IN THE SUPREME COURT

STATE OF SOUTH DAKOTA

No. 26795

SOUTH DAKOTA DEPARTMENT
OF REVENUE,

Appellant,

v.

PAUL NELSON FARM, INC.,

Appellee.

APPEAL FROM THE CIRCUIT COURT
SIXTH JUDICIAL CIRCUIT
HUGHES COUNTY, SOUTH DAKOTA

The Honorable Patricia J. DeVaney
Circuit Court Judge

BRIEF OF APPELLANT
SOUTH DAKOTA DEPARTMENT OF REVENUE

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NOTICE OF APPEAL FILED August 27, 2013

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PRELIMINARY STATEMENT

For the convenience of the Court, Appellant South Dakota Department of Revenue will be referred to as the "Department." Appellee Paul Nelson Farm, Inc. will be referred to as "Paul Nelson Farm."

Reference to the Settled Record will be indicated by "SR __." The Administrative Record will be cited as "AR __." The Hearing Transcript contained in the Administrative Record will be cited as "HT __." The Appendix will be cited as "APP __."

JURISDICTIONAL STATEMENT

The Hughes County Circuit Court entered an Order on June 17, 2013, affirming in part and reversing in part the Secretary of the Department of Revenue's Final Decision.

SR 43. Notice of Entry was served on August 26, 2013. SR 98-99. On August 27, 2013, the Department filed its Notice of Appeal, a Docketing Statement, and a Certificate of Service with the circuit court. SR 100-140. On September 5, 2013, Paul Nelson Farm filed a cross-appeal.

STATEMENT OF LEGAL ISSUES

ISSUE 1. WHETHER THE CIRCUIT COURT ERRED IN DETERMINING THAT PAUL NELSON FARM DID NOT HAVE TO REMIT USE TAX ON ITS PURCHASES OF FOOD WHEN NO SALES TAX HAD BEEN PAID AT THE TIME OF PURCHASE.

The circuit court ruled that the food Paul Nelson Farm had purchased without paying South Dakota sales tax was exempt from South Dakota use tax.

Relevant Case(s):

Greystone Catering Co. v. S.C. Dep't of Revenue & Taxation, 486 S.E.2d 7 (S.C. 1997)

Kehl v. Iowa Dep't of Revenue & Finance, 2002 WL 31882962 (Iowa App.)

Relevant Statute(s):

SDCL 10-45-2

SDCL 10-46-2

SDCL 10-46-4

SDCL 10-46-1(17)

Relevant Rule(s):

ARSD 64:06:02:75

STATEMENT OF THE CASE AND FACTS

Paul Nelson Farm is a South Dakota corporation with its primary place of business located near Agar, South Dakota. AR 15. "Paul Nelson Farm is in the business of operating an all-inclusive hunting lodge and retreat, . . . providing the hunting experience of a lifetime for [its] guests." HT 11. On March 29, 2010, the Department commenced a sales and use tax audit of Paul Nelson Farm's books and records for the November 2006 through October 2009 tax periods. AR 10. During the course of the audit, the Department did not find any issues or errors relating to sales tax; however, it did find issues or errors relating to use tax. AR 10-42; HT 36-37.

The issues in this case stem from hunting packages offered by Paul Nelson Farm. During the audit period a typical hunting package at Paul Nelson Farm included three days of hunting, overnight lodging, all meals and beverages, unlimited use of the private sporting clays range, all ammunition for clay shooting and hunting, five pheasants per day, an option to shoot extra birds at an additional price per bird, bird cleaning and packaging, guides and dogs, kennels for guests' dogs, use of a 12 gauge shotgun and wireless internet. HT 12. Package price varied depending on the number of hunters:

- 6 or more hunters: $4,395 per person
- 5 hunters: $4,795 per person
- 4 hunters: $4,995 per person
- 3 hunters: $5,295 per person
- 2 hunters $5,595 per person
- Single hunter: $5,895 per person

AR 49. Based on the testimony at hearing, Paul Nelson Farm would provide an "itemized receipt" to the hunters upon request. However, this "itemized receipt" was an allocation of cost "or more like a budget." HT 19. The itemized receipt did not separate costs based on the amounts used. HT 18.

Paul Nelson Farm remitted sales tax on the proceeds of the packages referenced above. AR 10-42. However, Paul Nelson Farm failed to pay sales tax to vendors on various items, including but not limited to, food, non-alcoholic beverages, and ammunition at the time those items were purchased from the vendors. Id. Consequently, the Department assessed use tax on all purchases in which sales tax had not been paid. Id.

On July 29, 2010, the Department issued a Certificate of Assessment to Paul Nelson Farm in the amount of $29,428.06, consisting of $22,815.09 of tax and $6,612.97 of interest. Id. Of the items assessed, Paul Nelson Farm disagreed with the Department's assessment of use tax on food, non-alcoholic beverages, and ammunition. On

September 15, 2010, Paul Nelson Farm requested an administrative hearing contesting $17,405.14,[1] the amount relating to Paul Nelson Farm's purchase of food, non-alcoholic beverages, and ammunition. AR 53-77. The question before the Hearing Examiner was whether Paul Nelson Farm used or consumed the food, non-alcoholic beverages, and ammunition to provide its guests hunting services.

An administrative hearing was held on this matter on March 15, 2012. AR 143. On August 2, 2012, the Hearing Examiner, after reviewing the evidence, the parties' arguments, and the law, entered a Proposed Decision affirming the Certificate of Assessment in all respects. AR 143-146. On August 18, 2012, the Secretary issued a Final Decision adopting the Hearing Examiner's Proposed Decision in full. AR 150. The Notice of Entry of the Final Decision was issued on August 21, 2012. AR 148-149.

Paul Nelson Farm then executed a Notice of Appeal to the Hughes County Circuit Court on September 13, 2012. SR 1. Oral argument was held on March 19, 2013, before the Honorable Patricia J. DeVaney, Circuit Court Judge. SR 2. On June 17, 2013, the circuit court issued a Memorandum

[1] The $17,405.14 consists of $12,025.23 of tax and $5,379.91 of interest. Paul Nelson Farm has identified the disputed

Decision and Order, affirming in part and reversing in part the Secretary's Final Decision. SR 20-43. Specifically, the circuit court affirmed the assessment of use tax on non-alcoholic beverages and ammunition and reversed the assessment of use tax on food. SR 43. Notice of Entry was served on August 26, 2013. SR 98-99. On August 27, 2013, the Department filed its Notice of Appeal, a Docketing Statement, and a Certificate of Service with the circuit court. SR 100-140. On September 5, 2013, Paul Nelson Farm filed a cross-appeal.

STANDARD OF REVIEW

The applicable standard of review "will vary depending on whether the issue is one of fact or one of law." Orth v. Stoebner & Permann. Constr., Inc., 2006 S.D. 99, ¶ 27, 724 N.W.2d 586, 592 (quoting Tischler v. United Parcel Service, 1996 S.D. 98, ¶ 23, 552 N.W.2d 597, 602). When the court reviews a question of fact, "the actions of the agency are judged by the clearly erroneous standard; and when the issue is a question of law, then the actions of the agency are fully reviewable [i.e., de novo]." Id. Furthermore, when an agency makes factual determinations on the basis of deposition testimony or documentary evidence, the matter is reviewed de novo. McKibben v. Horton Vehicle

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transactions in the Taxpayer Listings. AR 78-84.

Components, Inc., 2009 S.D. 47, ¶ 11, 767 N.W.2d 890, 894 (citing Truck Ins. Exch. v. CNA, 2001 S.D. 46, ¶ 6, 624 N.W.2d 705, 708).

"Whether a statute imposes a tax under a given factual situation is a question of law and thus no deference is given to any conclusion reached by the Department of Revenue or the circuit court." TRM ATM Corp. v. S.D. Dep't of Revenue & Regulation, 2010 S.D. 90, ¶ 3, 793 N.W.2d 1, 2 (citing S.D. Dep't of Revenue v. Sanborn Tel. Coop., 455 N.W.2d 223, 225 (S.D. 1990)). "Statutes which impose taxes are to be construed liberally in favor of the taxpayer and strictly against the taxing body. Statutes exempting property from taxation should be strictly construed in favor of the taxing power." Butler Mach. Co. v. S.D. Dep't of Revenue, 2002 S.D. 134, ¶ 6, 653 N.W. 2d 757, 759 (internal citations omitted). "Exemptions from tax are privileges accorded as a matter of legislative grace and not as a matter of taxpayer right . . . Tax exemptions are never presumed . . . [T]he general rule has been established that the taxpayer has the burden of proving entitlement to a statutory exemption." Matter of Pam Oil, Inc., 459 N.W.2d 251, 255 (S.D. 1990).

ARGUMENT

ISSUE 1. THE CIRCUIT COURT ERRED IN DETERMINING THAT PAUL NELSON FARM DID NOT HAVE TO REMIT USE TAX ON ITS PURCHASES OF FOOD WHEN NO SALES TAX HAD BEEN PAID AT THE TIME OF PURCHASE.

The issue before this Court is whether the circuit court erred in determining that Paul Nelson Farm can purchase food as an exempt sale for resale.[2] The circuit court erred in that determination because, as discussed below: (1) food is subject to South Dakota use tax when no sales tax has been paid on it; and (2) South Dakota law does not allow Paul Nelson Farm, whose ordinary course of business is providing hunting services, to purchase food as an exempt sale for resale.

A. Food is tangible personal property subject to South Dakota sales and use tax.

In analyzing taxability issues, this Court has directed us to begin with South Dakota's tax imposition statutes. South Dakota has a broad-based sales tax on tangible personal property and services where everything is taxable unless specifically exempted. See SDCL 10-45-2, 10-45-4, 10-45-4.1. Since 1935, SDCL 10-45-2 has authorized sales tax on the sale of tangible personal

property. If tangible personal property is subject to sales tax, the user of that tangible personal property is subject to use tax in circumstances when no sales tax has been remitted. SDCL 10-46-2; 10-46-4. Here, Paul Nelson Farm was assessed use tax on its use of food, non-alcoholic beverages, and ammunition. Paul Nelson Farm does not contest that those items are tangible personal property, and therefore, absent a specific exemption, they are in fact subject to South Dakota sales and use tax. SDCL 10-45-2; 10-46-2; 10-46-4.

B. South Dakota's use tax and exemptions to such tax.

South Dakota's use tax imposes an excise tax on the privilege of the use, storage, and consumption of tangible personal property.

> SDCL 10-46-2. An excise tax is hereby imposed on the privilege of the use, storage, and consumption in this state of tangible personal property purchased for use in this state at the same rate of percent of the purchase price of said property as is imposed pursuant to chapter 10-45.

Furthermore, 10-46-4 provides:

> SDCL 10-46-4. In addition, said tax is hereby imposed upon every person using, storing, or otherwise consuming such property within this state until such tax has been paid directly to a

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[2] The circuit court correctly determined that Paul Nelson Farm cannot purchase non-alcoholic beverages and ammunition as an exempt sale for resale.

> retailer or the secretary of revenue as hereinafter provided.

In general, service providers are the end-user or consumer of all products and services they purchase.[3] See SDCL 10-46-2, 10-46-4. This includes items and services used in performing their service, unless there is a specific exemption for the items or services purchased. SDCL 10-46-2; SDCL 10-46-4; see ARSD chs. 64:06:01 to 64:06:03.

In order to qualify for the sale for resale exemption, or any other exemption, the burden rests on the party seeking an exemption to demonstrate that the gross receipts at issue fit squarely within the exemption provision. Pam Oil, 459 N.W.2d at 255 ("[T]he general rule has been established that the taxpayer has the burden of proving entitlement to a statutory exemption."); Butler Mach. Co., 2002 S.D. 134, ¶ 13, 653 N.W.2d at 761 ("We will not presume an exemption where one is not clearly *provided* by the legislature") (emphasis added); Watertown Coop. Elevator Assn. v. S.D. Dep't of Revenue, 2001 S.D. 56, ¶

[3] ARSD 64:06:02:07, dealing with barber and beauty shops, best articulates the concept of when a service provider may make purchases exempt from sales tax because they are purchases for resale. ARSD 64:06:02:07 provides in part: "Items sold to customers for their use off the premises may be purchased from suppliers exempt from sales tax because they are purchases for resale." In determining whether tangible personal property can be purchased for resale, the

10, 627 N.W.2d at 171 ("Statutes allowing tax exemptions are exactingly and narrowly construed in favor of the taxing body.") (emphasis added); see also Petition of Famous Brands, Inc., 347 N.W.2d 882, 885 (S.D. 1984) ("The legislative intent is determined from what the legislature said, rather than from what we or others think it should have said").

In Robinson & Muenster Associates, Inc. v. South Dakota Department of Revenue, this Court defined "use" as "including the exercise of right or power over tangible personal property incidental to the ownership of that property, *except that it does not include the sale of that property in the regular course of business.*" 1999 S.D. 132, ¶ 11, 601 N.W.2d 610, 613 (internal quotation marks omitted). Continuing on, the Court stated that, "'[w]e understand this to mean that use tax, consistent with its complementary relationship to sales tax, generally applies to retail transactions and not to transactions where items are purchased for resale.'" Id. (quoting Sioux Falls Newspapers, Inc. v. Secretary of Revenue, 423 N.W.2d 806, 810 (S.D.1988); Sanborn Tel. Coop., 455 N.W.2d at 225).

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pertinent questions are "Who will use the property?" and "Where will the property be used?".

As discussed in the next sections, use tax was appropriately assessed on Paul Nelson Farm's purchase of food because (1) Paul Nelson Farm's ordinary course of business is providing hunting services; (2) there is no general purpose sale for resale exemption that would allow Paul Nelson Farm to purchase tangible personal property, in this case food, for use in a service; and (3) there is a specific administrative rule that requires lodging establishments to pay on consumables.

1. Paul Nelson Farm's ordinary course of business is providing hunting services – specifically, the "hunting experience of a lifetime."

Paul Nelson Farm is in the business of operating a private all-inclusive hunting lodge and retreat. HT 11, 16-17. The reason people go to Paul Nelson Farm is to hunt the state bird, the pheasant. When individuals purchase Paul Nelson Farm's hunting packages, they are looking for the hunting experience of a lifetime. HT 11.

As a convenience and in order to enhance the hunting experience, Paul Nelson Farm provides its guests food, non-alcoholic beverages, and unlimited ammunition.[4] HT 10

[4] At a very basic level, Paul Nelson Farm is no different than a janitor providing cleaning services. Certainly, a janitor could just use water to clean, but in order to enhance or improve his service he would purchase and use stronger cleaning products. Because the cleaning products, which are tangible personal property, are used and consumed

(according to Erik Nelson, "[i]t is more than a hunting experience, it's the full experience."). If a person wanted to go to Paul Nelson Farm solely for a meal or to purchase ammunition, they could not, because Paul Nelson Farm is not open to the public.[5] HT 16-17. The reason people purchase Paul Nelson Farm's hunting packages is to hunt. Therefore, Paul Nelson Farm's regular course of business is providing hunting services.

The point that Paul Nelson Farm uses the food to provide its services is further reinforced when examining the use of the ammunition. If the hunter is highly skilled, they may use five shells to get their birds. Id. If the hunter is less skilled, they may take 300 shots to get their birds. HT 15. The skilled hunter receives no credit and the unskilled hunter does not pay more for their package. HT 14-15. Neither hunter leaves Paul Nelson Farm with any unspent shells. HT 14-15. The shells, like the

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by the janitor in order to provide his services, the janitor's cleaning products are subject to South Dakota use tax and cannot be purchased as an exempt sale for resale. See SDCL 10-46-2. Like the janitor, Paul Nelson Farm uses and consumes the food, non-alcoholic beverages, and ammunition to enhance its hunting services and provide the hunting experience of a lifetime. See HT 12-18. Also, like the janitor, Paul Nelson Farm cannot purchase its food and ammunition as an exempt sale for resale. SDCL 10-46-2; 10-46-4.

food, are used by Paul Nelson Farm in providing the hunting services.

Ultimately, the primary reason people visit Paul Nelson Farm is for the "hunting experience of a lifetime," not to purchase food or ammunition. Exhibit 3; HT 10. Even if a person wanted to go to Paul Nelson Farm for a meal or to purchase ammunition, they could not, as Paul Nelson Farm is not open to the public as a restaurant or an ammunition store. HT 16-17. Paul Nelson Farm is not a restaurant, an all-you-can-eat buffet, or a general store selling ammunition. Paul Nelson Farm's regular course of business is providing pheasant hunting services. Based on the definition of use, and the fact that Paul Nelson Farm's ordinary course of business is providing hunting services, the food, non-alcoholic beverages, and ammunition are all taxable.

2. Tangible personal property that is incorporated into a service provided does not qualify for any sale for resale exemption.

South Dakota law does provide specific sale for resale (or retail) exemptions for tangible personal property, products transferred electronically, and services. See SDCL 10-46-9; ARSD 64:06:03:25; ARSD 64:06:01:08.03

[5] Paul Nelson Farm is not a restaurant or an ammunition store. HT 16-17.

("Administrative rules have the force of law and are presumed valid.") Feltrop v. S.D. Dep't of Soc. Servs., 1997 S.D. 13, ¶ 5, 559 N.W.2d 883, 884 (citing State v. Dorhout, 513 N.W.2d 390, 394 (S.D. 1994) (citations omitted)). However, South Dakota does not have a general provision which exempts tangible personal property or products transferred electronically that have been incorporated into a service. Contra TEX. CODE ANN. § 151.006(3); [6] 7-Eleven v. Combs, 311 S.W.3d 676 (Tex. App. 2010); TENN. CODE ANN. § 67-6-102.[7] Under South Dakota law, tangible personal property purchased and incorporated into a service does not qualify for the sale for resale exemption.

In its argument to the circuit court, Paul Nelson Farm never discusses South Dakota's laws and rules specifically

[6] Texas law includes as a sale-for-resale ". . .tangible personal property to a purchaser who acquires the property for the purpose of transferring it in the United States of America or a possession or territory of the United States of America or in the United Mexican States as an integral part of a taxable service;" TEX. CODE ANN. § 151.006(3).

[7] Tennessee law provides that "sale for resale" includes: "Food or beverages sold to a hotel, motel, inn or other dealer that provides lodging accommodations if such food or beverages are subsequently transferred to the customer in conjunction with the dealer's sale of lodging accommodations to the customer, regardless of whether the dealer makes a separately stated charge for such property[.] . . ." TENN. CODE ANN. § 67-6-102(77)(B)(i)(d).

pertaining to the sale for resale exemption. Instead, Paul Nelson Farm has primarily relied on two South Dakota cases, Robinson & Muenster Associates, Inc. v. South Dakota Department of Revenue, 1999 SD 132, 601 N.W.2d 610, and Sioux Falls Newspapers, Inc. v. Secretary of Revenue, 423 N.W.2d 806 (S.D. 1988). Both Robinson and Sioux Falls Newspapers are distinguishable because in those cases, the taxpayers purchased tangible personal property for use in the sale of other tangible personal property. Robinson & Muenster Assocs., 1999 S.D. 132, 601 N.W.2d 610 (Robinson purchased tangible personal property, lists/samples, in order to create a database or report, also tangible personal property, it sold to its clients – it created and sold databases in its regular course of business.); Sioux Falls Newspapers, 423 N.W.2d 806 (S.D. 1988) (the Argus Leader purchased tangible personal property, syndicated materials, which it incorporated into its newspaper and sold its newspaper, tangible personal property – it created and sold newspapers in its regular course of business). These decisions are a straight application of South Dakota's resale exemptions for tangible personal property purchased for use in tangible personal property in the taxpayers' regular course of business. SDCL 10-46-1(17); 10-46-9; ARSD 64:06:03:25. The fact remains, there is no

sale for resale exemption that would allow a person to purchase food for use in a service.

The Legislature has shown that it knows how to create an exemption. Regarding the hunting lodge/pheasant hunting industry, the Legislature specifically exempted from South Dakota sales tax "the gross receipts from the sale of live gamebirds sold by the producer to nonprofit organizations which release such birds or to commercial hunting operators who charge fees to hunt such birds." SDCL 10-45-18.1. The Legislature also created a corresponding exemption from South Dakota's use tax on the "gross receipts from the sale of live gamebirds sold by the producer to nonprofit organizations which release such birds or to commercial hunting operators who charge fees to hunt such birds." SDCL 10-46-16.1. However, the Legislature has not created an exemption for the food, non-alcoholic beverages, or ammunition at issue in this case. In fact, South Dakota has a specific administrative rule, ARSD 64:06:02:75, that requires Paul Nelson Farm to pay use tax on its purchase of these items. See Feltrop v. S.D. Dep't of Soc. Servs., 1997 S.D. 13, ¶ 5, 559 N.W.2d 883, 884 (citing Dorhout, 513 N.W.2d at 394 (citations omitted)) ("Administrative rules have the force of law and are presumed valid.").

3. Paul Nelson Farm is a lodging establishment and by rule cannot purchase food, non-alcoholic beverages, and ammunition as an exempt sale for resale.

Aside from the hunting services, Paul Nelson operates a lodging establishment. Since 1975, lodging establishments have paid state and municipal sales or use tax on all purchases – including food and complimentary continental breakfasts.

> 64:06:02:75. Sales of supplies and equipment to a lodging establishment are taxable. Lodging establishments are the consumers of supplies and equipment which are consumed or used by them in rendering their services. If the sales tax on such items is not paid to a South Dakota licensed supplier when they are purchased, the cost of such items must be reported as a use tax item on the sales tax return. Examples of such items include paper cups, plastic cups, laundry bags, soap, shower caps, toilet tissue, facial tissue, shoe polish, toilet bands, stationary, consumables and refreshments provided as a convenience to the guest, cleaning products, and other items consumed on the premises by the lodging establishment.
> . . .

(Emphasis added). In this case, the food, non-alcoholic beverages, and ammunition all fall under consumables. See Black's Law Dictionary (9th ed. 2009)(defining "consumable" as "[a] thing (such as food) that cannot be used without changing or extinguishing its substance.") Ammunition could also fall under the supplies and equipment category for the hunting lodge. ARSD 64:06:02:75. The plain language of the administrative rule and definition of

consumable requires that Paul Nelson Farm be responsible for use tax on the ammunition, food, and non-alcoholic beverages. Id.; see also Krsnak v. S.D. Dep't of Env't & Natural Res., 2012 S.D. 89, ¶ 16, 824 N.W.2d 429, 436 ("[A]n agency is usually given a reasonable range of informed discretion in the interpretation and application of its own rules when the language subject to construction is technical in nature or ambiguous, or when the agency interpretation is one of long standing.").

Lodging establishments are not the only service providers that have to pay sales or use tax on purchases of food. Hospitals and nursing homes that offer exempt healthcare services also have to pay sales or use tax on all purchases of food. ARSD 64:06:02:72. Lodging establishments, hospitals, and nursing homes all pass this cost to their customers and patients, just like Paul Nelson Farm. In fact, all of the above-listed service providers pay tax on the food they purchase, regardless of any itemization of the purchases. See ARSD 64:06:02:72; 64:06:02:75.

Whether a customer rents a hotel room or purchases a hunting package from Paul Nelson Farm, they do not get a choice to pay less if they decide not to eat. The meal or continental breakfast is being provided as a convenience to

the guest. Customers can either eat the breakfast or not, but the cost of the room stays the same. Unlimited ammunition is another convenience Paul Nelson Farm provides. The hunters, as Paul Nelson Farm's customers, do not have the choice to decline the items and pay a lower price. The primary service provided by a lodging establishment is providing a room to stay. Like the food and ammunition used by Paul Nelson Farm, a continental breakfast is used by the lodging establishment to enhance the experience and the stay. There is no reason to treat Paul Nelson Farm, a hunting lodge, differently than any other lodging establishment in South Dakota.

C. The circuit court erred in determining that Paul Nelson Farm can purchase food as an exempt sale for resale.

Despite the foregoing, the circuit court, in four paragraphs determined that the Department's assessment of use tax on food purchased by Paul Nelson Farm was in violation of SDCL 10-46-1(17).

1. The Circuit Court Created an Arbitrary Distinction Between the Food Provided by Other Lodging Establishments and Paul Nelson Farm's Hunting Lodge.

The circuit court created an arbitrary distinction between the food provided by other lodging establishments and hunting lodges. Specifically, the circuit court based this decision on the fact that "the cost of the meals, as

allocated by Paul Nelson Farm, constitutes approximately one-tenth of the total package cost." SR 23. Nowhere in South Dakota law is a ten percent threshold for taxability discussed.

As Erik Nelson testified to at hearing, Paul Nelson Farm would provide an "itemized receipt" upon request. However, this "itemized receipt" was an allocation of cost "or more like a budget." HT 19. The costs were not separated based on the amounts used. HT 18. In its decision, the circuit court also noted that:

> This court does not find the itemized lists to be dispositive in this case, however, as they are not provided as a matter of routine to all guests; they are prepared yearly and in advance of any requests; and they are not tailored to actual use or consumption of the items. The witness for Paul Nelson Farm initially conceded that the itemization could be characterized as a "budget" or cost allocation for the business, although he responded affirmatively in response to a leading question on redirect that the lists are itemized receipts of what they would charge per item, yet in practice, all guests are charged the same package price and not give the option of purchasing on certain line items. (Hr'g Tr. at 19-20). Moreover, this court would note that while the total package prices have increased considerably over the years, the cost of the meals and ammunition as itemized on these lists has gone unchanged. (Admin. R. at 58-77). This court further notes that there is no separate line item for beverages and instead costs listed for "breakfasts," "lunches" and "dinner." Id.

Despite finding that the itemized lists are not dispositive and are like a budget, the circuit court still relies on

the numbers contained in it to craft its ten percent threshold. Based on the circuit court's rationale, Paul Nelson Farm could create all sorts of exemptions for itself by manipulating the budgetary numbers in relation to its total package price. Such an absurd result must be dismissed. See Argus Leader v. Hagen, 2007 S.D. 96, ¶ 15, 739 N.W.2d 475, 480 ("In construing a statute, we presume 'that the legislature did not intend an absurd or unreasonable result' from the application of the statute.").

2. The circuit court's decision ignores South Dakota law and is based on an out of state intermediate court of appeals case.

In deciding that Paul Nelson Farm's purchase of food was tax-exempt, the circuit court relied heavily on Nashville Clubhouse Inn v. Johnson, 27 S.W.3d 542 (Tenn. Ct. App. 2000). However, there is no need to look to other states when South Dakota law is clear. Not only is Nashville Clubhouse Inn a decision from an out-of-state intermediate court of appeals, but Tennessee has a specific statute allowing hotels, motels, inns and other dealers that provide lodging accommodations to purchase food and beverages as a sale-for-resale. TENN. CODE ANN. § 67-6-102(77)(B)(i)(d). See supra Note 7.

It is unclear why the circuit relied on Nashville Clubhouse Inn rather than the "analogous out of state cases, Greystone Catering Co. v. S.C. Dep't of Revenue & Taxation, 486 S.E.2d 7 (S.C. 1997), and Kehl v. Iowa Dep't of Revenue & Finance, 2002 WL 31882962 (Iowa App.)." SR 37.

Kehl involved food provided to guests during a riverboat cruise. Kehl, 2002 WL 31882962 at 1. The food was included in a package deal and patrons were charged the same whether they ate the food or not. Id. at 3. Hence, the patrons did not separately bargain for the service of food. Id. The court found that the food was not purchased for the purpose of a resale; rather it was purchased to be part of a "package deal." Id. As a result, the court reasoned the riverboat business was the final consumer and the business owed taxes on the food purchased for the package deal. Id.

Greystone Catering Company involved a hotel operator that offered guests breakfast and evening beverages as part of a package deal on a room. Greystone Catering Co., 486 S.E.2d at 7. The hotel guests were not offered the choice of accepting or rejecting the food or drinks in exchange for a lower price. Id. at 8. The court stated that the last transaction for consideration is usually considered

the taxable retail sale. Id. According to the court, an indication of the last transaction is charges stated separately on the bill. Id. If items are billed separately, the court reasoned the guest would be the final consumer. Id. However, if items were not billed separately, the court concluded the hotel would be the final consumer when they withdrew the item from inventory and the taxes would be owed by the hotel. Id.

3. The meals sold at a restaurant are distinguishable from the meals provided by a hunting lodge.

Finally, the circuit court states that it cannot logically distinguish between the provision of the meals to the guests of Paul Nelson Farm and those provided by an all-you-can-eat buffet and cites to the testimony of the Department's auditor and ARSD 64:06:03:26. SR 22. Then, citing to a Tax Facts, the circuit court states that "the Department treats the purchase of meals from restaurants by those offering hunting packages as a tax exempt transaction, so long as the package provider pays sales tax on the entire package fee." Id.

The circuit court's reliance on ARSD 64:06:03:26 and the Tax Facts are in error. See id. To begin, ARSD 64:06:03:26 deals with meals provided to restaurant

employees and is inapplicable.[8] Here, Paul Nelson Farm is not a restaurant and the transactions upon which tax was assessed were not on meals provided to employees of Paul Nelson Farm. AR 10-42. Additionally, there is a distinction between the ordinary course of business for a restaurant and a hunting lodge. Paul Nelson Farm's ordinary course of business is providing hunting services while a restaurant's ordinary course of business is selling food. Therefore, a restaurant can purchase its food as an exempt sale for resale. However, there is no similar exemption for hunting lodges. See supra 8-19. The portion of the Tax Facts the circuit court relied on is also inapplicable. See SR 22. The parties agree that Paul Nelson Farm is not purchasing meal vouchers from local restaurants so that its guests can go to town for a meal.

[8] ARSD 64:06:03:26 provides:

> Receipts from meals furnished by restaurants, hotels, and boarding houses are taxable. If meals are furnished by proprietors of cafes, restaurants, or boarding houses to employees and a separate charge is made, sales tax must be paid on the receipts. If the employer furnishes meals to employees as part consideration for employment, the restaurant, cafe, or boarding house is liable for the state and municipal use tax upon the cost of the meals so furnished to the employees. This tax includes the applicable municipal and state sales and use taxes.

See generally AR. ARSD 64:06:03:26 and the Tax Facts do not apply to the facts in this case.

For the reasons discussed in this section, the circuit court erred in reversing the assessment of use tax on food Paul Nelson Farm purchased and used to provide hunting services. Specifically, the circuit court should have found that Paul Nelson Farm uses and consumes the food, non-alcoholic beverages, and ammunition to provide its hunting services. Consequently, the decision of the circuit court as it relates to food must be reversed.

CONCLUSION

Ultimately, the question before this Court is whether a service provider is entitled to a sale for resale tax exemption when the provider purchases tangible personal property that is incorporated into a service. In this case, the end product is a hunting experience. The tangible personal property at issue is being used by the purchaser, Paul Nelson Farm to provide that service. The end user, a guest of Paul Nelson Farm, purchases the hunting experience, not a meal or a box of shells to use or consume at their leisure. The burden rests on Paul Nelson Farm to demonstrate that its gross receipts fit squarely within the exemption provision. Matter of Pam Oil, Inc.,

459 N.W.2d at 255. South Dakota law does not provide a general provision which exempts tangible personal property or a product transferred electronically incorporated into a service. See SDCL chs. 10-45 and 10-46; ARSD chs. 64:06:01 to 64:06:03.

The Department is not aware of, nor has Paul Nelson Farm cited to, any statute or authority that would exempt the food, non-alcoholic beverages, or ammunition at issue in this case. See Appellant's Brief. Paul Nelson Farm has not met its burden entitling it to a sale-for-resale exemption and its argument must be dismissed.

Respectfully submitted this ___ day of October, 2013.

_____
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CERTIFICATE OF SERVICE

The undersigned hereby certifies that two true and correct copies of Appellant South Dakota Department of Revenue's Brief in the matter of South Dakota Department of Revenue v. Paul Nelson Farm, Inc. were served on:

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properly addressed as above, postage prepaid, by mailing first class United States mail at the United States Post Office, Pierre, South Dakota.

Dated and mailed this ___ day of October, 2013.

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IN THE SUPREME COURT
OF THE
STATE OF SOUTH DAKOTA

APPEAL NO. 26795

PAUL NELSON FARM, INC.,

Appellee,

-vs-

SOUTH DAKOTA DEPARTMENT
OF REVENUE

Appellant.

APPEAL FROM THE CIRCUIT COURT
SIXTH JUDICIAL CIRCUIT
HUGHES COUNTY, SOUTH DAKOTA

THE HONORABLE PATRICIA J. DEVANEY
CIRCUIT COURT JUDGE, PRESIDING

BRIEF OF APPELLEE
PAUL NELSON FARM, INC

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NOTICE OF APPEAL FILED AUGUST 28, 2013

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PRELIMINARY STATEMENT

For the convenience of the Court, Appellee will adopt the abbreviations used in the Appellate Brief. Accordingly, Appellee Paul Nelson Farm, Inc., will be referred to as "Paul Nelson Farm." Appellant South Dakota Department of Revenue will be referred to as the "Department."

Reference to the Settled Record will be indicated by "SR ___." The Administrative Record will be cited as AR ___." The Hearing Transcript contained in the Administrative Record will be cited as "HT ___."

JURISDICTIONAL STATEMENT

This is an administrative appeal by Paul Nelson Farm under SDCL 1-26-30 et. seq. from the Final Decision of the Secretary of the Department of Revenue dated August 18, 2012, notice of entry of which was given on August 21, 2012, which adopted the Proposed Decision of Hearing Examiner Ryan P. Darling, dated August 6, 2012.

The Hughes County Circuit Court entered an Order on June 17, 2013, affirming in part and reversing in part the Secretary of the Department of Revenue's Final Decision. SR 43. Notice of Entry was served on August 26, 2013. SR 98-99. On August 27, 2013, the Department filed its Notice of Appeal. SR 100-140. On September 5, 2013, Paul Nelson Farm filed a Notice of Review. This Court has jurisdiction over this appeal pursuant to SDCL 1-26-37 and SDCL 15-26A-3.

STATEMENT OF LEGAL ISSUES

Issue 1. WHETHER THE CIRCUIT COURT WAS CORRECT IN DETERMINING THAT PAUL NELSON FARM, INC., WAS NOT REQUIRED TO REMIT USE TAX ON FOOD RESOLD AS PART OF A SALES PACKAGE TO ITS GUESTS?

The Circuit Court held that Paul Nelson Farm was not required to remit use tax on food it had purchased to be resold as part of a sales package.

Authority:

SDCL 10-46-1(17)
SDCL 10-46-2
In re Sioux Falls Newspapers, 423 N.W.2d 806 (SD 1988)
Robinson & Muenster Assocs. v. South Dakota Dep't of Revenue, 1999 SD 132, 601 N.W.2d 610.

Issue 2. WHETHER THE CIRCUIT COURT ERRED IN DETERMINING THAT PAUL NELSON FARM, INC., WAS REQUIRED TO REMIT USE TAX ON NON-ALCOHOLIC BEVERAGES AND AMMUNITION RESOLD AS PART OF A SALES PACKAGE TO ITS GUESTS?

The Circuit Court held that Paul Nelson Farm was required to remit use tax on non-alcoholic beverages and ammunition it had purchased to be resold as part of a sales package.

Authority:

SDCL 10-46-1(17)
SDCL 10-46-2
In re Sioux Falls Newspapers, 423 N.W.2d 806 (SD 1988)
Robinson & Muenster Assocs. v. South Dakota Dep't of Revenue, 1999 SD 132, 601 N.W.2d 610.

STATEMENT OF THE CASE

Paul Nelson Farm is in the business of operating an all inclusive hunting lodge and retreat. HT 11:22; AR 47. During the period of period November 2006 – October 2009 ("Period in Issue"), a typical hunting package at Paul Nelson Farm included three days of hunting, overnight lodging, all meals and beverages, unlimited private sporting clays range, all ammunition for clays and hunting, five pheasants per day, an option to shoot extra birds at an additional price per bird, bird cleaning and packaging, guides and dogs, kennels for guests dogs, use of 12 gauge shotgun and wireless internet. HT 12:7-

19. Guests of Paul Nelson Farm are charged one amount for all items included in the package. HT 6:7-23.

SDCL 10-46-2 imposes a use tax on personal property for "use" in this state. That said, SDCL 10-46-1(17) provides, in part, that the term "use" does "not include the sale of . . . [tangible personal] property in the regular course of business." Accordingly, this Court has found that SDCL 10-46-2 does not impose a tax on items that are resold, reasoning that "use tax, consistent with its complementary relationship to sales tax, generally applies to retail transactions and not to transactions where items are purchased for resale." *Robinson & Muenster Assocs. v. South Dakota Dep't of Revenue*, 1999 SD 132, ¶ 11, 601 N.W.2d 610, 613 (*quoting In re Sioux Falls Newspapers*, 423 N.W.2d at 810).

As is authorized and customary for items purchased for resale, Paul Nelson Farm purchased items of food, beverages, and shotgun shells without paying sales tax for those items. HT 40:22-41:1-3, AR 53-54. During the term of the audit period, Paul Nelson Farm collected from customers and timely remitted sales tax on all proceeds from sales of the above referenced packages. HT 8:19-21; 50:22-25.

The Department commenced an audit of Paul Nelson Farm for the period of November 2006 to October 2009. AR 14-16. The Department assessed use tax on items of food, beverages, and shotgun shells purchased by Paul Nelson Farm for resale to its guests. *Id.* Paul Nelson Farm timely filed a request for hearing on regarding the audit on September 15, 2010. AR 53-54. A hearing on the matter was held on March 15, 2012. The Final Decision of the Secretary of the Department of Revenue dated August 18, 2012 adopted the Proposed Decision of Hearing Examiner Ryan P. Darling, dated August 6,

2012. Paul Nelson Farm commenced an administrative appeal by filing a Notice of Appeal with the Hughes County Circuit Court on September 13, 2012.

The circuit court entered its order on June 17, 2013, affirming in part and reversing in part the Secretary of the Department of Revenue's Final Decision. SR 43. In the court's memorandum decision, the circuit court held that Paul Nelson Farm was not required to remit use tax on food it had purchased to be resold as part of a sales package to its guests, but that it was required to remit use tax on ammunition and non-alcoholic beverages it had purchased to be resold as part of a sales package to its guests. The Department served Notice of Entry on August 26, 2013. SR 98-99. On August 27, 2013, the Department filed its Notice of Appeal. SR 100-140. On September 5, 2013, Paul Nelson Farm filed a Notice of Review. This Court has jurisdiction over this appeal pursuant to SDCL 1-26-37 and SDCL 15-26A-3.

STATEMENT OF THE FACTS

By admission of the Department, the relevant facts regarding this matter are essentially undisputed. HT 45:7-11. Paul Nelson Farm is a South Dakota Corporation with its primary place of business located near Agar, Sully County, South Dakota. AR 14-16. Paul Nelson Farm is in the business of operating an all inclusive hunting lodge and retreat. HT 11:22; AR 49. During the term of the audit period, a typical hunting package at Paul Nelson Farm included three days of hunting, overnight lodging, all meals and beverages, unlimited private sporting clays range, all ammunition for clays and hunting, five pheasants per day, an option to shoot extra birds at an additional price per bird, bird cleaning and packaging, guides and dogs, kennels for guests dogs, use of 12 gauge shotgun and wireless internet. HT 12:7-19; AR 49.

Generally, but not always, guests of Paul Nelson Farm are charged one amount for all items included in the package. HT 6:7-23.[1] For example, as shown on their website in 2011, a single hunter in 2011 would have been charged $5,895.00 for their package. AR 49. It is clearly advertised that you are not simply paying for hunting, but that you are paying for other items such as food, shotgun shells, and beverages. *Id.* During the term of the audit period, Paul Nelson Farm collected from customers and timely remitted sales tax on all proceeds from sales of the above referenced packages. HT 8:19-21; 50:22-25.

As one could expect, Paul Nelson Farm's Guests expressed a desire for itemized receipts breaking out the separate costs to them for it package, so, for example, the guests could have a breakdown of the price for accounting and federal income tax deduction purposes. HT 7:6-15; AR 58-107. In line with those requests, in its normal course of business, Paul Nelson Farm prepared itemized receipts readily available for its guests during all of the audit period. HT 7:6-25. The documents are prepared yearly, in advance of any requests, for guests to be able to break down the price of their package by line item. *Id*. It is not disputed that guests have ask for and received these itemized receipts in the past. *Id.*

As is customary (and proper) for items purchased for resale, Paul Nelson Farm purchased items of food, beverages, and shotgun shells without paying sales tax for those items. HT 40:22-41:1-3, AR 53-54. As is undisputed in the record, the items of food, non-alcoholic beverages, and ammunition in dispute are used and consumed by guests of

[1] There are, however, for example, situations where people stay, but do not hunt, and are charged a lower price.

Paul Nelson Farm, and not for the personal use of Paul Nelson Farm. HT 9:21-10-11; 54:2-15.

On or about July 29, 2010, the Department issued a Certificate of Assessment which determined that Paul Nelson Farm owed use tax between the period of November 2006 to October 2009 in the amount of $22,815.09 and interest in the amount of $6,612.97, totaling $29,428.06. AR at 11 (Certificate of Assessment). Of that amount, the total amount of tax disputed for use tax on ammunition, food, and non-alcoholic beverages is $12,025.23, as well as $5,379.91 of interest that was assessed on that amount. HT 43:21-44:1. Paul Nelson Farm has since paid the total amount of the assessment under protest. HT 43:21-44:1.

STANDARD OF REVIEW

The general standard of review in administrative appeals is established by SDCL 1-26-36. Similar to most appeals, the applicable standard of review "will vary depending on whether the issue is one of fact or one of law." *Orth v. Stoebner & Permann. Const., Inc.*, 2006 SD 99, ¶ 27, 724 N.W.2d 586, 592 (*quoting Tischler v. United Parcel Service*, 1996 SD 98, ¶ 23, 552 N.W.2d 597, 602). "When the issue is a question of fact, then the actions of the agency are judged by the clearly erroneous standard; and when the issue is a question of law, then the actions of the agency are fully reviewable [i.e., de novo]." *Id.* However, when an agency makes factual determinations on the basis of documentary evidence, the factual determinations are reviewed de novo. *Vollmer v. Wal-Mart Store, Inc.*, 2007 SD 25, ¶ 12, 729 N.W.2d 377, 382 (*citing Watertown Coop. Elevator Ass'n v. S.D. Dept. of Revenue*, 2001 SD 56, ¶ 10, 627 N.W.2d 167, 171 (further citations omitted).

"The question of whether statute imposes a tax under a given factual situation is a question of law." *Robinson & Muenster Assocs. v. South Dakota Dep't of Revenue*, 1999 SD 132, ¶ 7, 601 N.W.2d 610, 612 (*quoting Matter of Sales & Use Tax Refund Request of Media One, Inc*., 1997 SD 17, ¶ 9, 559 N.W.2d 875, 877). "Statutes which impose taxes are to be construed liberally in favor of the taxpayer and strictly against the taxing body." *Id.* "Statutes exempting property from taxation should be strictly construed in favor of the taxing power." *Id.* "The words in such statutes should be given a reasonable, natural, and practical meaning to effectuate the purpose of the statute." *Id.*

ARGUMENT

1. THE CIRCUIT COURT CORRECTLY RULED THAT PAUL NELSON FARM, INC., WAS NOT REQUIRED TO REMIT USE TAX ON FOOD RESOLD AS PART OF A SALES PACKAGE TO ITS GUESTS?

A. Tangible Personal Property Purchased For Resale Is Not Subject to Use Tax.

South Dakota's Use Tax is codified at SDCL 10-46-2. The statute provides:

> An excise tax is hereby imposed on the privilege of the use, storage, and consumption in this state of tangible personal property purchased for use in this state at the same rate of percent of the purchase price of said property as is imposed pursuant to chapter 10-45.

However, SDCL 10-46-2 does not impose a tax on items of tangible personal property purchased for resale. As reasoned by the Supreme Court, "SDCL 10-46-1 mandates the meanings to be given to terms used in this section of the code. SDCL 10-46-1(17) provides, in part, that the term "use" does 'not include the sale of . . . [tangible personal] property in the regular course of business.'" *In re Sioux Falls Newspapers*, 423 N.W.2d 806, 810 (SD 1988). In accordance with that reasoning, "use tax, consistent with its complementary relationship to sales tax, generally applies to retail transactions and not to transactions where items are purchased for resale." *Robinson & Muenster Assocs. v.*

South Dakota Dep't of Revenue, 1999 SD 132, ¶ 11, 601 N.W.2d 610, 613 (*quoting In re Sioux Falls Newspapers*, 423 N.W.2d at 810). Essentially, the Legislature crafted a taxing system preventing double taxation.

The Department appears to argue that any sale of food, or any product, is taxable baring a statutory exemption. In fact, without specific reference to a statute, the Department contends that "South Dakota has a broad-based sales tax on tangible personal property and services where everything is taxable unless specifically exempted." With all due respect to the Department, that contention is simply not an accurate statement of the law, specifically as it relates to this case. Specifically, the "sales tax" taxing statute, SDCL 10-45-2, does not impose a tax on retail sale for resale, as "sale at retail" is defined as "any sale . . . *for any purpose other than for resale*[.] SDCL 10-45-1. In addition, as reasoned above, the "use tax" taxing statute does not impose a tax on tangible personal property that is sold in the regular course of business. SDCL 10-46-1(17).

However, the Department is accurate in providing the proper order of review, in that, when "analyzing taxability issues, this Court has directed us to begin with South Dakota's tax imposition statutes." Appellant's Br. at 8. In this case, when looking to the statutes imposing the tax, it is plain that those statutes do not impose a tax on tangible personal property that is purchased in the regular course of business. Such has been the holding of this Court on repeated occasions. *See, e.g., In re Sioux Falls Newspapers*, 423 N.W.2d 806, 810 (SD 1988).

B. Statutes Which Impose Taxes Are to be Construed Liberally In Favor of the Taxpayer and Strictly Against the Taxing Body

"Statutes which impose taxes are to be construed liberally in favor of the taxpayer and strictly against the taxing body." *Robinson & Muenster Assocs. v. South*

Dakota Dep't of Revenue, 1999 SD 132, ¶ 7, 601 N.W.2d 610, 612 (*quoting Matter of Sales & Use Tax Refund Request of Media One, Inc*., 1997 SD 17, ¶ 9, 559 N.W.2d 875, 877). "Statutes exempting property from taxation should be strictly construed in favor of the taxing power." *Id.* "The words in such statutes should be given a reasonable, natural, and practical meaning to effectuate the purpose of the statute." *Id.*

In the case at hand, relying on *dictum* in *Department of Revenue v. Sanborn Tel. Coop.*, 455 N.W.2d 223 (SD 1990)[2], the circuit court reasoned that it was applying an "exception" and strictly construed such against Paul Nelson Farm. However, regardless of the *dictum* of *Sanborn Tel. Coop.*, the statute at hand is not an exemption statute, even if the circuit court accurately referred to it as an exception. SDCL 10-46-2 is the taxing statute. Rather than writing a statutory exemption on a taxable sale, the Legislature chose not to tax sales for resale. If the Court does not construe such language strictly against the Department, is renders meaningless the long held axiom that "[s]tatutes which impose taxes are to be construed liberally in favor of the taxpayer and strictly against the taxing body." *Robinson & Muenster Assocs. v. South Dakota Dep't of Revenue*, 1999 SD 132, ¶ 7, 601 N.W.2d 610, 612.

Further, regardless of the Court's determination, it is important to recognize that "[t]he words in such statutes should be given a reasonable, natural, and practical meaning to effectuate the purpose of the statute." *Id.* Stated another way, "[w]ords and phrases in

[2] A closer review of *Department of Revenue v. Sanborn Tel. Coop*, as provided *infra*, would indicate a contrast to the case at hand and support the arguments of Paul Nelson Farm. Further, despite the reliance on *Sanborn*, the trial court did not address counsel's argument that the decision in *Robinson & Muenster Assocs.* appear to construe such language against the Department. Paul Nelson Farm would submit that *Robinson & Muenster Assocs.* provides support for the proposition that this statute has not be strictly construed against a taxpayer, and ought not be.

a statute must be given their plain meaning and effect. When the language in a statute is clear, certain and unambiguous, there is no reason for construction, and the Court's only function is to declare the meaning of the statute as clearly expressed." *Holscher v. Valley Queen Cheese Factory*, 2006 SD 35, ¶ 33, 713 N.W.2d 555. In the case at hand, the language of the statute is clear, and is expressed in *Robinson & Muenster Assocs. v. South Dakota Dep't of Revenue*: "use tax, consistent with its complementary relationship to sales tax, generally applies to retail transactions and not to transactions where items are purchased for resale." 1999 SD 132, ¶ 11, 601 N.W.2d 610, 613

C. Paul Nelson Farm Purchased Food for Resale in the Normal Course of Business to its Guests.

The food, as well as ammunition and beverages, in which the Department seeks to impose use tax is purchased for resale. It is accepted by the Department, and the record is clear, that Paul Nelson Farm is in the business of operating an all-inclusive hunting lodge and retreat, and that the guests of Paul Nelson Farm are served in a buffet format similar to any restaurant one could find. HT 9:21-10-11; 54:2-15. There is no evidence that Paul Nelson Farm personally consumes the food purchased for resale. Rather, they are transferred by the guests of Paul Nelson Farm as part of the package they purchase.

The Department contends that tax liability arises because the food (along with beverages and shotgun shells) is sold in a package along with the hunting and the other items. That reasoning has no basis in law, and is the exact form of double taxation which has been repeatedly rejected by the South Dakota Supreme Court. Two cases from the South Dakota Supreme Court clearly outline the proper mode of analysis for materials purchased resale: *In re Sioux Falls Newspapers*, 423 N.W.2d 806 (SD 1988), and *Robinson & Muenster Assocs. v. South Dakota Department of Revenue*, 1999 SD 132,

601 N.W.2d 610. South Dakota precedent found in *Sioux Falls Newspapers* and *Robinson & Muenster,* is clear, and provides that use tax is not appropriate in cases that are far more questionable than the case at hand.

In *Sioux Falls Newspapers*, the Department attempted to assess use tax on syndicated material utilized by the Argus Leader. The Court found that use tax the syndicated materials were tangible personal property, and therefore were simply transferred to the Argus Leader's customers as along with the rest of the material. *Id.* at 810-11. Similar to this case, the Argus does not charge separately for the syndicated material, but charges one "package" price for the entire paper. The reasoning of the Supreme Court is insightful in this case:

> With this in mind, the issue is whether the syndicated materials purchased by Argus were purchased for resale, i.e., for sale in the regular course of business. Department argues that Argus uses these materials and that Argus sells newspapers, not syndicated materials. We believe Department is attempting to broaden the meaning of the statutes beyond legislative intent. Although Argus sells newspapers, "expressions of opinion, editorial or otherwise" are an inextricable part of the definition of a newspaper. . . . the various news articles, columns, and editorials are the very essence of what has been traditionally perceived as a "newspaper." Argus does not purchase these syndicated materials for personal use. After the materials are received, they are photographed, the image from the film is transferred to the newsprint, and the actual pieces of paper received are discarded. The syndicated materials are purchased by Argus with the intent to reproduce them in the newspaper to sell to readers. Therefore, these syndicated materials, if not the paper they are transmitted on, are an essential part of the newspaper and are purchased for resale in the ordinary course of Argus' business.

Id. at 811.

This reasoning is equally applicable as to why use tax should not be assessed in this case. A person pays one package price for an entire newspaper, despite the fact there are syndicated columns in addition to local writing content. A person does not get to

choose whether or not to purchase the syndicated material. The Court here indicated that purchasing products in a package has little impact on whether a product was purchased for resale. *Id.*

In addition, unlike the case at hand, there is no available itemized receipt to separate syndicated columns from other content. The Court found that the Department was applying a too narrow of test in stating that the Argus sells "newspapers, not syndicated materials," as syndicated columns are an inextricable part of a newspaper, and those were purchased, nor for personal use, but for resale to customers. *Id.* The same is true in the case at hand, Paul Nelson Farm purchases tangible personal property, i.e. food, with the intent to transfer those products to guests. Such is not purchased for personal use, but rather are transferred to a guest as an essential part of their hunting package. HT 10:16-11:5. (Explaining essential nature of food, beverages, and ammunition in their package).

The Court took its rejection of double taxation further in *Robinson & Muenster Assocs.* There Robinson & Muenster Associates, Inc. (Robinson) provided polling services for its customers. 1999 SD 132, *Id.* at ¶ 3. In performing that service, Robinson purchased telematching services along with samples and lists of telephone numbers for demographically identified groups or areas from out-of-state providers. *Id.* at ¶ 2. Robinson used the samples in creating a report for its customers, but then destroyed the products. *Id.* at ¶¶ 3, 5. Robinson did not pay a sales tax on its purchase of the samples, but did charge sales tax for the entire report, which incorporated the cost of the samples. *Id.* at ¶ 3. Unlike the case at hand (or *Sioux Falls Newspapers*), the final customers in

Robinson, or Robinson itself, *never* received ownership or possession to the samples. *Id.* at ¶ 4.

The Court reasoned that if the sample is an ingredient essential to and incorporated within the final product, the samples are not subject to the use tax, regardless of the fact there was no direct transfer of ownership of the tangible property. *Id.* at ¶ 12. The Court found, although there was a lack of transfer of actual ownership of the samples, Robinson did not purchase these samples for personal use and that the samples were an ingredient essential to and incorporated into the final product and service provide by Robinson, and as such, were purchased for resale. *Id.* at ¶ 13. Once again, this is despite the fact that Robinson paid one "package" price for the report and the inputs.

In the case at hand, there is no need to reach the analysis given in *Robinson & Muenster Assocs.* In this case, unlike in *Robinson & Muenster Assocs.*, the goods are actually transferred, for consideration, to the guests of Paul Nelson Farm, making it a far easier case. HT 9:21-10-11; 54:2-15. Nevertheless, to the extent the Department argues that Paul Nelson Farm is solely providing a service, similar to *Robinson & Munster Assocs.,* these products are essential to their final product.

Those cases are contrasted by the Court's decision in *Department of Revenue v. Sanborn Tel. Coop.,* 455 N.W.2d 223 (SD 1990). However, an analysis of that case reveals the rational of the Court rested on two matters: that the phonebooks were advertised as complimentary and they were free of charge to customers and non-customers alike:

> In support of Department's claim, we note that inside the telephone directory under the title "General Rules and Regulations," it specifically

> states: "Directories, equipment, instruments, and lines furnished by the Telephone Company, on the premises of a subscriber, are the property of the Telephone Company" and "One directory for each location and/or each instrument leased through the Sanborn Telephone Co-op Inc. is furnished without charge." (Emphasis added.) This certainly negates any claim of resale of the directories. The only evidence from Sanborn contradicting this is testimony which claimed that there was a charge assessed for the directories as part of the local service rate. It is important to note, however, that Sanborn is the entity which orders and pays for the directories and would obviously control what is printed therein.
>
> We interpret the specific language contained in the directories to mean exactly what it says, "one directory . . . is furnished without charge" and that they are "the property of the Telephone Company."
>
> Additionally, we find that there is insufficient evidence to establish CEI's resale of the guides. They are distributed free of charge to subscribers or the general public could pick them up at CEI's office.

Id. at 225-26.

Reliance of the *Sanborn* Court on those facts is well placed. In contrast to the case at hand, the taxpayer in Sanborn advertised the personal property as complimentary. Further, such were free of charge to customers and non-customers alike. Accordingly, not customer would have the right to demand a book. In the case at hand, the record is clear that food (as well as beverages and ammunition) were being paid for as part of the package price. For example, a review of the website package information specifically includes those items as part of the package that is being paid for. *See* AR 49; Exh. 3. Nowhere are those items listed or advertised as “complimentary,” “free,” or provided as a convenience. To further support this, Paul Nelson Farm, as a normal business practice, provides detailed itemized billings to guests who ask for such which specifically indicate the amount that each item in the package cost. *See* Exh. A-T. Moreover, the food (as well as beverages and ammunition) are not available to the general public, but rather the

customers of Paul Nelson Farm. HT 10:1-19. The rationale of the Court in *Sanborn* only further supports why Paul Nelson farm is not liable for use tax in this case.

Although the South Dakota Supreme Court precedent outlined above gives the proper, and most important, framework in this case, the Department continues to rely heavily on two out of state cases to support its argument. As a starting point, the value of out of state precedent is significantly weakened based on reliance on each jurisdictions revenue statues and codes being different. In addition, each case relied is distinguishable and not particularly applicable to this case. *Kehl v. Iowa Dep't of Revenue & Fin.*, 2002 Iowa App. LEXIS 1355, 2002 WL 31882962) (Iowa App.), for example, is an unpublished case from a intermediate court of appeals which, by Iowa rule, is not to be used as legal authority. Further, *Kehl* did not present a situation where an itemized receipt showed a breakdown of price for each item. *Greystone Catering Co. v. South Carolina Dep't of Revenue & Taxation*, 486 S.E.2d 7 (S.C. 1997), is completely off base, as it does not even address use tax, but rather addresses applicability of "accommodations tax" and a "sales tax". Further, the case relies on the facts which are not present in this case, reasoning: [Taxpayer had] chosen to advertise a room which includes 'free breakfast' and 'complimentary drinks.' [Taxpayer] does not have an identifiable separate charge for these free items." In the present case, Paul Nelson Farm identified a separate charge for each item, and did not advertise any item as "complimentary" or "free."

More importantly, although the Department cherry picked two cases that attempt to serve its purpose, case law is split as to whether such are taxable under each state's applicable use tax (if the state has a use tax), and in general, many states have reached a conclusions contrary to the Department.

For example, *Nashville Clubhouse Inn v. Johnson*, 27 S.W.3d 542 (Tenn. Ct. App. 2000)[3], a Court reviewed upscale limited service hotels catering to business travelers, providing guests with a "complimentary" breakfast each morning and with "complimentary" alcoholic and nonalcoholic beverages at a manager's reception held each evening. *Id.* at 543. The Guests did not pay separate sales or alcoholic beverage taxes on their complimentary breakfasts or beverages, but the hotel collected the sales tax on each guest's bill. *Id.* After an audit "the hotels must live with the legal consequences of their choice to represent to registered guests that they are giving away breakfasts and beverages free rather than selling them." *Id.* at 544. The Court, although noting a "split of authority" amongst the states, applied "form over substance" and found there was a transfer of possession of the food from the hotels to their registered guests, and there was consideration for the transfer because the proof was undisputed that the cost of providing the food and beverages was included with the room as part of a package deal. *Id.* at 545-546. In the end, the Court reasoned:

> the issue in this case is whether the hotels were selling breakfasts and beverages "as such" to their registered guests. In order for there to be a sale, there must be a transfer of title or possession and consideration. There was a transfer of possession of the food from the hotels to their registered guests, and there was consideration for the transfer because the proof is undisputed that the cost of providing the food and beverages was included with the room as part of a package deal. Surely a registered guest would have had a contractual right to demand breakfast or beverages had one of the hotels declined to give it to him or her.

[3] The Department states that the Circuit Court "relied heavily" on *Nashville Clubhouse Inn v. Johnson.* However, other than addressing the case law presented by the parties in briefing, the circuit court made little reference to such and explicitly stated the court was looking to them with "caution." However, Paul Nelson Farm would agree that South Dakota statutes and case law are the focus of this issue.

Id. at 547. *See also S & R Hotels v. Fitch*, 634 So. 2d 922, 926-927 (La.App. 2 Cir. Mar. 30, 1994) (analyzing complimentary breakfasts to hotel guests, reasoning they are similar to those "airline cases cited by the plaintiffs in which the price of meals was separable from the price of the airline ticket.").

As noted above, in the case at hand, this not nearly as close a question as presented in *Nashville Clubhouse Inn*. A guest of Paul Nelson Farm, as advertised, is paying for more than simple hunting or lodging. He or she is paying for, amongst other items, ammunition, food, and beverages when paying the package price. For example, a review of the website package information specifically includes those items as part of the package that is being paid for. *See* Exh. 3. Nowhere are those items listed or advertised as "complimentary," "free," or provided as a convenience. To further support this, Paul Nelson Farm, as a normal business practice, provides detailed itemized billings to guests who ask for such which specifically indicate the amount that each item in the package cost. *See* Exh. A-T.

However, the rationale in *Nashville Clubhouse Inn* provides a framework on how to analyze resale of goods in a package deal. The final rational of the case is that a resale takes place when a consumer purchases a contractual right to the goods based on purchase of the "package." Although there can be dispute regarding whether a guest has a contractual right to a complimentary item, as no consideration is given, there can be no dispute that in this case, where it is clearly advertised and billed that you are purchasing meals, ammunition, and beverages, that there is a resale of goods. In *Nashville Clubhouse Inn*, there is no dispute that if it would have been advertised as a package price, it would be considered a resale. Rather, the Department itself argued that the "live

with the legal consequences of their choice to represent to registered guests that they are giving away breakfasts and beverages free rather than selling them." *Nashville Clubhouse Inn*, 27 S.W.3d at 545. In this case, there is no need to reach the "close" question, as it is undisputed that Paul Nelson Farm advertises and represents that it is charging people for food, beverages, and ammunition in the package price.

The Department further argues that Paul Nelson Farm cannot purchase items for resale because it is a "service provider," and service providers cannot purchase items for resale. This argument is without merit.

In fact, this is the exact argument that was rejected by the South Dakota Supreme Court in *Robinson & Muenster Assocs. v. South Dakota Dep't of Revenue*, 1999 SD 132, 601 N.W.2d 610. There the Department argued that "Robinson is a provider of research services and failed to pay the required use tax on certain samples used in providing research services to its customers." *Id.* at ¶ 9. The Supreme Court rejected this argument, finding that regardless of what the Department regarded a service the "samples were an essential part of the final product sold to Robinson's customers. The samples were purchased for incorporation into the final product and then sold in the ordinary course of business." *Id.* at ¶ 14. In essence, the Department has incorporated Justice Sabers dissent as its interpretation in this case.

The case at hand is far less complicated than *Robinson & Muenster Assocs*. Paul Nelson Farm purchases tangible personal property, i.e. food, non-alcoholic beverages, and ammunition, without any transformation into a "final product." Those items of tangible personal property are sold to guests as part of a package deal, in which those

items have an itemized price. The actual tangible personal property is actually transferred to their customer, for a separate price as shown on the itemized receipts.

But, even applying the reasoning of the Department that Paul Nelson Farm provides, at least in part, a "service," neither statute nor case law indicate that is a relevant factor. The only issue that matters is whether or not an item of tangible personal property is purchased for resale in the regular course of business. Robinson & Muenster Assocs. was providing a "service," but resold certain tangible personal property in providing a service as part of its regular course of business. The Court made no distinction about whether a service was being provided, in part or in whole, but rather applied the plain language of SDCL 10-46-2 read in conjunction with SDCL 10-46-1(17).[4]

Lastly, the Department relies on ARSD 64:06:02:75 for their position. Nevertheless, a close review of the rule supports the interpretation that an item is purchased for resale if a customer purchases a contractual right to the goods. ARSD 64:06:02:75 states, in pertinent part:

> Sales of supplies and equipment to a lodging establishment are taxable. Lodging establishments are the consumers of supplies and equipment which are consumed or used by them in rendering their services. If the sales tax on such items is not paid to a South Dakota licensed supplier when they are purchased, the cost of such items must be reported as a use tax item on the sales tax return. Examples of such items include paper cups, plastic cups, laundry bags, soap, shower caps, toilet tissue, facial tissue, shoe polish, toilet bands, stationary, consumables and refreshments provided as a convenience to the guest, cleaning products, and other items consumed on the premises by the lodging establishment.

[4] In addition, the Department's official position is that a hunting lodge may purchase food for resale as long as it is sold under a separate charge from a package price. *See infra.* Such is not reconcilable with the Department's argument on this issue.

Analysis of this language only supports the position of Paul Nelson Farm. "[I]t is well-settled that where general words precede the enumeration of particular classes of things, the *ejusdem generis* cannon of construction requires that the general words will be construed as applying only to things of the same general kind as those enumerated." *DeHaven v. Hall*, 2008 SD 57, ¶ 51, 753 N.W.2d 429, 444-445 (*citing Grievance of O'Neill*, 347 NW2d 887 (SD 1984)).

Accordingly, while the first sentence of ARSD 64:06:02:75 states supplies and equipment to a lodging establishment are taxable, taxable expenditures under the first part of the rule must be of the same general kind as those specifically enumerated in the part of the rule. *See id.* ("Accordingly, while the first sentence of SDCL 15-17-37 allows the recovery of 'expenditures necessarily incurred in gathering and procuring evidence or bringing the matter to trial,' and the last phrase of the second sentence includes 'other similar expenses and charges,' recoverable expenditures under the first sentence must be of the same general kind as those specifically enumerated in the second sentence.")

In the case at hand, there are only two classes of examples listed. First, there are "cleaning products, and other items consumed on the premises by the lodging establishment." ARSD 64:06:02:75. Paul Nelson Farm is not making a claim for refund of any items which are actually consumed by Paul Nelson Farm, for example dish soap, laundry detergent, and cleaning supplies. The other items are "consumables and refreshments provided as a convenience to the guest," for example "paper cups, plastic cups, laundry bags, soap, shower caps, toilet tissue, facial tissue, shoe polish, toilet bands, stationary." ARSD 64:06:02:75.

This language is consistent with the "contractual right to demand" analysis provide above. Certainly a guest does not have a contractual right to demand a transfer of cleaning supplies used to maintain a lodging establishment. Moreover, if an item is given merely as a "convenience to the guest," there would be not contractual right to demand that good as it would be transferred without consideration as a "convenience to the guest." Although there may be split of authority as to how this applies to advertised "complimentary" food, which in substance may be more than a given as a convenience to the guest, that is not the issue in this case. There is no dispute that Paul Nelson Farm does not, nor has it during the relevant audit period, listed the food, beverages, and ammunition as complimentary. Rather, these items are clearly listed as items you are paying for on its website and items that have a specific, definable itemized value on the itemized receipts.

This is the only legitimate way to construe ARSD 64:06:02:75. SDCL Ch 10-46 only authorizes a complimentary tax on items that are not resold. *See Robinson & Muenster Assocs.,* 1999 SD 132, ¶ 11, 601 N.W.2d 610, 613 (*quoting In re Sioux Falls Newspapers*, 423 N.W.2d at 810). To the extent that the ARSD 64:06:02:75 is interpreted to impose a tax on food, beverages, and ammunition which are resold, it would attempt to impose a tax in excess of the authority granted in SDCL Ch. 10-46, and would be invalid. *See Division of Human Rights ex rel. Ewing v. Prudential Ins. Co.,* 273 N.W.2d 111, 114-15 (SD 1978) (Holding that a "rule can in no way expand upon the statute that it purports to implement" and that, if possible, a "rule must be interpreted within the scope of the statute that it purports to implement." If it is not, it is invalid as a

matter of law."). In this case, ARSD 64:06:02:75 can only be construed in a way that would prevent double taxation on a resale of goods.

In addition, despite the arguments of the Department on this issue to the Court, the Department does not actually interpret ARSD 64:06:02:75 in the absurd fashion which would preclude a lodging establishment from purchasing goods, including food, for resale. To do so would be unworkable. To prove such, the April 2010 version of the Department of Revenue's "Tax Facts" for "Hunting and Fishing Services" is enlightening as to how the Department actually interprets ARSD 64:06:02:75. *See* AR 38-42. The Department's position is fairly simple: The Department interprets ARSD 64:06:02:75 as allowing hunting lodges to purchase food for resale as long as there is a separate charge for the meal from the package price.[5] AR 39. This only supports the position that the Department is aware that the key inquiry is whether an item is being provided as a convenience to a guest.

However, the Department's distinction between a package price and separate charge is arbitrary. Distinction between the two is found nowhere in statute or administrative rule. Further, as reasoned *supra*, this Court did not find persuasive the argument by the Department that in *Sioux Falls Newspapers* that a newspaper does not charge separately for syndicated columns in a newspaper, but rather charge one flat package price for a newspaper, regardless if someone reads the column. *See* 423 N.W.2d 806 (SD 1988).

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[5] Although not in the record, as reference to the Department's current interpretation, such is found at: http://www.state.sd.us/drr2/businesstax/publications/taxfacts/0713/HuntingFishing0713.pdf. The Department's positions remain essentially unchanged.

The absurdity of the Department's current argument is shown when looking to how other lodging establishments under the Department's own publications. The Department, in its brief to the Court, argues that a motel is unable to purchase food (or any goods) for resale. However, if the Court reviews the April 2010 version of the Department of Revenue's "Tax Facts" for "Hunting and Fishing Services", it is clear that, even if a motel charges a package price for a guest, the hotel may purchase restaurant meals and guide services without paying sales or use tax on the underlying meals or guide services. AR 39 (at "Example 2" at the beginning of the page); *see also* HT at 48:11-50:12. There is no justifiable reason why a motel/hotel may purchase food without paying use/sales tax on such items and sell such to hunters as part of a package deal, but a hunting lodge must pay use tax. Such a distinction is entirely arbitrary.

The reasoning of the circuit court as it applied to the resale of food is proper and should be affirmed. The Department in this case imposed requirements for exemption from tax that are not contained within any statute or regulation, and which cannot fairly be inferred as being the intent of the Legislature. Rather, it seems quite clear that the Department simply plucked those requirements out of thin air. Paul Nelson Farm's sale of meals as part of a package price is just that, a resale of food. The Department's position is not supported by the facts or the law, and the circuit court should be affirmed on this issue.

II. THE CIRCUIT COURT ERRED IN DETERMINING THAT PAUL NELSON FARM, INC., WAS REQUIRED TO REMIT USE TAX ON NON-ALCOHOLIC BEVERAGES AND AMMUNITION RESOLD AS PART OF A SALES PACKAGE TO ITS GUESTS.

The circuit court determined that food was purchased for resale, however beverages and ammunition were not. The reasoning under the prior section fairly sets

forth Paul Nelson Farm's legal framework regarding "sale for resale" purchases, and will not be repeated here. However, under that framework, the circuit court erred in addressing the issues of beverages and ammunition.

Similar to food, beverages being provided to the guests are clearly advertised as being paid for as part of the package price. *See* AR 49; Exh. 3. Beverages in many ways are the equivalent of a analyzing a meal. In any other setting, there has not been an artificial distinction between food and drink. Surely, a guest would have had a contractual right to beverages, similar to food, had Paul Nelson Farm declined to give it to him or her. In short, these are products that are purchased and resold to a customer for consideration and should not be subject to use tax for the same reasoning that food is not subject to use tax.

Paul Nelson Farm would submit that the circuit court further made error as it relates to its resale of ammunition. Ammunition being transferred to guests is also clearly advertised as being paid for as part of the package price. *See* AR 49; Exh. 3. Further, guests are separately billed for ammunition under the itemized billings prepared yearly, in advance of any requests, for guests to be able to break down the price of their package by line item. HT 7:6-15; AR 58-107.

The statutory language at issue relates to whether ammunition was purchased for resale in Paul Nelson Farm's regular course of business. In the case at hand, Paul Nelson Farm purchased ammunition. In Paul Nelson Farm's regular course of business, guests pay a package price. In exchange for that consideration, the guest has a contractual right to shotgun shells from Paul Nelson Farm, and those shotgun shells are transferred to the customer to shoot at birds. Despite the fact that some people miss more birds than others,

and therefore use more shells, is irrelevant. If such was relevant, the Department would not allow buffets to purchase food for resale.

The Department has repeatedly likened the situation to Paul Nelson Farm being equivalent to a custodian because a custodian must pay use tax on his or her cleaning products used to perform his or her services. However, that example is a perfect example as to explain the distinction. If a custodian contracts to clean a house, the customer with whom the custodian contracted with has no right to demand that the custodian transfer to the customer the custodian's bottle of Mr. Clean (i.e. the "tangible personal property"). On the other hand, if a guest of Paul Nelson Farm shows pays a package price after it was advertised that the package price included shot gun shells, that person has a contractual right to have the shotgun shells (i.e. the "tangible personal property") transferred because it was part of the barging and not provided as a gift or as a convenience to the guest.

Accordingly, the reasoning of the circuit court as it applied to the resale of ammunition and beverages should be reversed. The Department's position is not supported by the facts or the law, and the circuit court should be reversed on this issue.

CONCLUSION

For all of the foregoing reasons, Paul Nelson Farm prays that Court enter its order reversing the Final Decision of the Department and overruling the Certificate of Assessment to the extent that it imposes use tax, interest, and penalties on food, non-alcoholic beverages, and ammunition in the amount of $12,025.23, as well as $5,379.91 of interest that was assessed on that amount.

REQUEST FOR ORAL ARGUMENT

Paul Nelson Farm respectfully requests the opportunity to present oral argument.

Dated this 25th day of November, 2013.

MAY, ADAM, GERDES & THOMPSON LLP

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that two true copies of the Brief of Appellee in the above-entitled action was duly served upon John T. Richter by being hand delivered on the 25th day of November, 2013, to the following named person at his last known address as follows:

John T. Richter
Attorney at Law
SD Dept. of Revenue
445 East Capitol Avenue
Pierre, SD 57501-3185

The undersigned further certifies that fifteen (15) copies of the Brief of Appellee in the above-entitled action were hand delivered to Ms. Shirley A. Jameson-Fergel, Clerk of the Supreme Court, State Capitol, 500 East Capitol, Pierre, SD 57501 on the date above written.

_____
JUSTIN L. BELL

CERTIFICATE OF COMPLIANCE

Justin L. Bell, attorney for Appellee, hereby certifies that the foregoing Brief of Appellee complies with the type volume limitation imposed by the Court by Order dated March 15, 1999. Proportionally spaced typeface Times New Roman has been used. Brief of Appellee contains 7,812 words and does not exceed 40 pages. Microsoft Word processing software has been used.

Dated this 25th day of November, 2013.

MAY, ADAM, GERDES & THOMPSON LLP

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IN THE SUPREME COURT

STATE OF SOUTH DAKOTA

No. 26795

PAUL NELSON FARM, INC.,

Appellee,

v.

SOUTH DAKOTA DEPARTMENT
OF REVENUE,

Appellant.

APPEAL FROM THE CIRCUIT COURT
SIXTH JUDICIAL CIRCUIT
HUGHES COUNTY, SOUTH DAKOTA

The Honorable Patricia J. DeVaney
Circuit Court Judge

REPLY BRIEF OF APPELLANT SOUTH DAKOTA DEPARTMENT OF REVENUE

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NOTICE OF APPEAL FILED August 27, 2013

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IN THE SUPREME COURT

STATE OF SOUTH DAKOTA

PAUL NELSON FARM, INC.,	)	
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	)	*No. 26795*
v.	)	
	)	
SOUTH DAKOTA DEPARTMENT	)	
OF REVENUE,	)	
Appellant.	)	

PRELIMINARY STATEMENT

Pursuant to SDCL 15-26A-62, the Department submits this Reply Brief which is confined to the new matters raised in the Brief of Paul Nelson Farm, Inc. For the convenience of the Court, Paul Nelson Farm's brief will be cited as "Paul Nelson Farm's Brief at __" and the Department's initial brief will cited as "Department's Brief at __."

STATEMENT OF LEGAL ISSUE

ISSUE 1. WHETHER THE CIRCUIT COURT ERRED IN DETERMINING THAT PAUL NELSON FARM DID NOT HAVE TO REMIT USE TAX ON ITS PURCHASES OF FOOD WHEN NO SALES TAX HAD BEEN PAID AT THE TIME OF PURCHASE.

The circuit court ruled that the food Paul Nelson Farm had purchased without paying South Dakota sales tax was exempt from South Dakota use tax.

Relevant Case(s):

Greystone Catering Co. v. S.C. Dep't of Revenue & Taxation, 486 S.E.2d 7 (S.C. 1997)

Kehl v. Iowa Dep't of Revenue & Fin., 2002 WL 31882962 (Iowa App.)

Relevant Statute(s):

SDCL 10-45-2

SDCL 10-46-2

SDCL 10-46-4

SDCL 10-46-1(17)

Relevant Rule(s):

ARSD 64:06:02:75

STATEMENT OF THE CASE AND FACTS

The Department reaffirms and incorporates by reference its "Statement of the Case and Facts" as set forth in its initial Brief. Department's Brief at 3-6.

ARGUMENT

ISSUE 1. THE CIRCUIT COURT ERRED IN DETERMINING THAT PAUL NELSON FARM DID NOT HAVE TO REMIT USE TAX ON ITS PURCHASES OF FOOD WHEN NO SALES TAX HAD BEEN PAID AT THE TIME OF PURCHASE.

Paul Nelson Farm argues that it should not have to remit use tax on its purchases of food, non-alcoholic beverages, and ammunition when no sales tax had been paid at the time of purchase.[1] The critical inquiry is whether a service provider is entitled to a sale for resale exemption when the services provider purchases tangible personal property that is incorporated into a service.

In order to qualify for a sale for resale exemption, or any other exemption, the burden rests on the party seeking an exemption to demonstrate that the gross receipts at issue fit squarely within the exemption provision. Matter of Pam Oil, Inc., 459 N.W.2d 251 (S.D. 1990). "Statutes exempting property from taxation should be strictly construed in favor of the taxing power." Graceland Coll. Ctr. for Prof'l Dev. & Lifelong Learning, Inc. v. S.D. Dep't of Revenue, 2002 S.D. 145, ¶ 5, 654 N.W.2d 779, 782 (quoting Matter of Sales & Use Tax Refund Request of Media One, Inc., 1997 S.D. 17, ¶ 9, 559 N.W.2d 875, 877). The taxpayer "carries the burden of proving that [it] fall[s] within the exemption." Id. ¶ 12.

Therefore, as Paul Nelson Farm's arguments are addressed, it is important to keep in mind that in order to be entitled to any exemption Paul Nelson Farm must 1)

[1] The circuit court correctly determined that Paul Nelson Farm cannot purchase non-alcoholic beverages and ammunition

identify an applicable exemption; and 2) demonstrate that its activities fall squarely within that exemption's statutory language.

A. South Dakota's statutes and administrative rules do not allow Paul Nelson Farm to purchase food, non-alcoholic beverages, and ammunition as an exempt sale for resale.

The parties agree that in analyzing matters of taxability, this Court has directed us to begin with South Dakota's tax imposition statutes.[2] Paul Nelson Farm's Brief at 8. South Dakota law imposes sales tax on the gross receipts from tangible personal property and services unless specifically exempted. SDCL 10-45-2 (The gross receipts from the sale of tangible personal property are subject to South Dakota sales tax, "except as otherwise provided in this chapter."); SDCL 10-45-4 (The gross receipts of any person rendering a service are subject to South Dakota sales tax, "unless the service is specifically exempt from the provisions of this chapter."). The user of tangible personal property and services is subject to use

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as an exempt sale for resale.

[2] SDCL 10-45-2, 10-46-2, and 10-46-4 are the tax imposition statutes that control in this matter.

tax in circumstances when no sales tax has been remitted. SDCL 10-46-2, 10-46-4.[3]

Here, Paul Nelson Farm was assessed use tax on its use of food, non-alcoholic beverages, and ammunition. Paul Nelson Farm does not contest that those items are tangible personal property, and therefore, absent a specific exemption, are subject to South Dakota sales and use tax. See Paul Nelson Farm's Brief; SDCL 10-45-2, 10-46-2, 10-46-4.

Paul Nelson Farm argues that it should be allowed to purchase the food, non-alcoholic beverages, and ammunition as an exempt sale for resale. Although Paul Nelson Farm disputes whether we are dealing with an exemption, South Dakota Department of Revenue v. Sanborn Telephone Cooperative, 455 N.W.2d 223, 225 (S.D. 1990) specifically provides that a sale for resale is an exemption. Additionally, the mechanics of how Paul Nelson Farm was able to purchase food, non-alcoholic beverages, and

[3] Paul Nelson Farm alludes to double taxation throughout its brief. Paul Nelson Farm's Brief at 8,10, 12. The fact remains that there is no prohibition against double taxation. See S.D. CONST. There are multiple layers of taxation on nearly every item purchased. In fact, in South Dakota, several examples of double taxation exist within our own tax system, including contractor's excise tax, alcohol tax, and tobacco tax. See SDCL 10-46A-1; SDCL 35-5-2; SDCL 10-50-3.

ammunition without paying sales tax proves that a sale for resale is an exemption.

Retailers are required to collect and remit South Dakota sales tax. SDCL 10-45-1(11) (defining "retailer"); SDCL 10-45-24 (requiring retailers to obtain a sales tax license; SDCL 10-45-27.3 (requiring that "any person who holds a [sales tax] license [. . .] or who is a person whose receipts are subject to the tax imposed by this chapter shall, . . . file a return, and pay any tax due, to the Department of Revenue[.]"). A purchaser cannot simply declare that "I am hereby purchasing this ammunition exempt from tax as a sale for resale!" and expect to walk out of the business tax free. Contra SDCL 10-45-61. Instead, what is supposed to happen, is that a person who intends on purchasing an item as an exempt sale for resale must present the business with an exemption certificate. See SDCL 10-45-61. Exemption certificates allow retailers to document an otherwise taxable transaction.[4]

To this point, Paul Nelson Farm has not argued or identified that its activities fall within the scope of any exemption. See Paul Nelson Farm's brief. Before

[4] If, during an audit, a retailer does not possess an exemption certificate, they are responsible for remitting the sales tax. Ultimately, exemption certificates provide protection for the retailer. SDCL 10-45-61.

identifying any applicable exemption, Paul Nelson Farm stops on the definition of 'use'.

In Robinson & Muenster Associates, Inc. v. South Dakota Department of Revenue, this Court defined "use" as "including the exercise of right or power over tangible personal property incidental to the ownership of that property, *except that it does not include the sale of that property in the regular course of business.*" Id. ¶ 11, 601 N.W.2d at 613 (internal quotation marks omitted). Continuing on, the Court stated that, "[w]e understand this to mean that use tax, consistent with its complementary relationship to sales tax, generally applies to retail transactions and not to transactions where items are purchased for resale." Id. (quoting Sioux Falls Newspapers, Inc. v. Sec'y of Revenue, 423 N.W.2d 806, 810 (S.D.1988); Sanborn Tel. Coop., 455 N.W.2d at 225).

However, South Dakota law provides specific sale for resale (or retail) exemptions for tangible personal property, products transferred electronically, and services. See SDCL 10-46-9; ARSD 64:06:03:25; ARSD 64:06:01:08.03.[5] Stopping at the definition of 'use' would

[5] A review of ARSD 64:06:01, 64:06:02, and 64:06:03 reveals a multitude of other sale for resale exemptions.

render meaningless a multitude of statutes and rules defining what and when items can be purchased as an exempt sale for resale. See SDCL 10-46-9; ARSD ch. 64:06.[6] This Court has repeatedly stated that "[t]here is a presumption against a construction which would render a statute ineffective or meaningless." Yankton Ethanol, Inc. v. Vironment, Inc., 1999 S.D. 42, ¶ 15, 592 N.W.2d 596, 599 (citing In re Real Estate Tax Exemption for Black Hills Legal Services, Inc., 1997 S.D. 64, ¶ 12, 563 N.W.2d 429, 432; Rapid City Ed. Ass'n v. Sch. Dist., 522 N.W.2d 494, 498 (S.D.1994) (citing Nelson v. Sch. Bd. of Hill City Sch. Dist., 459 N.W.2d 451, 455 (S.D.1990))); see also Petition of Famous Brands, Inc., 347 N.W.2d 882, 885 (S.D. 1984) ("When the language of a statute is clear, certain, and unambiguous, there is no occasion for construction, and the court's only function is to declare the meaning of the statute as clearly expressed in the statute."); Nat'l Farmers Union Prop. & Cas. Co. v. Universal Underwriters Ins. Co., 534 N.W.2d 63, 65 (S.D. 1995) ("A statute must be read as a whole and effect must be given to all its provisions. … The legislature does not intend to insert

[6] "Administrative rules have the force of law and are presumed valid." Feltrop v. S.D. Dep't of Soc. Servs., 1997 S.D. 13, ¶ 5, 559 N.W.2d 883, 884 (citing State v.

surplusage in its enactments."); Hagemann ex rel. Estate of Hagemann v. NJS Eng'g, Inc., 2001 S.D. 102, ¶ 6 n.4, 632 N.W.2d 840, 844 n.4 (holding that the South Dakota Supreme Court "has consistently stated that statutes are to be read in *pari material*, interpreting multiple statutes 'consistently and harmoniously with each other.'"). Furthermore, under Paul Nelson Farm's broad interpretation of "resale," virtually all purchases made by a service provider would constitute a "sale for resale" and would thus be exempt from taxation. This Court has also stated that "in construing statutes together it is presumed that the legislature did not intend an absurd or unreasonable result." Martinmaas v. Engelmann, 2000 S.D. 85, ¶ 49, 612 N.W.2d 600, 611.

Regardless, South Dakota does not have a general provision which exempts tangible personal property or products transferred electronically that have been incorporated into a service because, in general, service providers are the end-user or consumer of all products and services they purchase. See SDCL 10-46-2, 10-46-4. Unless there is a specific exemption for the items or services purchased, they are subject to tax. SDCL 10-46-2; SDCL 10-

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Dorhout, 513 N.W.2d 390, 394 (S.D. 1994) (citations omitted)).

46-4; see ARSD chs. 64:06:01 to 64:06:03.[7] In this case, there is no such exemption.

South Dakota's statutes and rules are clear, Paul Nelson Farm must pay tax on their purchase of food, non-alcoholic beverages, and ammunition. In addition to the above authorities, and as discussed in the Department's initial brief, ARSD 64:06:02:75 specifically requires Paul Nelson Farm to pay use tax on its purchase of these items. Department's Brief at 17-19. To this point, Paul Nelson Farm has never identified a particular sale for resale statute or rule that would allow it to purchase the items at issue as an exempt sale for resale. See Paul Nelson Farm Brief. Because Paul Nelson Farm has not shown that its activities fit squarely within a statute or rule, their statutory arguments must be dismissed.

B. Paul Nelson Farm's case law arguments.

As discussed in the Department's initial brief, Paul Nelson Farm has relied heavily on Robinson & Muenster

[7] ARSD 64:06:02:07, dealing with barber and beauty shops, best articulates the concept of when a service provider may make purchases exempt from sales tax because they are purchases for resale. ARSD 64:06:02:07 provides in part: "Items sold to customers for their use off the premises may be purchased from suppliers exempt from sales tax because they are purchases for resale." Therefore, in determining whether tangible personal property can be purchased for resale, the pertinent questions are "Who will use the property?" and "Where will the property be used?".

Assocates, Inc. v. South Dakota Department of Revenue, 1999 S.D. 132, 601 N.W.2d 610, and Sioux Falls Newspapers, Inc. v. Secretary of Revenue, 423 N.W.2d 806 (S.D. 1988). The Department maintains that these decisions are consistent with a straight application of South Dakota's sale for resale exemptions for tangible personal property purchased for use in the taxpayer's regular course of business. SDCL 10-46-1(17); 10-46-9; ARSD 64:06:03:25.

The qualifier in this case is that the tangible personal property purchased must be resold in the taxpayer's regular course of business. Here, there is no resale. The food, non-alcoholic beverages, and ammunition are not resold to the end user. The end user, a guest of Paul Nelson Farm, purchases the hunting experience, not a meal or a box of shells to use or consume at their leisure. Paul Nelson Farm is not a restaurant, an all-you-can-eat buffet, or a general store selling ammunition. Paul Nelson Farm's regular course of business is providing pheasant hunting services. Paul Nelson Farm sells a service, the hunting experience of a lifetime. The food, non-alcoholic beverages, and ammunition are used by Paul Nelson Farm to provide its service.

The Department also points out that Paul Nelson Farm places emphasis on an 'itemized receipt' despite the fact

that Paul Nelson Farm's witness testified that this "itemized receipt" was an allocation of cost "or more like a budget." HT 19. Paul Nelson Farm goes so far as to refer to it as a "detailed itemized billing." Paul Nelson Farm's Brief at 14. Without citation, Paul Nelson Farm further states that "[t]he actual tangible personal property is actually transferred to their customer, for a separate price as shown on the itemized receipts." Paul Nelson Farm's Brief at 19. Paul Nelson Farm even asserts that "these items are clearly listed as items you are paying for on its website and items that have a specific, definable itemized value on the itemized receipts." Paul Nelson Farm's Brief at 21.

At the very least, this is misleading as Paul Nelson Farm does not detail or count the number of shells used, amount and type of food consumed, etc. See HT 18. ("They get the same sheet as a group that would eat in excess because no, we have no way of tracking the exact amount of what X group does or what Y group does…"). Moreover, if a person just wanted a meal, an item of food, a drink, or a box ammunition, the individual price is listed nowhere on Paul Nelson Farm's website. See AR 43-52 (only the package prices are listed). Paul Nelson Farm attempts to

characterize its budget or cost allocation as something it is not.

Paul Nelson Farm also cites to Nashville Clubhouse Inn v. Johnson, 27 S.W.3d 542 (Tenn. Ct. App. 2000), an intermediate court of appeals case from Tennessee. The facts in that case are distinguishable from the case at hand. In addition to providing hotel rooms, the taxpayers in Nashville Clubhouse Inn "also operat[ed] restaurants and lounges where meals and alcoholic beverages [could] be purchased for on-premise consumption." Id. at 546.

In this case, Paul Nelson Farm's hunting lodge is not open to the public. HT 16-17. Paul Nelson Farm is not a restaurant, an all-you-can-eat buffet, or a general store selling ammunition. Guests cannot go there to purchase a box of shells or a meal. Paul Nelson Farm's regular course of business is providing pheasant hunting services, not the sale of food, non-alcoholic beverage, or ammunition.

Even the court in Nashville Clubhouse Inn addressed the limitation of their decision and stated, "[m]any of the decisions both in favor of and in opposition to the hotels' arguments rest on unique provisions of each jurisdictions' revenue statutes and regulations. Thus, their precedential value is weakened. We are primarily guided by our statutes

and regulations and the judicial precedents construing them."

Both the Department and Paul Nelson Farm agree, "South Dakota statutes and case law are the focus of this issue." Paul Nelson Farm's brief at 16 n.3. As previously stated, South Dakota's statutes, rules, and case law all require Paul Nelson Farm to pay use tax on its purchases of food, non-alcoholic beverages, and ammunition.

C. Paul Nelson Farm's other arguments.

Paul Nelson Farm's final argument points to the Department's Hunting and Fishing Services Tax Facts dated April 2010. In that Tax Facts, the tax treatment of hunting lodges is specifically addressed.

> **Hunting Lodges**
>
> Because a hunting lodge is selling services and not tangible personal property, they cannot purchase tangible personal property for resale. Lodges are the consumers of supplies and equipment used by them in providing their services. If sales tax is not paid on supplies when purchased, then the cost of such items must be reported as a use tax item on the sales tax return. ARSD 64:06:02:75 states that sales of supplies and equipment to a lodging establishment are taxable.
>
> Food and drinks cannot be purchased for resale when:
>
> - Food and drinks are provided at no charge or included in a hunting package.

If tax was not paid on the food and drinks when purchased, the lodge will owe use tax on these items when provided to the consumer.

- The food or drinks will be sold at a restaurant or snack bar for a separate charge.
- The food or drinks are sold for a separate charge from the hunting package.

Sales tax applies to the sale of food or drinks at a restaurant or snack bar.

Lodges can purchase souvenirs for resale if they will be selling those items at a separate charge from the hunting package. The lodge owes sales or use tax at the time of purchase on souvenirs that are provided as part of the package.

Examples.

1. Pheasant lodge #1 sells an all-inclusive package for a flat rate. This package includes three days of hunting, lodging, meals, drinks and snacks. One fee covers all. The fee charged by the lodge is subject to sales tax. In addition, the lodge owes sales or use tax on all products purchased including food and drinks.

2. Lodge #2 also sells an all-inclusive package for one flat rate. Lodge #2 provides three daily meals with drinks, lodging, and three days of hunting. Lodge #2 has a snack bar where you can purchase hamburgers, pizzas, and other snack items. The lodge may purchase inventory sold at the snack bar for resale because the products are sold at a separate charge from the package. All items provided as part of the all-inclusive package are subject to use tax if sales tax was not paid when the lodge purchased them.

AR 39. The text and examples contained under the 'Hunting Lodges' section of the Tax Facts parallel the facts of this

case. The Tax Facts affirms that Paul Nelson Farm must pay use tax on its purchases of food, non-alcoholic beverages, and ammunition.

Conclusion

Paul Nelson Farm's broad interpretation of "resale" must be rejected. The food, non-alcoholic beverages, and ammunition purchased by Paul Nelson Farm were not purchased for resale. Rather, Paul Nelson Farm purchased and used the supplies for the sole purpose of providing hunting services.

It is undisputed that Paul Nelson Farm operates an all-inclusive hunting lodge and retreat. The reason people visit Paul Nelson Farm is to hunt pheasants. Hunting packages are sold at one flat rate.[8] The qualifier in this case is that the tangible personal property purchased must be resold in the taxpayer's regular course of business. Here there is no resale. The end user, a guest of Paul Nelson Farm, purchases Paul Nelson Farm's services, the hunting experience, not a meal or a box of shells to use or consume at their leisure. Paul Nelson Farm is not a

[8] Paul Nelson Farm footnotes on page 5 of its brief that "[t]here are, however, for example, situations where people stay, but do not hunt, and are charged a lower price." This statement appears for the first time in its brief to this Court and is unsupported by the record.

restaurant, an all-you-can-eat buffet, or a general store selling ammunition. Paul Nelson Farm's regular course of business is providing pheasant hunting services. There is no resale in this case as Paul Nelson Farm uses the food, non-alcoholic beverages, and ammunition to provide these services.

South Dakota's statutes, rules, case law, and the Department's Hunting and Fishing Services Tax Facts are in agreement, Paul Nelson Farm must remit use tax on the food, non-alcoholic beverages, and ammunition it uses to provide hunting services.

Therefore, based on the Department's initial brief and the above arguments and authorities, the Department respectfully requests that the Certificate of Assessment issued to Paul Nelson Farm on July 29, 2010 be affirmed in all respects. Specifically, the Department requests that this Court overturn the circuit court's ruling that Paul Nelson Farm did not have to remit use tax on its purchases of food when no sales tax had been paid at the time of purchase.

Respectfully submitted this ___ day of December, 2013.

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that two true and correct copies of Appellant South Dakota Department of Revenue's Reply Brief in the matter of South Dakota Paul Nelson Farm, Inc. v. Department of Revenue were served on:

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properly addressed as above, postage prepaid, by mailing first class United States mail at the United States Post Office, Pierre, South Dakota.

Dated and mailed this ___ day of December, 2013.

_____

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