

COPY

IN THE DISTRICT COURT OF LANCASTER COUNTY, NEBRASKA

AFFILIATED FOODS COOPERATIVE,)
 INC., A Nebraska Corporation,)
)
 Petitioner,)
)
 vs.)
)
 STATE OF NEBRASKA, STATE OF)
 NEBRASKA DEPARTMENT OF)
 REVENUE AND M. BERRI BALKA,)
 State Tax Commissioner,)
)
 Respondent.)

Docket 555

Page 169

ORDER

This case came before the Court on August 7, 1998, on appeal pursuant to Neb. Rev. Stat. § 84-917 of the Administrative Procedure Act from an order of the State Tax Commissioner sustaining a deficiency assessment for Nebraska cigarette tax issued to petitioner, Affiliated Foods Cooperative, Inc. Attorney Eric M. Johnson appeared for the petitioner and Assistant Attorney General L. Jay Bartel appeared for the respondent. Exhibits 1 and 2 were admitted into evidence, and the matter was argued and submitted to the Court. The Court now being fully advised, finds and orders as follows:

Findings of Fact

Affiliated Foods Cooperative is a non-profit cooperative grocery wholesaler located in Norfolk, Nebraska. The State Tax Commissioner conducted an audit of Affiliated Foods Cooperative books and records for the period of March 1, 1990 to April 30, 1993. Based on this audit, the Commissioner issued a deficiency assessment for Nebraska cigarette tax of \$200,791.00. The Commissioner also issued other assessments that are not a part of this action. During the audit period the rate of tax for cigarettes sold in Nebraska was .27 per package of 20

or less cigarettes. Neb. Rev. Stat. § 77-2602.01 (1996). Affiliated purchases, warehouses, sells and ships cigarettes to its members, both in Nebraska and other states where members reside.

All sellers of cigarettes in Nebraska are obligated to furnish monthly accounting forms to the state detailing their accounting for the Nebraska cigarette tax. Neb. Rev. Stat. § 77-2604 (1996). The monthly accounting forms filed by Affiliated during the audit period contained numerous undocumented and unexplained adjustments. These adjustments concerned how many cigarettes Affiliated purchased, sales and deliveries to other states, and inventory amounts.

Because of the undocumented changes on the monthly accounting forms, the Commissioner initially determined that Affiliated was unable to account for over 2.3 million packages of cigarettes. That is, Affiliated was unable to provide adequate documentation that these 2.3 million cigarettes had been sold in other states, thus Affiliated was liable for the Nebraska tax on the 2.3 million cigarettes. For two years, states auditors reviewed Affiliated's records to attempt to account for the 2.3 million cigarettes. The auditors reviewed the cigarette tax returns filed by Affiliated and by its out of state members, adding machine tapes supporting the tax returns, computer sales summaries, handbills, purchase invoices, handwritten spreadsheets, affidavits provided by cigarette manufacturers, and additional information provided by Affiliated during the audit. The final notice of deficiency was for \$200,791.00, based on 806,034 packages of cigarettes.

Affiliated protested this notice of deficiency. Before the Commissioner, Affiliated argued that the state auditors' assessment was in error because one piece of data, the computer sales summaries, understated the actual number of cigarettes sold to other states. Affiliated provided testimony that the computer sales summaries use SKU's (stock keeping units) , rather than

packages or number of cigarettes to track inventory. While admitting that in general one SKU equals one package of 20 cigarettes, Affiliated argued that this is not an accurate figure overall because of oversized promotional packages and bundled packages containing two or more packages in the same SKU.

Because of the possible discrepancy between one package of cigarettes and one SKU, Affiliated urged the Commissioner instead to use the data provided by Affiliated from meter readings or cigarette stamps. Each package of cigarettes shipped to another state is stamped with that state's cigarette tax stamp prior to shipment. The meter readings reflect the number of packages stamped. Using the meter readings provided by Affiliated, the company was able to account for more out-of-state cigarette sales, with a deficiency determination proposed by Affiliated of \$18,955.35, rather than the \$200,791.00 determination provided by the state.

The Commissioner found that Affiliated had failed to prove that the assessment issued by the state was incorrect for two reasons. First, the computer sales summaries were not the sole basis for the amount of cigarettes assessed. Second, the testimony of Affiliated's employees that the SKU method could cause inaccuracies was not sufficient evidence to show that the state's cigarette assessment was incorrect.

Findings of Law

The sole issue presented on appeal is whether the cigarette tax deficiency assessment issued by the Tax Commissioner is correct. The Court reviews this question "without a jury de novo on the record of the agency." Neb. Rev. Stat. § 84-917(5)(a) (1996). The Court may affirm, reverse, or modify the decision of the agency, or remand the case for further agency

proceedings. Neb. Rev. Stat. § 84-917(6)(b) (1996). The petitioner has the burden to show that the assessment is incorrect. Neb. Rev. Stat. § 77-2781 (1996).

Affiliated asks this Court to overrule the Tax Commissioner's decision, arguing that the department's factual basis for the assessment was flawed, and Affiliated could provide a more reliable method to determine the assessment using stamp meter readings. The fact that Affiliated has another method of computing the deficiency is irrelevant, unless Affiliated can prove that the assessment issued by the Tax Commissioner was erroneous. The audit method used by the state is not required to be perfect, but instead to provide competent, material and substantial evidence. *Dillard Dept. Stores, Inc., v. Polinsky*, 247 Neb. 821, 530 N.W.2d 637 (1995). Further, the fact that a cigarette package was stamped for out of state sale does not prove that the package was actually sold out of state.

Here, Affiliated is contesting the evidence uncovered by the audit. "Where the evidence is in conflict, the court can consider and may give weight to the fact that the agency hearing examiner observed the witnesses and accepted one version of the facts rather than another." *Ballard v. Nebraska Department of Social Services*, 2 Neb.App. 809, 815-16, 515 N.W.2d 437, 441 (1994), citing *Dieter v. State*, 228 Neb. 368, 422 N.W.2d 560 (1988) and *Department of Health v. Lutheran Hosp. & Homes Soc.*, 227 Neb. 116, 117, 416 N.W.2d 222, 223 (1987).

The evidence is in conflict here. The Commissioner, after listening to both parties and observing the witnesses, accepted the state's version of the facts. Under the de novo review standard, the Court is not bound by the Commissioner's factual findings. *Id.* The Court

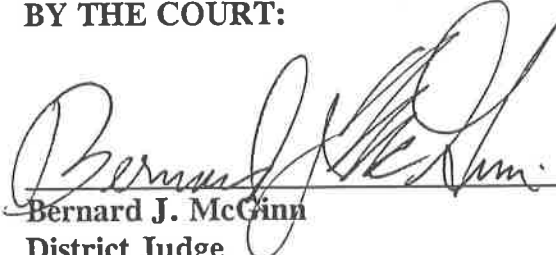
independently finds that the deficiency assessment issued by the Tax Commissioner is supported by the evidence contained in the record.

Even though Affiliated provided some evidence at the hearing that the computer sales summaries were flawed, petitioner has not met their burden of proof to show that the deficiency assessment was erroneous. The audit was based on various pieces of documentation, including tax returns, invoices, handbills, etc, that provide competent and material evidence for the assessment. The plaintiff has not shown any of these other pieces of documentation to be insufficient in any respect.

Accordingly, the decision of the Tax Commissioner is affirmed. Costs of this action are taxed to petitioner.

DATED AND SIGNED this 22nd day of September, 1998.

BY THE COURT:


Bernard J. McGinn
District Judge

cc *Eric M. Johnson*, Attorney for Petitioner
L. Jay Bartel, Assistant Attorney General, Attorney for Respondents