Direct], to be placed in VALPAK® Envelopes to be distributed” within Valpak’s territory.³⁴ Under a Participation Agreements, Valpak agrees to provide its advertisers with “assistance in planning and preparation of rough copy, proof, printing, insertion, addressing, postage, envelopes, and mailing distribution specified” in a Participation Agreement.³⁵ I find that Valpak is an advertising agency.³⁶

Everyone agrees that, under the terms of a Participation Agreement, an advertiser does not designate Valpak as an agent for tax purposes. As a result, Valpak is required to “operate as a retailer^[37] . . . and is presumed to be the owner of all advertising materials not transferred to the client.”³⁸ As such, Valpak is required, in part, to (1) “pay tax on labor or creative talent purchased from third-parties for the development or production of the ideas or for the work on advertising materials”³⁹ and (2) “pay tax on all purchases of advertising

³³ 316 NEB. ADMIN. CODE § 1-056.01.

³⁴ Exhibit 8, ¶3.1.

³⁵ Exhibit 10.

³⁶ Although Valpak argues it is not an advertising agency, if further argues that whether it is an advertising agency “makes no difference”.

³⁷ A retailer is defined as a seller. NEB. REV. STAT. § 77-2701.32 (Reissue 2009).

³⁸ 316 NEB. ADMIN. CODE § 1-056.05. *See also*, 316 NEB. ADMIN. CODE § 1-056.02A(1) (if an agency is not designated as a client’s agent, the advertising agency must operate as a retailer).

³⁹ 316 NEB. ADMIN. CODE § 1-056.05A.

materials, *except* . . . advertising materials that will be transferred to the client or to a customer or potential customer of the client”, which can be purchased for resale.⁴⁰ (Emphasis added.)

Advertising materials are deemed transferred to a client “if they are delivered to the client or . . . are delivered to customers or potential customers of the client.”⁴¹ In those events, the agency is required to collect tax (1) “from the client on the total amounts billed to the client for advertising materials”⁴², (2) “on amounts billed for work performed by the agency on materials transferred to the client”⁴³ and (3) “from the client on the total amount billed for the project including any commissions, surcharges, or agency fees connected with an advertising project that results in materials transferred to the client.”⁴⁴

While it is true that the Envelopes with advertising inserts distributed by Val-Pak Direct are distributed to potential customers of Valpak’s advertisers, there is no evidence the distributions were for resale.⁴⁵ In fact, it is quite clear the distributions were not for resale, as defined by statute.⁴⁶ The distributions were an endeavor to gain potential customers for Valpak’s advertisers.

It is evident Valpak did not consider the distribution of the Envelopes with advertising inserts by Val-Pak Direct to fall within the “transfer” exception, since it did not collect any

⁴⁰ 316 NEB. ADMIN. CODE § 1-056.05C.

⁴¹ 316 NEB. ADMIN. CODE § 1-056.05E.

⁴² 316 NEB. ADMIN. CODE § 1-056.05E(1).

⁴³ 316 NEB. ADMIN. CODE § 1-056.05E(2).

⁴⁴ 316 NEB. ADMIN. CODE § 1-056.05E(3).

⁴⁵ “Sale for resale” is defined to mean 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.” NEB. REV. STAT. § 77-2701.34 (Reissue 2009).

⁴⁶ It appears Valpak does not disagree with this conclusion, since it writes that, “[i]f Reg. 1-056.05(C) applied here, any advertising materials provided by [Val-Pak Direct] could be purchased by Valpak for resale but would be taxable to Valpak’s advertisers.” Valpak’s initial brief, at 54.

tax from its advertisers. In fact, as previously noted, the parties have stipulated that the amounts paid to Valpak by its advertisers, which, in part, resulted in the distribution of the materials printed and published by Val-Pak Direct to consumers in Nebraska under the terms of the Franchise Agreement, are not subject to Nebraska sale tax.⁴⁷ Valpak argues that the stipulation also means its “advertisers are not subject to Nebraska . . . use tax on the amounts they pay to Valpak.⁴⁸ I do not agree. As previously pointed out, “[t]he consumer’s use tax applies when the sales tax has not been paid”⁴⁹

I find that Valpak has not rebutted the presumption that it was the owner of all of the Envelopes with advertising inserts distributed by Val-Pak Direct in the state of Nebraska for the time periods covered by the Deficiency Assessments. As a result, except for the period between October 1, 2004, through February 28, 2005, I find that Valpak is liable for the use tax due for the periods between 2004 and 2009 as provided for in the Deficiency Assessments.

b. The Purchase of Advertising Materials Distributed in Nebraska: Presuming, as argued by Valpak, that it is not an advertising agency, the Tax Commissioner found that Valpak would still owe a use tax, because its purchase and use of the Envelopes with advertising inserts distributed in Nebraska constituted a taxable use of property subject to Nebraska’s consumer’s use tax. Even though I have agreed with the Tax Commissioner’s finding with respect to Valpak being an advertising agency and owing the use tax as a result of that finding, I will also look at this determination.

The Act provides “[t]here is hereby imposed a tax . . . upon the gross receipts from all sales of tangible personal property sold at retail in this state”⁵⁰ In addition, “[a] tax

⁴⁷ See, footnote 6.

⁴⁸ Valpak’s initial brief, at 54 (emphasis added).

⁴⁹ 316 NEB. ADMIN. CODE. § 1-002.02.

⁵⁰ NEB. REV. STAT. § 77-2703(1) (Cum. Supp. 2012).

is hereby imposed on the storage, use, or other consumption in this state of property purchased, leased, or rented from any retailer . . .”⁵¹ As previously stated, generally speaking, “use” is defined as “the exercise of any right or power over property incident to the ownership or possession of that property, . . .”⁵²; “purchase” is defined to include “any transfer of title or possession, exchange, barter, lease, or rental, conditional or otherwise, in any manner or by any means, of property for a consideration . . .”⁵³; and “property” is defined to mean “all tangible and intangible property that is subject to tax under subsection (1) of section 77-2703 and all rights, licenses, and franchises that are subject to tax under such subsection.”⁵⁴ With respect to a presumptive tax liability, the Department’s regulations provide that, “[f]or consumer's use tax purposes, it is presumed that any property or service sold, leased, or rented by any person for delivery in this state is sold, leased, or rented for storage, use, or other consumption in this state. The burden of proving the contrary is on the purchaser.”⁵⁵

Valpak argues that it did not use or purchase the Envelopes with advertising inserts, as those terms are defined. Specifically, Valpak argues it never physically possessed, accepted title to or exercised any right or power over the Envelopes with advertising inserts incident to ownership or possession. In support of its argument, Valpak points to the Franchise Agreement, which specifies that Val-Pak Direct has final approval of the form and content of each insert, retains the discretion to determine the appearance and style of the envelopes, determines the printing schedule and mails the Envelopes with advertising inserts to recipients through the US Postal Service.

⁵¹ NEB. REV. STAT. § 77-2703(2) (Cum. Supp. 2012).

⁵² NEB. REV. STAT. § 77-2701.42 (Reissue 2009).

⁵³ NEB. REV. STAT. § 77-2701.28 (Reissue 2009).

⁵⁴ NEB. REV. STAT. § 77-2701.27 (Reissue 2009).

⁵⁵ 316 NEB. ADMIN. CODE § 1-070.02.

While the Franchise Agreement does reserve some rights and responsibilities to Val-Pak Direct, some of which were exercised by Val-Pak Direct over the years, Valpak exercised sufficient rights and powers over the Envelopes with advertising inserts incident to ownership and possession to meet the statutory definitions of “use” and “purchase”. Valpak is in the business of providing direct mail services to advertisers who wish to market products and services primarily to the Omaha area. In fulfillment of its obligations to its advertisers, as outlined in the Participation Agreements, Valpak pays Val-Pak Direct to print and distribute the Envelopes with advertising inserts. These transactions involve a purchase; that is, the payment of consideration to Val-Pak Direct for the printing of inserts in a design specified and approved by Valpak’s advertisers. While Valpak does not obtain physical possession of the Envelopes with advertising inserts, it exercises the power to determine to which NTA the Envelopes with advertising inserts are distributed. The control exercised by Valpak over the Envelopes or advertising messages is directly incidental to ownership and possession and constitutes a use.

In *J.C. Penney v. Balka*⁵⁶, the Nebraska Supreme Court held that J.C. Penney exercised sufficient power over mail order catalogs advertising merchandise to customers in Nebraska to constitute a use where it, in part, caused the catalogs to be prepared, owned them and directed to whom the catalogs were to be delivered. While not as directly involved in all facets of the distribution in the instant case as J.C. Penney was, the actions of Valpak were not substantively different from those of J.C. Penney and do not warrant a different result.

In addition, subsequent to the Nebraska Supreme Court deciding *J.C. Penney*, the Department amended its regulation relating to the imposition of a consumer’s use tax to read:

The consumer's use tax is imposed upon the storage, use, distribution, or other consumption of any tangible personal property and on any intangible property or services the gross receipts of which are included in the measure of the sales tax under section 77-2703(1). The consumer’s use tax applies when the sales

⁵⁶ 254 Neb. 521, 577 N.W.2d 283 (1998).

tax has not been paid. It is presumed that any property or services sold, leased, or rented by any person for delivery in this state is sold, leased, or rented for storage, use, distribution, or other consumption in this state until the contrary is established. The burden of proving that any property or services delivered in this state is delivered for a purpose other than storage, use, distribution, or other consumption in this state is on the person who purchases, leases, or rents the property or services.⁵⁷

I find that, even if Valpak was not an advertising agency, its significant hands-on involvement through the Participation Agreements and the Franchise Agreement in, without limitation, developing the NTAs which advertisers wish to target, the frequency with which advertisers want to include an advertising message in the Envelopes with advertising inserts and the ultimate production and distribution of the Envelopes with advertising inserts to people in Nebraska constitutes a “use” subject to Nebraska’s consumer’s use tax.

CONCLUSION

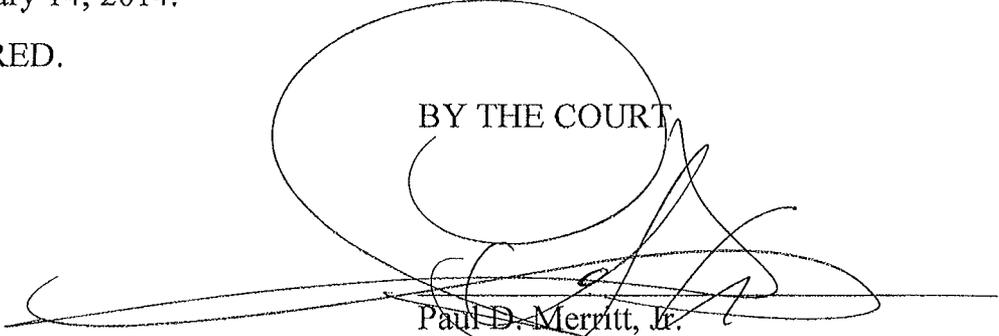
For the reasons set forth herein, I find that the decision of the Tax Commissioner rendered on February 19, 2013, should be, and it hereby is, affirmed. The costs of this action are taxed to Valpak.

A copy of this order is sent to counsel of record.

Dated January 14, 2014.

SO ORDERED.

BY THE COURT



Paul D. Merritt, Jr.
District Judge

c: Mr. Matthew R. Ottemann, Mr. L. Jay Bartel

⁵⁷ 316 NEB. ADMIN. CODE § 1-002.02.