

MAY 7 1984

IN THE DISTRICT COURT OF LANCASTER COUNTY, NEBRASKA State of Nebraska

METROPOLITAN UTILITIES)	Docket 365	Page 160
DISTRICT, A Municipal)		
Corporation and Political)		ORDER
Subdivision of the State of)		
Nebraska,)		
)		
Plaintiff-appellant,)		
)		
vs.)		
)		
DONALD S. LEUENBERGER, Tax)		
Commissioner of the State of)		
Nebraska, and the STATE OF)		
NEBRASKA, DEPARTMENT OF REVENUE,)		
)		
Defendant-appellees.)		

Now, this matter came on for trial on the 8th day of February, 1984, upon the pleadings and files; the plaintiff-appellant being present by and through its attorney, W. L. Strong, and the defendant-appellees being present by and through their attorney, Ralph Gillan, Assistant Attorney General. Evidence was adduced, and the matter argued. Briefs now having been filed and the Court being duly advised in the premises finds as follows:

1. That the Court has jurisdiction of the parties and subject matter hereto.

2. This is an appeal from an order of the State Tax Commissioner dated October 12, 1982, wherein the Tax Commissioner assessed a use tax, penalty and interest on chemicals used by plaintiff-appellant in providing its customers water, the Tax Commissioner having previously given an amended notice of deficiency determination dated May 27, 1981.

3. Plaintiff is the provider of water for domestic use in the Omaha, Nebraska, area. It acquires water from the Missouri River near Florence in Omaha and another portion of its water from wells near the Platte River south of Omaha.

After receiving the raw water from each of these sources, the plaintiff-appellant inserts certain chemicals into the water to make it potable. These chemicals are lime, soda ash, aluminum sulfate, sodium sulfate, cationic polyelectrolytes, chlorine and flouride, which plaintiff-appellant purchases.

After an audit by the State Tax Commissioner, the State Tax Commissioner served a notice of deficiency determination upon the plaintiff-appellant assessing sales and use taxes, interest and penalties in the total amount of \$62,667.83 for the audit period of September 1, 1975, through August 31, 1978.

The taxes were assessed on certain chemicals purchased by plaintiff-appellant and used in the processing or as an ingredient of finished water sold to plaintiff-appellant's customers.

4. Plaintiff-appellant claims that the purchase of said chemicals by plaintiff-appellant are exempt from use and sales tax. Plaintiff-appellant, in its brief, has abandoned its claim of exemption on aluminum sulfate, sodium silicate, cationic polyelectrolytes, but maintains that both lime and soda ash should be exempt from use and sales tax.

5. On November 27, 1978, plaintiff-appellant filed a petition before the State Tax Commissioner for redetermination and on January 8, 1979, after informal meetings between plaintiff-appellant and the Tax Commissioner, plaintiff-appellant filed an amended petition for redetermination. On July 29, 1982, a hearing was held before the hearing officer of the State Tax Commissioner.

6. On October 13, 1982, the State Tax Commissioner issued his findings and order wherein he held that soda ash was an ingredient of the finished water and, therefore, was exempt, but that lime was not exempt from the sales or use tax.

7. In the State Tax Commissioner's 1978 audit, chlorine and flouride were exempted from sales and use tax and those ingredients are not in issue.

8. In the October 13, 1982 order, the Tax Commissioner, although it was not an issue, concluded that a public utility furnishes services and, therefore, neither lime nor soda ash were exempt from sales and use tax.

9. The Tax Commissioner having found that soda ash is an ingredient of the finished water, there are only two issues before the Court: (1) Does a utility furnish service or a product to its customers and (2) Is lime purchased by plaintiff-appellant exempt from sales and use tax because it becomes an ingredient in the water sold to the customer?

10. Everyone knows that after a utility's water is treated, it is distributed through pipes to the customer and, when the water enters the customer's premises, it is metered. The customer pays for the water on the basis of gallons used and pays sales tax on the amount purchased. If the utility were delivering a service, the customer would not be required to pay sales tax upon the water.

11. This Court holds that the Tax Commissioner was in error in holding the plaintiff-appellant, in-delivering water, was providing a service, and the Court further finds that, in fact, the plaintiff-appellant was selling a finished product to its customer at all times relevant hereto.

12. Lime is used to remove "hardness" from the water; to reduce corrosion in pipes; inhibit bacterial growth and control calcium "plating" of pipes. The primary purpose of the injected lime is to raise the pH factor of the water. pH is the negative log rhythm of hydrogen ion concentration in the water. Control of the hydrogen ion concentration results in the above-described benefits. A portion of the lime remains in the finished water and is essential to maintaining the proper pH level. This is particularly helpful since chlorine used to control bacteria diminishes in effectiveness for that purpose the farther water is distributed from the place where the chlorine is injected, That lime which does not reach the customer is consumed in the process and its residue has no value.

13. The Court finds that lime is an essential ingredient of finished potable water and that the entire substance of lime either enters into and becomes an ingredient or component

part of the finished water or is consumed in the process of manufacturing and is therefore exempt from sales and use tax. See Nucor Steel v. Herrington, 212 Neb. 310.

14. That the order of the State Tax Commissioner of October 13, 1982, finding that utilities delivering water is providing a service rather than selling a product should be vacated and set aside; that the State Tax Commissioner's order finding lime purchased by plaintiff-appellant is not exempt from sales and use tax should also be vacated and set aside.

15. That the costs of this action should be taxed to the defendants-appellees.

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that plaintiff-appellant is selling a product, to-wit: Finished potable water and, in so doing, is not providing a service under the tax statutes; that plaintiff-appellant is entitled to have a sales and use tax exemption for any ingredients purchased for inclusion in the finished potable water.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that lime and soda ash, when purchased by the plaintiff for use in its finished water product, is exempt from sales and use tax.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the costs of this action be and they hereby are taxed to the defendants-appellees.

Dated this 2nd day of May, 1984.

BY THE COURT:

A handwritten signature in cursive script, appearing to read "Dale E. Johnson", written over a horizontal line.

District Judge