

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE
SECRETARY OF REVENUE

IN THE MATTER OF:

The Proposed Assessment of Additional Sales)
and Use Tax for the period March 1, 1999)
through December 31, 2001, by the)
Secretary of Revenue of North Carolina)
vs.)
[Taxpayer])

FINAL DECISION
Docket No. 2003-317

This matter was heard before the Assistant Secretary of Revenue, Eugene J. Cella, in the City of Raleigh, on September 16, 2003, upon application for hearing by the Taxpayer wherein he protested a proposed assessment of tax, penalty and interest for the period March 1, 1999 through December 31, 2001. The hearing was held by the Assistant Secretary pursuant to G.S. 105-260.1. The Taxpayer was represented by [Taxpayer's President, a CPA, and President and owner of a printing company]. Representing the Sales and Use Tax Division were W. Timothy Holmes, Assistant Director, and Danny R. Fulcher, Administration Officer.

Pursuant to G.S. 105-241.1, the Department mailed a Notice of Proposed Assessment to the Taxpayer on March 5, 2002 assessing additional tax, penalty and interest of \$7,854.45 for the period March 1, 1999 through December 31, 2001. The Taxpayer filed a timely protest to the proposed assessment and requested a hearing before the Secretary of Revenue.

ISSUES

The issues to be decided in this matter are:

- (1) Are the separately stated charges for dies listed on the Taxpayer's invoices to its printer customers retail sales subject to sales tax?
- (2) Is the Department estopped from assessing additional sales tax on dies in the current audit report because the retail sale of dies was not addressed or included in a prior audit report?

EVIDENCE

The Sales and Use Tax Division presented the following items into evidence at the hearing:

1. 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 the auditor's report dated February 27, 2002 covering the period March 1, 1999 through December 31, 2001, designated as Exhibit E-2.
3. Copy of Notice of Sales and Use Tax Assessment dated March 5, 2002, designated as Exhibit E-3.
4. Copy of letter dated April 4, 2002 from the Taxpayer to the Department of Revenue, (Department), designated as Exhibit E-4, with the following attachments:
 - a. Diagram of how Dies go through work flow analysis.
 - b. Copy of Notice of Sales and Use Tax Assessment dated March 5, 2002.
 - c. Copy of the audit report completed February 27, 2002 covering the period March 1, 1999 through December 31, 2001.
5. Copy of letter dated May 10, 2002 from the Sales and Use Tax Division, (Division) to the Taxpayer, designated as Exhibit E-5.
6. Copy of letter dated May 22, 2002 from the Taxpayer to the Division, designated as Exhibit E-6, including the following attachments:
 - a. Copy of statement dated April 10, 2002 from [a company] to the Taxpayer covering the period December 31, 1998 through March 18, 1999.
 - b. Copy of order form from [a company].
 - c. Copy of record of Accounts Receivable Customer Ledger for [a company] to the Taxpayer covering the period November 30, 2001 through April 30, 2002.
 - d. Copy of [an invoice number] dated February 16, 2001 from [a company] to the Taxpayer.
 - e. Copy of brass order form from [a company] with Customer QuickReport attached for the period January 1999 through December 2001.
 - f. Copy of purchase order form from [a company] with Customer QuickReport attached for the period January 1, 1999 through January 1, 2002.
 - g. Copy of Section 7 of the Sales and Use Tax Technical Bulletins.
7. Facsimile dated June 10, 2002 from a Revenue Field Auditor to the Division, designated as Exhibit E-7, with the following attachments:
 - a. Copy of [an invoice number], dated July 2, 2001, to [a company] from the Taxpayer.
 - b. Copy of [an invoice number], dated April 4, 2001, to [a company] from the Taxpayer.
 - c. Copy of [an invoice number], dated April 20, 2001, to [a company] from the Taxpayer.

- d. Copy of [an invoice number], dated April 23, 2001, to [a company] from the Taxpayer.
 - e. Copy of [an invoice number], dated January 29, 2001, to [a company] from the Taxpayer.
 - f. Copy of [an invoice number], dated January 22, 2001, to [a company] from the Taxpayer.
 - g. Copy of [an invoice number], dated April 18, 2001, to [a company] from the Taxpayer.
 - h. Copy of diagram submitted by the Taxpayer to show how Dies go through the work flow analysis.
- 8. Copy of letter dated June 25, 2002, from the Division to the Taxpayer, designated as Exhibit E-8.
 - 9. Copy of letter dated July 8, 2002, from the Taxpayer's Certified Public Accountant to the Division, designated as Exhibit E-9, with the following attachment:
 - a. Copy of Sales and Use Tax Technical Bulletin Section 7-1 E.
 - 10. Copy of letter dated August 19, 2002, from the Division to the Taxpayer's Certified Public Accountant, designated as Exhibit E-10.
 - 11. Copy of letter dated September 12, 2002, from the Division to the Taxpayer's Certified Public Accountant, designated as Exhibit E-11.
 - 12. Copy of letter dated September 25, 2002, from the Taxpayer to the Division, designated as Exhibit E-12, with the following attachments:
 - a. Copy of letter dated September 12, 2002, from the Division to the Taxpayer's Certified Public Accountant.
 - b. Request for Sales and Use Tax Credit by Vendee, Form E-599 M, dated August 22, 2002, to [a company] from the Taxpayer.
 - c. Copy of a Manufacturers' Certificate, Form E-575, dated September 19, 2002, from [a company].
 - d. Copy of a facsimile dated September 18, 2002 of [an Out-of-State] Sales and Use Certificate of Exemption, Form ST-11, from [a company] to an unnamed supplier.
 - e. Copy of [an Out-of-State] Department of Revenue Blanket Certificate of Resale dated September 18, 2002, from [a company] to the Taxpayer.
 - f. Copy of [an Out-of-State] Sales and Use Tax Certificate of Exemption, Form ST-10, dated September 5, 2002, from [a company] to the Taxpayer.
 - g. Copy of Manufacturers' Certificate, Form E-575, dated December 3, 1992, from [a company] to the Taxpayer.
 - h. Copy of Manufacturers' Certificate, Form E-575, dated February 6, 2002, from [a company] to the Taxpayer.
 - i. Copy of Manufacturers' Certificate, Form E-575, dated September 16, 2002, from [a company] to the Taxpayer.
 - j. Copy of [an Out-of-State] Sales and Use Tax Certificate of Exemption, Form ST-10, dated February 7, 2002, from [a company] to the Taxpayer.
 - k. Facsimile of Manufacturers' Certificate, Form E-575, dated September 18, 2002, from [a company] to the Taxpayer.

- l. Facsimile of [an Out-of-State] Sales and Use Tax Certificate of Exemption, Form ST-11, dated September 18, 2002, from [a company] to the Taxpayer.
 - m. Facsimile of a [an Out-of-State] Sales Tax Exemption Certificate, Form 149, dated September 19, 2002, from [a company] to the Taxpayer.
 - n. Facsimile of Merchants Certificate of Registration dated November 19, 1993, from [a merchant] to the Taxpayer.
 - o. Facsimile of [an Out-of-State] Sales and Use Tax Certificate of Exemption, Form ST-10, dated September 18, 2002, from [a company] to the Taxpayer.
 - p. Sixty copies of North Carolina Certificates of Resale, Form E-590, from various customers listed in Schedule 2 of the second amended audit report.
 - o. Forty-six copies of North Carolina Certificates of Resale, Form E-590, and other exemption forms from various customers not included in the audit assessment.
13. Copy of the Amended Auditor Report dated October 30, 2002, covering the period March 1, 1999 through December 31, 2001, designated as Exhibit E-13.
 14. Copy of Notice of Amended Sales And Use Tax Assessment dated October 31, 2002, designated as Exhibit E-14.
 15. Copy of letter dated November 13, 2002, from the Division to the Taxpayer, designated as Exhibit E-15.
 16. Copy of letter dated January 17, 2003, from the Taxpayer's Certified Public Accountant to the Division and 28 attached statements, designated as Exhibit E-16.
 17. Copy of letter dated February 26, 2002, from the Division to the Taxpayer's Certified Public Accountant, designated as Exhibit E-17.
 18. Copy of the Second Amended Audit Report dated March 26, 2003, covering the period March 1, 1999 through December 31, 2001, designated as Exhibit E-18.
 19. Copy of letter dated March 26, 2003, from the Taxpayer's Certified Public Accountant to the Division and 32 attached statements from the printer customers, designated as Exhibit E-19.
 20. Copy of Notice of Sales and Use Tax Assessment dated April 1, 2003, designated as Exhibit E-20.
 21. Copy of letter dated April 22, 2003, from the Division to [a company], designated as Exhibit E-21.
 22. Facsimile dated April 30, 2003, of letter from the Taxpayer's Certified Public Accountant to the Division, designated as Exhibit E-22, with the following attachment:
 - a. Copy of Facsimile cover sheet.
 23. Copy of letter dated May 16, 2003, from Division to the Taxpayer's Certified Public Accountant, designated as Exhibit E-23.

24. Copy of the cover sheet and explanation of changes from the auditor's report dated January 5, 1993 covering the period December 1, 1989 through October 31, 1992, designated as Exhibit E-24.
25. Copy of Sales and Use Tax Technical Bulletin 5-2 A, dated June 1, 2002, designated as Exhibit E-25.
26. Copy of Sales and Use Tax Technical Bulletin 7-1 D, dated June 1, 2002, designated as Exhibit E-26.
27. Copy of letter dated July 11, 2003, from Assistant Secretary of Revenue to the Taxpayer's Certified Public Accountant, designated as Exhibit E-27.

FINDINGS OF FACT

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

1. The Taxpayer is engaged in business as a contract manufacturer specializing in embossing, die cutting and foil stamping of printed materials for its printer customers.
2. The Taxpayer issued certificates of resale to vendors as their authority not to charge and collect sales or use tax on dies.
3. The Taxpayer made a separate charge for the dies on its sales invoices to its printer customers but did not charge sales tax on the dies.
4. The Department assessed sales tax on the Taxpayer's charges for the dies sold to its printer customers.
5. The Taxpayer's customers could take possession of the dies at any time; however, most allowed the Taxpayer to store them for possible future use.
6. None of the certificates of resale the Taxpayer received from its printer customers listed dies as items being purchased for resale.
7. The Taxpayer used the dies purchased in its contract printing work for its printer customers.
8. The Taxpayer furnished two groups of statement post audit concerning the dies. The two groups of statement contain conflicting information regarding the ownership of the dies. The first group stated that the Taxpayer's printer customers own the dies and the second group, most of which are from the same customer as the first group, state that the dies are the property of the customers of the Taxpayer's printer customers.
9. A notice of Sales and Use Tax Assessment was mailed to the Taxpayer on March 5, 2002 and amended notices were mailed on October 31, 2002 and April 1, 2003.
10. The Taxpayer objected to the assessments and made a timely request for hearing.

CONCLUSIONS OF LAW

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

1. As a retailer engaged in the business of making retail sales of tangible personal property, the Taxpayer was liable for collecting the applicable State and local sales tax on its sales pursuant to G.S. 105-164.4, G.S. 105-467, G.S. 105-483, and G.S. 105-498.
2. Sales of mill machinery or mill machinery parts and accessories are subject to the 1% preferential rate of State tax, \$80.00 maximum per Article under G.S. 105-164.4(a)(1d), G.S. 105-164.4A and G.S. 105-164.4A(2). The dies sold by the Taxpayer are subject to the 1% State preferential rate of tax.
3. A retail sale is defined as the transfer of title or possession of tangible personal property, conditional or otherwise, in any manner or by any means whatsoever, under G.S. 164.3 (15). Ownership of the dies was transferred to the Taxpayer's customers; however, the Taxpayer stored the dies for their customers for convenience and protection purposes.
4. The dies were used by the Taxpayer in their contract work for their printer customers pursuant to the definition of "use" found in G.S. 105-164.3(18).
5. Pursuant to G.S. 105-164.26, it is presumed that all gross receipts of both wholesalers and retailers are subject to the retail sales tax unless the contrary is established by proper records. No records have been provided by the Taxpayer to show that the dies themselves were exempt when sold to the printers.
6. G.S. 105-264 provides Taxpayers with a measure of protection from the assessment of additional tax based on erroneous written advice given by the Department. No such erroneous written advice was rendered upon completion of the prior audit of the Taxpayer's business or since that time.
7. Notice of proposed sales and use tax assessment for the audit period and notices of proposed amended sales and use tax assessment were issued to the Taxpayer pursuant to G.S. 105-241.1.
8. The Taxpayer timely protested the Notice of Sales and Use Tax Assessment dated March 5, 2002, as well as the Notices of Amended Sales and Use Tax Assessment dated October 31, 2002 and April 1, 2003.

FINAL DECISION

The Taxpayer specializes in embossing, die cutting and foil stamping of printed materials that are in most cases provided by its printer customers.

The Taxpayer contends that it purchased dies from vendors for resale to its printer customers who, in turn, resold the dies to their customers. The Taxpayer issued its vendors

certificates of resale for the dies and therefore paid no tax on dies at the time of purchase. The Taxpayer also feels that its purchase of dies for resale is evidenced by the certificates of resale it received from some of its printer customers. Customers could take possession of the dies at any time although most choose to allow the Taxpayer to store them on their behalf for possible future use. Two different sets of statements were furnished from some of the Taxpayer's printer customers as proof that they were purchasing the dies for resale to their customers. The Taxpayer further claims that its present tax policies were formulated as a result of the audit conducted by the Department in 1992 and that dies were not mentioned in that audit.

G.S. 105-164.26 provides that it is presumed that all gross receipts for both wholesalers and retailers are subject to the retail sales tax unless proper records establish the contrary. Certificates of resale must describe the type of tangible personal property sold by the purchaser and none of the certificates received by the Taxpayer from its printer customers listed dies as an item being purchased for resale. The certificates cover only the tangible personal property produced by the Taxpayer on behalf of its printer customers for their customers. The Department's position is that the true object of the transaction between the Taxpayer and its printer customers was for the embossing, die cutting and foil stamping of printed materials and not for the sale of dies. The Taxpayer purchased the dies and used them as a necessary part in its contract printing work for its printer customers. The fact that the Taxpayer may transfer legal ownership of the dies to its customers is incidental to the actual purpose of the transaction, which is to use the dies in fulfilling its obligation to its customers. The Taxpayer retained the dies in its possession for any potential future use in providing additional contract work for its printer customers. The Department takes the position that the Taxpayer erroneously issued certificates of resale for the dies which it purchased and actually used in preparing printing material for its customers. Since the Taxpayer made a separate charge on its invoices to its printer customers for the dies, the Department assessed sales tax on the charge.

Post audit the Taxpayer furnished the Department with its first group of statements from some of its printer customers to prove the transfer of ownership of the dies from the Taxpayer to its printer customers. These statements state that the dies sold by the Taxpayer to its printer customers are the property of the “printer customers” and the dies are stored at the Taxpayer’s facility for their convenience and protection.

Later, the Taxpayer furnished a second group of statements which uses language to indicate that the dies were purchased for resale to the customers of the Taxpayer’s printer customers and they have been charged all applicable sales taxes for the dies.

The two groups of statements furnished by the Taxpayer contain conflicting information regarding the ownership of the dies. Note the language in the first group of statements states that the printer customers understand that the dies are their property. However, the second group of statements, most of which are from the same customers as the first group of statements, state that the dies are the property of the customers of the Taxpayer’s printer customers. The conflicting information in the two statements raises the question of the accuracy of the statements. The facts and circumstances therefore indicate that the taxpayer has not met the burden of proving the sales of the dies were exempt from tax. In addition, the Taxpayer never provided any proof that its printer customers have collected sales tax on the sale of the dies to their customers.

It is printing industry practice to use dies in the production of printed material for customers. Rarely do the printers sell and/or furnish the dies to their customers. Therefore, printers are liable for tax on the cost of dies when purchased for use. In this case, since the Taxpayer actually made a charge for the dies on its invoices to its printer customers, it is the Department’s position that the Taxpayer was making a retail sale of dies to its printer customers and sale tax is due thereon as assessed.

The Department is not prevented from assessing additional tax in a subsequent audit by the fact that certain areas were not addressed or included in a prior audit. The information in

the Taxpayer's file was reviewed and there was no evidence that it ever requested and/or received any written advice or approval concerning any procedure or method of operation, including the use of dies. In consideration of G.S. 105-264, there is no evidence that erroneous information was given to the Taxpayer by the Department in a prior audit report regarding dies.

In summary, I must agree with the Sales and Use Tax Division's position since none of the certificates of resale which the Taxpayer obtained from its printer customers reflect that they are purchasing dies for resale. Also, the Taxpayer has not provided the Department with any documentation such as invoices, reflecting collection of sales tax on the sales of dies by the Taxpayer's printer customers to their customers. The fact that the Taxpayer erroneously issued a certificate of resale to its vendors and has subsequently gathered conflicting statements from a portion of its printer customers does not relieve it of its liability for the tax assessed.

Therefore, the proposed assessment of sales and use tax and interest is deemed correct under the law and the facts and is hereby sustained. Because the failure to pay the correct amount of the tax was not the result of an intentional or negligent disregard of the law on the part of the taxpayer, I find reasonable cause to waive the penalties. The proposed assessment is sustained as modified herein and hereby declared to be finally determined and immediately due and collectible with interest as allowed by law.

Made and entered this 9th day of January, 2004.

Eugene J. Cella
Assistant Secretary of Administrative Hearings