

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE
SECRETARY OF REVENUE

IN THE MATTER OF:

The Proposed Assessment of Sales and Use)
Tax for the period January 1, 1998 through)
September 30, 2000, by the Secretary of)
Revenue of North Carolina)
)
vs.)
)
[Taxpayer])

FINAL DECISION
Docket No. 2001-397

This matter was heard before the Assistant Secretary of Administrative Hearings, Eugene J. Cella, in the City of Raleigh, on October 16, 2001, upon application for hearing by the taxpayer wherein he protested the proposed assessment of tax, penalty, and interest for the period January 1, 1996 through April 30, 1999. The hearing was held by the Assistant Secretary pursuant to the provisions of G.S. 105-260.1. Representing the Sales and Use Tax Division was W. Timothy Holmes, Assistant Director. [Taxpayer's Representatives] were present at the hearing representing the Taxpayer.

Pursuant to G.S. 105-241.1, the Department mailed a Notice of Sales and Use Tax Assessment on July 5, 1999 to the Taxpayer, assessing tax, penalty, and interest in the amount of \$30,539.01. The Taxpayer objected to the proposed assessment in a letter dated July 19, 1999 and timely requested a hearing.

ISSUES

The issues to be decided are:

1. Was the Taxpayer a manufacturer?
2. Was the Taxpayer liable for use tax at the 1% State tax rate on its equipment purchases?
3. Was the Taxpayer liable for sales tax on its separately itemized sales of parts on invoices to customers?

EVIDENCE

The following items were introduced into evidence:

1. Copy of memorandum dated May 16, 2001, from the Secretary of Revenue to the Assistant Secretary of Administrative Hearings, designated as Exhibit E-1.
2. Copy of face sheet of auditor's report and comments dated June 25, 1999, designated as Exhibit E-2.
3. Copy of Notice of Sales and Use-Audit Tax Assessment dated July 5, 1999, designated as Exhibit E-3.
4. Copy of letter dated July 19, 1999 from the Taxpayer to the Department, designated as Exhibit E-4.
5. Copy of letter dated August 5, 1999 from the Sales and Use Tax Division to the Taxpayer, designated as Exhibit E-5.
6. Copy of letter dated March 27, 2000 from the Sales and Use Tax Division to the Field Operations Division, designated as Exhibit E-6.
7. Copy of letter dated April 20, 2000 from the Sales and Use Tax Division to the Taxpayer, designated as Exhibit E-7.
8. Copy of letter dated May 10, 2000 from the Taxpayer to the Sales and Use Tax Division, designated as Exhibit E-8.
9. Copy of letter dated May 24, 2000 from the Sales and Use Tax Division to the Taxpayer, designated as Exhibit E-9.
10. Copy of letter dated October 19, 2000 from the Taxpayer to the Sales and Use Tax Division, designated as Exhibit E-10.
11. Copy of letter dated November 22, 2000 from the Sales and Use Tax Division to the Taxpayer, designated as Exhibit E-11.
12. Copy of letter dated June 7, 2001 from the Assistant Secretary of Revenue to the Taxpayer, designated as Exhibit E-12.
13. Copy of NCAC T17 :07B .0202(a), designated as Exhibit E-13.
14. Copy of NCAC T17 :07B .0406, designated as Exhibit E-14.
15. Copy of Master Hatcheries, Inc., V. Coble, 286 N.C. 518, 212 S.E. 2d 150 (1975), designated as Exhibit E-15.

FINDINGS OF FACT

Based on the foregoing evidence of record, the Assistant Secretary makes the following findings of fact:

1. The Taxpayer operated as a retailer engaged in the business of rebuilding racing engines during the audit period.
2. The Taxpayer primarily received engines from customers that required rebuilding in order to be used by such customers in [car] races.
3. The Taxpayer built some new engines for lease which represented less than 25% of its business.
4. The Taxpayer purchased parts used in rebuilding customers' engines, exempt from sales or use tax based on Certificates of Resale issued to vendors.
5. When the Taxpayer rebuilt customers' engines, it operated under a performance type service agreement 75% of the time. In some cases, the firm separately stated the sales of new parts it installed in the customers' engines.
6. The Taxpayer did not charge sales tax on invoices issued to customers when the sales price of parts installed on the customer-owned engines was separately stated. The Department assessed sales tax on these repair parts.
7. In cases where the Taxpayer did not separately charge customers for parts used to rebuild customers' engines, the Taxpayer failed to accrue and remit use tax on the cost price of such parts. Although the auditor failed to assess use tax on these parts, the Department advised the Taxpayer of its liability for use tax on the cost of the parts by letter dated April 20, 2000.
8. The Taxpayer purchased equipment used in its operations without payment of sales or use tax to the vendors and failed to accrue and remit any use tax due on these purchases. The Department assessed use tax on the cost price of the equipment purchased from out-of-state vendors who did not charge sales tax.
9. The Notice of Proposed assessment was mailed to the Taxpayer on July 5, 1999.
10. The Taxpayer filed a written request for a hearing and notified the Department that it objected to the assessment on July 19, 1999.

CONCLUSIONS OF LAW

Based on the foregoing findings of fact, the Assistant Secretary makes the following conclusions of law:

1. The Taxpayer was, at all material times during the audit period, a retailer engaged in the business of making retail sales of tangible personal property subject to sales tax. The Taxpayer was also engaged in the business of rebuilding engines pursuant to service agreements during the audit period.

2. The Taxpayer was not classified as a manufacturer since it did not manufacture new and different products for sale during the audit period.
3. Because the Taxpayer's operation did not constitute "manufacturing," its purchases of equipment were not subject to the 1% State tax within G.S. 105-164.4(a)(1d) or 105-164.4A(2).
4. The general rate of state tax and applicable local tax is due on the cost of equipment purchased for use in the Taxpayer's operations.
5. The Taxpayer was liable for sales tax on its retail sales of repair parts sold to customers and installed in their engines. The Taxpayer should have accrued and paid use tax on the cost of parts furnished and installed upon customers' engines pursuant to its service agreements, notwithstanding that the auditor failed to assess such tax.

DECISION

The Taxpayer was engaged in the business of rebuilding race car engines pursuant to service agreements for racing teams during the audit period. In some cases the Taxpayer made retail sales of repair parts separately stating the sales price for the parts installed in engines on the customers' invoices. In other instances, the Taxpayer did not sell parts, but instead furnished and installed new parts on customer-owned engine blocks for a rebuilding fee under a service agreement.

The Taxpayer purchased engine repair parts exempt from sales or use tax pursuant to Certificates of Resale issued to its vendors. The Taxpayer either sold these parts to customers, separately stating the sales price on invoices, or used the engine parts in providing a rebuilt engine to its customers pursuant to a service agreement. The Taxpayer failed to charge and collect sales tax on its parts sales and failed to accrue and remit use tax on the cost price of the parts used in its service agreements. The Department has assessed the sales and use tax on these transactions.

The engines the Taxpayer built for lease were a minimal part of its business. Since the Taxpayer was not primarily engaged in manufacturing new and different products from solely-owned raw materials for sale, it is my opinion that the Taxpayer was not a manufacturer as contemplated by G.S. 105-164.4(a)(1d) or 105-164.4A(2). Therefore, the Taxpayer was liable

for the general state and local rates of use tax on the cost price of the equipment purchased from out of state vendors who did not collect the tax.

I find, therefore, that the proposed assessment of additional sales and use tax plus accrued interest is deemed to be correct under the law and the facts and is hereby sustained. Because the failure to pay the tax was not the result of intentional disregard of the North Carolina statutes, I find reasonable cause to waive penalties.

Wherefore the assessment is sustained in its entirety, and is declared to be final and immediately due and collectible.

This 22nd day of January, 2002.

Signature _____

Eugene J. Cella

Assistant Secretary of Administrative Tax Hearings
North Carolina Department of Revenue