

IN THE DISTRICT COURT OF LANCASTER COUNTY, NEBRASKA

**LABCORP NEBRASKA, INC., a foreign
corporation registered to do business in
the State of Nebraska,**

Petitioner,

vs.

**NEBRASKA DEPARTMENT OF REVENUE,
an agency of the State of Nebraska, and
TONY FULTON, Nebraska Tax
Commissioner,**

Respondents.

**LABORATORY CORPORATION OF
AMERICA HOLDINGS, a foreign
corporation registered to do business in
the State of Nebraska,**

Petitioner,

vs.

**NEBRASKA DEPARTMENT OF REVENUE,
an agency of the State of Nebraska, and
TONY FULTON, Nebraska Tax
Commissioner,**

Respondents.

CASE NOS. CI 18-3825; 18-3826

ORDER ON APPEAL

This matter came before the Court on March 19, 2019, on appeals from final decisions of Respondents the Nebraska Department of Revenue ("DOR") and Tony Fulton, Tax Commissioner ("Tax Commissioner") (collectively "Respondents") denying claims for refund of sales and use tax filed by Petitioners LabCorp Nebraska, Inc. and Laboratory Corporation of America Holdings (collectively "Petitioners"). Colin J. Bernard appeared on behalf of Petitioners. L. Jay Bartel appeared on behalf of Respondents.

The Court took judicial notice of the transcripts filed on December 11, 2018.¹ The Court heard arguments and took the matter under advisement. The Court, being fully advised in the premises, now finds and orders as follows:

FACTUAL BACKGROUND

Petitioners are global life sciences companies that own and operate medical laboratory testing facilities in Lincoln and Lexington, Nebraska. CI 18-3825, Tr. 1, 230; CI 18-3826, Tr. 1. They provide diagnostic, drug development and technology-enabled solutions for a broad range of customers, including managed care organizations, biopharmaceutical companies, governmental agencies, physicians and other healthcare providers, hospitals and health systems, patients, contract research organizations, and independent clinical laboratories. CI 18-3825, Tr. 230.

Diagnostic reagents are “use[d] in diagnosis of disease or other conditions.” *Id.* They are “intended for use in collection, preparation, and examination of specimens taken from the human body.” *Id.* “Diagnostic reagents make up a critical component of the in vitro diagnostic testing process.” *Id.* These diagnostic reagents are labeled for “prescription only” and are ordered by a patient’s treating physician. *Id.* at 236, 280; CI 18-3826, Tr. 88; Pet. ¶ 13; Answer ¶ 13. Each Petitioner “purchases” and “uses” these diagnostic reagents under the direction of a licensed physician. CI 18-3825, Tr. 236; CI 18-3826, Tr. 88. The diagnostic reagents used in diagnostic testing are not internally consumed or externally applied to a patient. CI 18-3825, Tr. 236.

On December 20, 2017, Petitioners submitted claims for refunds of Nebraska sales and use taxes paid from November 2014 to September 2017. *Id.* at 1; CI 18-

¹ The Court received transcripts for both cases. All references to the transcript will be cited by the case number, followed by “Tr.” and the relevant page number.

3826, Tr. 1. Petitioners claimed that their purchases of diagnostic reagents were exempt from sales and use tax under NEB. REV. STAT. § 77-2704.09(1). CI 18-3825, Tr. 42; CI 18-3826, Tr. 4.

On October 15, 2018, the DOR issued a final order denying Petitioners' claims for refund on the grounds that the diagnostic reagents "were not purchased by a physician to be prescribed to an individual patient as required under Sales and Use Tax Regulation 1-051.02A." CI 18-3825, Tr. 1; CI 18-3826, Tr. 1. On November 14, 2018, both Petitioners appealed.

STANDARD OF REVIEW

These appeals are governed by the Administrative Procedure Act ("APA"). "Any final action of the Tax Commissioner may be appealed, and the appeal shall be in accordance with the [APA]." NEB. REV. STAT. § 77-27,127. A petition for review filed pursuant to the APA "shall be conducted by the district court without a jury de novo on the record of the agency[.]" *Id.* § 84-917(5)(a). 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." *Prokop v. Lower Loup Nat. Res. Dist.*, 302 Neb. 10, 39, 921 N.W.2d 375, 398 (2019). 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).

"To the extent that the meaning and interpretation of statutes and regulations are 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 by the court below." *Neb. Protective Servs. Unit, Inc. v. State*, 299 Neb. 797, 801, 901

N.W.2d 767, 771 (2018). The court, however, accords “deference to an agency’s interpretation of its own regulations unless plainly erroneous or inconsistent.” *Id.*

ANALYSIS

The issue on appeal is whether the diagnostic reagents that are used in diagnostic testing are exempt from sales and use tax under NEB. REV. STAT. § 77-2704.09(1). Petitioners argue that (1) the diagnostic reagents meet the statutory exemption under § 77-2704.09(1), and (2) the diagnostic reagents satisfy the exemption detailed in Sales and Use Tax Regulation 1-051.02A, and even if they do not satisfy the regulation, the language of Regulation 1-051.02A is an impermissible regulatory alteration of statute.

I. Sales and Use Tax Exemption Under NEB. REV. STAT. § 77-2704.09(1)

“Statutory language is to be given its plain and ordinary meaning, and an appellate court will not resort to interpretation to ascertain the meaning of statutory words which are plain, direct, and unambiguous.” *Stewart v. Neb. Dep’t of Revenue*, 294 Neb. 1010, 1015–16, 885 N.W.2d 723, 728 (2016). “It is not within the province of the courts to read a meaning into a statute that is not there or to read anything direct and plain out of a statute.” *Id.* “The burden of showing entitlement to a tax exemption is on the applicant.” *Woodmen of the World Life Ins. Soc’y v. Neb. Dep’t of Revenue*, 299 Neb. 43, 53, 907 N.W.2d 1, 15 (2018). “Statutory tax exemption provisions are to be strictly construed, and their operation will not be extended by judicial construction.” *Id.* “An exemption from taxation must be clearly authorized by the relevant statutory provision.” *Id.* at 53–54, 907 N.W.2d at 15. “An exemption from taxation is never presumed.” *Id.* at 54, 907 N.W.2d at 15.

Section 77-2704.09(1) exempts prescription drugs from sales and use taxes if those drugs are sold for a patient's use. Specifically:

Sales 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 . . . drugs, not including over-the-counter drugs, when **sold for a patient's use under a prescription**

(emphasis added). The term "drug" is defined as:

[A] compound, substance, preparation, and component of a compound, substance, or preparation, other than food and food ingredients, dietary supplements, or alcoholic beverages:

. . . .

(ii) Intended for use in the diagnosis, cure, mitigation, treatment, or prevention of disease

Id. at § 77-2704.09(2)(a)(ii).

The DOR does not dispute that the diagnostic reagents at issue meet the definition of "drug" under the statute. Rather, the DOR argues that the diagnostic reagents purchased by Petitioners are not exempt from sales and use tax under § 77-2704.09(1), because they are not "drugs . . . sold for a patient's use," but drugs sold to Petitioners to use in conducting diagnostic tests. The plain language of the statute supports this position.

Here, the diagnostic reagents at issue are not used by patients. The evidence shows that these diagnostic reagents are used by Petitioners to conduct diagnostic tests on human samples. While a physician's order for a test may be considered a prescription, there is no evidence that these diagnostic reagents purchased by Petitioners are prescribed for any patient's use. Rather, these diagnostic reagents are purchased under the direction of the laboratory's medical director for Petitioners' use in conducting diagnostic tests. CI 18-3825, Tr. 236.

Petitioners argue that diagnostic reagents are exempt from taxation under § 77-2704.09(1) because (1) the DOR's denial of their claims is inconsistent with the Streamlined Sales and Use Tax Agreement ("SSUTA") and an interpretive opinion issued by the SSUTA Compliance Review and Interpretations Committee concluding that "reagents" meet the definition of "drug"; and (2) Nebraska State Taxability Matrix supports their position that diagnostic reagents are exempt from taxation.

A. SSUTA

Nebraska is a member of the SSUTA. See NEB. REV. STAT. §§ 77-2712.02 to 77-2712.07. The statute, however, expressly precludes individuals, like Petitioners, from relying on the SSUTA or interpretive opinion to challenge the DOR's actions or inactions. Section 77-2712.07(2) specifically provides:

No person shall have any cause of action or defense under the agreement or by virtue of this 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 Nebraska, or any political subdivision of Nebraska, on the ground that the action or inaction is inconsistent with the agreement.

It further provides: "No law of Nebraska, or the application thereof, may be declared invalid as to any person or circumstance on the ground that the provision or application is inconsistent with the agreement." *Id.* at § 77-2712.07(3). Thus, under the statute, Petitioners cannot challenge the Tax Commissioner's denial of their refund claims based on the opinions of the SSUTA Compliance Review and Interpretations Committee. In any event, this argument is irrelevant because the DOR does not dispute that diagnostic reagents meet the definition of "drug" under the statute, but instead argues that diagnostic reagents are not exempt from taxation because they are not "sold for a patient's use under a prescription."

B. Nebraska State Taxability Matrix

Petitioners next argue that Nebraska State Taxability Matrix supports their position that diagnostic reagents are exempt from taxation. In 2018, Nebraska completed a taxability matrix detailing the taxability of several different items. CI 18-3826, Tr. 104–129. This taxability matrix indicates that “[p]rescription drugs for human use to hospitals” and “[p]rescription drugs for human use to other medical facilities” are exempt under § 77-2704.09(1). *Id.* at 111. Yet, as discussed above, diagnostic reagents are not purchased by Petitioners for “human use,” but rather, for their own use in conducting diagnostic tests on human samples.

Petitioners further argue that the taxability matrix does not distinguish between the drugs purchased by non-profit and for-profit facilities, and therefore, the DOR’s attempt to distinguish them and deny their claims on that basis is erroneous.² This argument is without merit because the statute clearly mandates different treatment. *Compare* NEB. REV. STAT. § 77-2704.12(1)(e)(i) (“Sales and use taxes shall not be imposed on the . . . purchases by . . . any nonprofit [hospital].”), *with* § 77-2704.09(1) (“Sales and use taxes shall not be imposed on the . . . drugs, not including over-the-counter drugs, when sold for a patient’s use under a prescription.”). Because Petitioners are for-profit facilities, their purchases of diagnostic reagents must be “for patient’s use under a prescription” to be exempt from taxation.

Petitioners also refer to the DOR’s guide on issues pertaining to for-profit nursing homes. This guide states that “[f]or-profit nursing homes may purchase [drugs] exempt when the [drugs] are transferred to a specific patient and purchased with a

² In their Answers, Respondents stated that hospitals and other medical facilities’ purchase of diagnostic reagents are exempt from taxation only if those hospitals and facilities are non-profits. CI 18-3825, Answer ¶ 37; CI 18-3826, Answer ¶ 36.

prescription.”³ Petitioners argue that the DOR’s denial of their refund claims is inconsistent with their past practices of allowing for-profit nursing homes to purchase certain drugs exempt, when those drugs were purchased for patient use under prescription. This argument is again without merit, because the diagnostic reagents at issue are not “transferred to a specific patient” for his or her use.

C. Other Arguments

In their reply brief, Petitioners argue that the DOR incorrectly reads nonexistent words into § 77-2704.09(1) to limit its applicability. Specifically, Petitioners argue that the plain language of the statute does not require “drugs” to be either “internally ingested by, or externally applied to” a patient. They argue that because the statute does not contain any limiting language, the definition of “use” expands past direct consumption, and “ultimately it is the patient using the drug, and its results, for their diagnosis and treatment” “when that reagent is applied to the patient’s specimen.” Pet’rs’ Br. 4–6. The Court does not find this argument persuasive.

As discussed in detail above, the plain language of the statute only exempts sales of drugs from taxation “when sold for patient’s use under a prescription.” NEB. REV. STAT. § 77-2704.09(1). “Statutory tax exemption provisions are to be strictly construed, and their operation will not be extended by judicial construction.” *Woodmen of the World Life Ins. Soc’y v. Neb. Dep’t of Revenue*, 299 Neb. 43, 53, 907 N.W.2d 1, 15 (2018). Applying the strict construction required, the exemption for prescription drugs granted in § 77-2704.09(1) cannot be interpreted to apply to Petitioners’ purchase and use of diagnostic reagents. See CI 18-3825, Tr. 236 (stating that “[each Petitioner] purchases and uses diagnostic reagents.”).

³ Nebraska Sales and Use Tax Guide for For-Profit Nursing Homes Information Guide, October 30, 2017.

II. Sales and Use Tax Regulation 1-051.02A

Petitioners next argue that the DOR's reliance on Sales and Use Tax Regulation 1-051.02A in denying their refund claims was erroneous because (1) Petitioners' circumstances satisfy the exemption under Regulation 1-051.02A, and (2) Petitioners need not satisfy Regulation 1-051.02A as it is an impermissible alteration of statute.

A. Petitioners' circumstances do not satisfy the exemption under Regulation 1-051.02A.

Regulation 1-051.02A provides:

Sales of drugs, except over-the-counter drugs, prosthetic devices, durable medical equipment, mobility enhancing equipment, and home medical supplies, are exempt from sales tax if purchased by a physician or dentist **to be prescribed, dispensed, administered, or transferred to an individual human patient** during the treatment of the patient, if the purchase by the patient would be exempt under Reg 1-050, Medicines and Medical Equipment.

316 Neb. Admin. Code, ch. 1, § 1.051.02A. "Generally, for purposes of construction, a rule or order of an administrative agency is treated like a statute." *Prokop v. Lower Loup Nat. Res. Dist.*, 302 Neb. 10, 23, 921 N.W.2d 375, 389 (2019). "Absent a statutory or regulatory indication to the contrary, language contained in a rule or regulation is to be given its plain and ordinary meaning." *Id.* at 23–24, 921 N.W.2d at 389. The court accords "deference to an agency or political subdivision's interpretation of its own rules unless plainly erroneous or inconsistent." *Id.*

The plain language of the regulation exempts drugs from taxation if they are purchased by a physician "to be prescribed, dispensed, administered, or transferred to an individual human patient." Here, the undisputed evidence shows that Petitioners purchased diagnostic reagents under the direction of its licensed physician to be used in conducting diagnostic tests. See CI 18-3825. Tr. 236, 280; CI 18-3826, Tr. 88, 90.

Clearly, they are not purchased “to be prescribed . . . to an individual human patient” for his or her use. While these diagnostic reagents are labeled “for prescription only,” there is no evidence that they are purchased under a prescription issued for those individual patients. Rather, Petitioners purchase these diagnostic reagents in bulk to be used in future diagnostic tests. As such, the Tax Commissioner properly found that Petitioners’ “purchases of diagnostic reagents which are used in its diagnostic test laboratory are not exempt from sales tax because the reagents are not purchased by a physician to be prescribed to an individual patient as required under Sales and Use Tax Regulation 1-051.02A.” CI 18-3825, Tr. 1; CI 18-3826, Tr. 1.

B. Regulation 1-051.02A is not an impermissible regulatory alteration of statute.

Petitioners further argue that “regardless of whether [their] circumstances satisfy the regulation or not, their purchase of the diagnostic reagents would remain exempt from taxation because the language of Regulation 1-051.02A impermissibly modifies the exemption presented in Section 77-2704.09(1).” Pet’rs’ Br. 10.

“Agency regulations properly adopted and filed with the Secretary of State of Nebraska have the effect of statutory law.” *Swift & Co. v. Neb. Dep’t of Revenue*, 278 Neb. 763, 767, 773 N.W.2d 381, 385 (2009). “However, an administrative agency cannot use its rulemaking power to modify, alter, or enlarge provisions of a statute which it is charged with administering.” *Id.* “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 Tel. v. Neb. Dep’t of Revenue*, 264 Neb. 515, 527, 650 N.W.2d 467, 477 (2002). “This is particularly so when the legislature fails to take any action to change such an interpretation.” *Id.*

Under § 77-2704.09(1), drugs are exempt from taxation when they are “sold for a patient’s use under a prescription.” Likewise, under Regulation 1-051.02A, drugs are exempt from taxation when they are “purchased by a physician . . . to be prescribed, dispensed, administered, or transferred to an individual human patient[.]” As Respondents correctly point out, the key here is that the drug must be purchased for use by an individual patient under a prescription. Contrary to Petitioners’ argument, Regulation 1-051.02A does not dramatically limit the scope of the exemption, because the plain language of the statute limits exemption to those drugs that are “sold for patient’s use under a prescription.” Thus, the Tax Commissioner did not err in relying on the regulation to deny Petitioners’ refund claims.

CONCLUSION

Upon examination of the entire record, the Court finds that Petitioners’ purchases of diagnostic reagents are not “sold for patient’s use under a prescription” as required by § 77-2704.09(1), and therefore, are not exempt from Nebraska sales and use tax.

IT IS, THEREFORE, ORDERED, ADJUDGED, AND DECREED that the Tax Commissioner’s final decision dated October 15, 2018, is hereby **AFFIRMED**.

DATED this 29th day of April 2019.

BY THE COURT:



Susan I. Strong
District Court Judge