

STATE OF NORTH CAROLINA

**BEFORE THE
SECRETARY OF REVENUE**

**COUNTY OF WAKE
IN THE MATTER OF:**

The Proposed Assessment of Sales and Use)
Tax for the period June 1, 1999 through)
May 31, 2002, by the Secretary of Revenue)
)
vs.)
)
Taxpayer)

FINAL DECISION
Docket No. 2003-553

This matter was heard before the Assistant Secretary of Revenue for Administrative Tax Hearings, Eugene J. Cella, in the City of Raleigh, on May 6, 2004, upon application for hearing by the Taxpayer wherein it protested the assessment of tax, penalty, and interest for the period June 1, 1999 through May 31, 2002. The hearing was held by the Assistant Secretary pursuant to the provisions of G.S. 105-260.1. The Taxpayer was represented by _____, Vice President of the Corporation, and _____, Controller for the Corporation. Representing the Sales and Use Tax Division were W. Timothy Holmes, Assistant Director, and Amy A. McLemore, Administration Officer.

Pursuant to G.S. 105-241.1, the Department mailed a Notice of Sales & Use Tax Assessment to the Taxpayer on April 21, 2003. The Taxpayer objected to the assessment in a letter dated May 19, 2003 and timely requested a hearing.

ISSUES

The issues to be decided are as follows:

- (1) Are the shop supplies the Taxpayer purchased for use in repairing and servicing its customers' boats subject to use tax?
- (2) Is the sales tax the Taxpayer collected from its customers on the portion of the materials charges representing shop supplies used or consumed by the Taxpayer an erroneous collection?
- (3) Are the environmental fees the Taxpayer charged its customers in connection with the servicing and repair of their boats subject to sales tax?

EVIDENCE

The following items were introduced into evidence by the Department:

- (1) Memorandum dated May 16, 2001 from the Secretary of Revenue to the Assistant Secretary of Administrative Tax Hearings, designated as Exhibit E-1.
- (2) Copy of audit report dated April 4, 2003, covering the period June 1, 1999 through May 31, 2002, designated as Exhibit E-2.
- (3) Copy of Notice of Sales and Use Tax Assessment dated April 21, 2003, designated as Exhibit E-3.
- (4) Letter dated May 19, 2003, from the Taxpayer to the Department, designated as Exhibit E-4.
- (5) Letter dated July 2, 2003, from the Sales and Use Tax Division to the Taxpayer, designated as Exhibit E-5.
- (6) Letter dated August 1, 2003, from the Sales and Use Tax Division to the Taxpayer, designated as Exhibit E-6.
- (7) Letter dated September 30, 2003, from the Taxpayer to the Sales and Use Tax Division, designated as Exhibit E-7.
- (8) Letter dated October 9, 2003, from the Sales and Use Tax Division to the Taxpayer, designated Exhibit E-8.
- (9) Copy of the Taxpayer's unnumbered invoice dated December 14, 2001 issued to a customer during the audit period, designated Exhibit E-9.
- (10) Copy of the Taxpayer's invoice numbered 652 dated May 30, 2002, designated Exhibit E-10.
- (11) Letter dated December 8, 2003 from the Assistant Secretary of Revenue for Administrative Tax Hearings to the Taxpayer, designated Exhibit E-11.
- (12) Letter dated February 11, 2004 from the Assistant Secretary of Revenue for Administrative Tax Hearings to the Taxpayer, designated Exhibit E-12.
- (13) Letter dated September 16, 2002 and attached exhibits from the Taxpayer to the Department, designated Exhibit E-13.
- (14) Letter dated November 15, 2002 from the Sales and Use Tax Division to the Taxpayer, designated Exhibit E-14.

- (15) Letter dated April 7, 2004, from the Assistant Secretary of Revenue for Administrative Tax Hearings to the Taxpayer, designated Exhibit E-15.
- (16) Copy of Sales and Use Tax Technical Bulletin 34-21, designated Exhibit E-16.

The following items were introduced into evidence by the Taxpayer during the hearing:

- (17) An exhibit showing the Taxpayer's projection of a tax credit due the Taxpayer on tangible personal property purchased for resale but actually consumed by the Taxpayer, designated as Exhibit TP-1.
- (18) An exhibit showing the Taxpayer's reconciliation of its sales and use tax liability during the audit period, including the credit computed in Exhibit TP-1, designated as Exhibit TP-2.

FINDINGS OF FACT

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

- (1) The Taxpayer was an S Corporation engaged in the business of boat repair and service during the audit period.
- (2) When the Taxpayer invoiced its customers for repairs to their boats, it listed three charges: a labor charge, a materials charge, and an environmental charge.
- (3) The Taxpayer made purchases of shop supplies, such as sandpaper, gloves, brushes, and rags, upon which no sales tax was paid to the Taxpayer's vendors. The Taxpayer provided these vendors with resale certificates for those purchases.
- (4) The shop supplies were used by the Taxpayer in repairing and servicing its customers' boats.
- (5) Sales tax was collected from customers on the materials charge, and it was remitted to the Department. Included in the materials charge were charges for all of the shop supplies attributed to the service or repair project listed on the invoice.
- (6) The Taxpayer was advised that, in order for the Department to refund or credit the Taxpayer for any sales tax erroneously collected from its customers on the portion of its material charges that actually represented shop supplies that were not sold to customers but were used or consumed by the Taxpayer, the Taxpayer

must first refund the amount of tax collected in error to its customers and provide documentation thereof to the Department. The Taxpayer decided against that course of action.

- (7) The Taxpayer charged its customers environmental fees in order to defray the Taxpayer's costs associated with keeping its boatyard and marina clean, in compliance with the requirements of the United States Department of Labor's Occupational Safety and Health Administration.
- (8) The Taxpayer did not collect any sales tax on the environmental charges invoiced to its customers.
- (9) A notice of proposed sales and use tax assessment was mailed to the Taxpayer on April 21, 2003.
- (10) The Taxpayer objected to the assessment and timely requested a hearing to resolve the matter.

CONCLUSIONS OF LAW

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

- (1) The repair parts and other tangible personal property that the Taxpayer uses in the repair or servicing of boats and that are sold and delivered to customers should be included in the materials charge it invoices its customers.
- (2) The repair parts are purchased by the Taxpayer to resell to its customers, and, for those purchases, the Taxpayer should provide its vendors with a resale certificate.
- (3) The gloves, paint brushes, small tools, paper masks, and other shop supplies that the Taxpayer uses or consumes while repairing or otherwise servicing boats and which are not subsequently delivered to its customers are subject to sales or use tax on their cost price.
- (4) Any tax the Taxpayer collected erroneously must be remitted to the Department, and the Department cannot refund that tax unless the Taxpayer has first refunded the tax to its customer.
- (5) The Taxpayer is liable for the additional State and applicable county tax.
- (6) The Notice of Sales & Use Tax Assessment for the audit period was issued pursuant to G.S. 105-241.1 on April 21, 2003.

FINAL DECISION

The Taxpayer objects to the use tax assessed on the Taxpayer's purchases of the shop supplies used in its operations because the shop supplies are included in the charge for materials included on its customers' invoices and sales tax was collected on that charge. The Taxpayer feels that tax is being collected twice on these shop supplies. Objection is also made to the assessment of sales tax on environmental fees added to customers' invoices because those fees represent the labor services required to maintain a clean boatyard to comply with OSHA regulations and do not represent a sale of tangible personal property.

It is true that the Taxpayer first collected sales tax on the materials charges invoiced to customers and remitted it to the Department, and the Department later assessed use tax on the Taxpayer's cost of the shop supplies included in the materials charges. However, I must agree with the Sales and Use Tax Division that the Taxpayer should not have collected sales tax from its customers on the shop supplies -- such as paint brushes, sandpaper, and small tools -- that it used or consumed in its business operations, because the Taxpayer did not sell these items or transfer title to these supplies to its customers. It is my understanding that the shop supplies were used and consumed by the Taxpayer in its boat repair business, and the Taxpayer should have paid sales or use tax at the time it purchased those supplies. The Taxpayer paid the 1% State rate of tax to some of its vendors when it purchased some of the supplies in question, but, in a majority of cases, the Taxpayer issued resale certificates to its vendors and paid no sales or use tax on the shop supplies at the time of purchase.

Since erroneous collections were made on shop supplies by the Taxpayer, the Sales and Use Tax Division has offered the Taxpayer the chance to refund its customers sales tax collected in error and then receive a credit for that tax in the audit assessment. The Taxpayer is understandably hesitant to take such a course of action, because any perception by customers that the Taxpayer overtaxed them on former transactions might lead those customers to go elsewhere to have their boats repaired in the future. However, that is the only remedy provided for in the statutes. As the Taxpayer appears to understand the ramifications of its decision not to refund its customers the sales tax it erroneously collected, there is nothing more the Department can do resolve the matter.

With respect to the sales tax assessed on the environmental fees, the statutes defining the term “sales price” during the audit period clearly provide that labor or service costs, including services that go into the fabrication, manufacture, or delivery of tangible personal property and/or any services necessary to complete the sale of tangible personal property are to be considered part of the sales price of that tangible personal property. It is clear that the Taxpayer makes every effort to keep its boatyard clean enough that it exceeds even the strictest of OSHA and other environmental regulations and, in so doing, incurs substantial costs. These costs are directly related to its boat repair business, and, as such, any fee the Taxpayer charges its customers to recoup these costs, is, by statute, to be considered part of the sales price of the tangible personal property sold to the Taxpayer’s customers and subject to sales tax,

notwithstanding that the fee may be separately stated on the customer invoices. I find that the Department has correctly assessed the sales tax on the environmental fees in question.

I do feel that the Taxpayer does a very good job of maintaining its financial records, which was helpful to the Department during the audit process. The mistakes made in collecting and remitting sales tax during the audit period do appear inadvertent. Therefore, I am authorizing the waiver of the penalties included in the assessment, provided the tax and accrued interest are paid in full.

Therefore, the assessment of tax and interest is deemed correct under the law and the facts and is hereby declared to be finally determined and immediately due and payable as allowed by law.

Made and entered this 29th day of July, 2004.

Eugene J. Cella
Assistant Secretary of Administrative Hearings