

**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 March 1, 1997 through )  
March 31, 2003 by the Secretary of )  
Revenue of North Carolina )  
 )  
vs. )  
 )  
[Taxpayer] )

**FINAL DECISION**  
**Docket No. 2004-260**

This matter was heard before the Assistant Secretary of Administrative Hearings, Eugene J. Cella, in the City of Raleigh, on February 16, 2005, upon application for hearing by the Taxpayer wherein it protested the proposed assessment of tax, penalty and interest for the period March 1, 1997 through March 31, 2003. The hearing was held by the Assistant Secretary pursuant to G.S. §105-260.1. Representing the Sales and Use Tax Division were W. Timothy Holmes, Assistant Director, M. D. Stephenson, Administration Officer, and Karen Ousley Boyer, Assistant Attorney General. The Taxpayer was represented by two Attorneys and a Certified Public Accountant.

Pursuant to G.S. §105-241.1, the Department mailed a Notice of Sales and Use Tax Assessment to the Taxpayer on February 18, 2003 assessing tax, penalty and interest in the amount of \$97,973.03. The Taxpayer objected to the proposed assessment and timely requested a hearing.

**ISSUE**

The issue to be decided is:

Did the Taxpayer purchase printed advertising material from its franchisor for "storage, use, or consumption" subject to North Carolina use tax?

## EVIDENCE

The following items were introduced into evidence by the Sales and Use Tax Division:

- (1) Copy of Memorandum dated May 16, 2001 from the Secretary of Revenue to the Assistant Secretary of Tax Administration, designated Exhibit E-1.
- (2) Copy of auditor's report for the period March 1, 1997 through March 31, 2003, designated Exhibit E-2.
- (3) Copy of Notice of Sales and Use Tax Assessment dated April 1, 2003, designated Exhibit E-3.
- (4) Copy of letter dated May 21, 2003 and attachment from the Taxpayer's representative to the Sales and Use Tax Division (Division), designated Exhibit E-4.
- (5) Copy of letter dated June 12, 2003 from the Division to the Taxpayer's representative, designated Exhibit E-5
- (6) Copy of letter dated June 20, 2003 from the Taxpayer's representative to the Division, designated Exhibit E-6.
- (7) Copy of letter dated July 31, 2003, and attachments numbered a, b, c, and d thereto from the Taxpayer's representative to the Division, designated Exhibit E-7.
  - a. Copy of [Franchisor] Franchise Agreement.
  - b. Copy of Invoice number 90077036 issued to the Taxpayer by its franchisor and attached "Breakdown of Charges," "Unit Information," and "Invoice for Services" supporting the invoice.
  - c. Copy of Straight Bill of Lading.
  - d. Copy of Postage Statement.
- (8) Copy of letter dated August 25, 2003 from the Division to the Taxpayer's representative, designated Exhibit E-8.
- (9) Copy of letter dated September 3, 2003 from the Taxpayer's representative to the Division, designated Exhibit E-9.
- (10) Copy of letter dated September 10, 2003 from the Division to the Taxpayer's representative, designated Exhibit E-10.
- (11) Copy of letter dated September 30, 2003, and attachments a, b, and c thereto from the Taxpayer's representative to the Division, designated Exhibit E-11.

- a. Copy of [Franchisor] Franchise Agreement.
  - b. Copy of "Agreement for Assignment of a [Franchisor] License Agreement to a Corporation."
  - c. Copy of Superior Court Decision of the State of Connecticut No. 523267 dated December 2, 1994.
- (12) Copy of letter dated November 5, 2003 from the Division to the Taxpayer's representative, designated Exhibit E-12.
  - (13) Sample Copy of [Franchisor Trade Name] envelope containing advertisements, designated Exhibit E-13.
  - (14) Copy of definition of the word "dominion" from page 417 of the Second College Edition of The American Heritage Dictionary, designated Exhibit E-14.
  - (15) Copy of Val-Pak of Omaha, Inc. v. Department of Revenue of the State of Nebraska, 249 Neb. 776 545 NW2d 447 (4/5/96), designated Exhibit E-15.
  - (16) Copy of letter dated April 5, 2004 from the Taxpayer's representative to the Division, designated Exhibit E-16.
  - (17) Copy of letter dated April 15, 2004 from the Division to the Taxpayer's representative, designated Exhibit E-17.
  - (18) Copy of letter dated April 30, 2004 from the Taxpayer's representative to the Division, designated Exhibit E-18.
  - (19) Copy of a section of the U.S. Postal Service Publication 804 – Drop Shipment Procedures for Destination Entry, designated Exhibit E-19.
  - (20) Copy of 17 N.C.A.C. 07B .0901(a) and (b), designated Exhibit E-20.
  - (21) Copy of Sales and Use Tax Technical Bulletin 24-1, designated Exhibit E-21.
  - (22) Copy of G.S. §25-2-401(2), designated Exhibit E-22.
  - (23) Copy of the definition of the term "delivery" from page 378 of the Second College Edition of The American Heritage Dictionary, designated Exhibit E-23.
  - (24) Copy of the definition of the term "possession" from Black's Law Dictionary, designated Exhibit E-24.
  - (25) Copy of Val Pak of Central Connecticut North, Inc. v. Commissioner, 44 Conn. Supp. 133, 670 A.2d 343 (Conn. 1994), designated Exhibit E-25.

- (26) Copy of *D. H. Holmes v. McNamara*, 468 US 24, 108 S. Ct. 1619, 100 L.E.2d 21 (1988), designated Exhibit E-26.
- (27) Copy of letter dated January 11, 2005 from the Assistant Secretary of Administrative Hearings to the Taxpayer's representative, designated Exhibit E-27.

The following exhibits were submitted by the parties during or after the administrative hearing on December 4, 2003.

- (28) Brief for Tax Hearing, dated February 16, 2005 from the Division to the Assistant Secretary for Tax Administration, designated Exhibit E-28.
- (29) Memorandum In Support of Taxpayer's Protest, submitted by the Taxpayer's attorney to the Assistant Secretary for Administrative Hearings, designated Exhibit T-1.
- (30) Supplemental Memorandum in Support of Taxpayer's Protest, submitted by the Taxpayer's attorney to the Assistant Secretary for Administrative Hearings, including attachments labeled Exhibits 12 through Exhibit 16, designated Exhibit T-2.
- (31) Copy of letter dated April 1, 2005 from the Division to the Assistant Secretary of Administrative Hearings, designated Exhibit E-29.
- (32) Copy of Memorandum dated April 1, 2005 from the Division to the Assistant Secretary of Administrative Hearings, designated Exhibit E-30.
- (33) Copy of letter dated April 29, 2005 from the Taxpayer's Attorney to the Assistant Secretary of Administrative Hearings, designated Exhibit T-3.
- (34) Copy of letter dated May 6, 2005 from the Assistant Secretary of Administrative Hearings to the Taxpayer's Attorney, designated S-1.
- (35) Copy of letter dated May 23, 2005 from the Taxpayer's Attorney to the Assistant Secretary of Administrative Hearings, designated Exhibit T-4.
- (36) Copy of letter dated May 26, 2005 from the Assistant Secretary of Administrative Hearings to the Taxpayer's Attorney, designated S-2.
- (36) Copy of Taxpayer's Reply Memorandum in Support of Taxpayer's Protest and attached Affidavit of \_\_\_\_\_ dated May 26, 2005, designated Exhibit T-5.

## **FINDINGS OF FACT**

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

- (1) The Taxpayer, a direct mail advertising agency, is an independent franchisee of [Franchisor].
- (2) The franchisor publishes, prints and assembles “[Franchisor Trade Name] Envelopes” (envelopes) at its facility in [another state]. The franchisor is owned by the [Holding Company].
- (3) The Taxpayer operates as an advertising agency within 17 N.C.A.C. 07B .0901(a), and its receipts from providing professional advertising services are not subject to sales or use tax. However, the Taxpayer’s purchases of tangible personal property for use in producing advertising are subject to the general rate of State tax and applicable local sales or use tax.
- (4) The Taxpayer solicits clients in North Carolina, agrees to provide them with direct mail advertising services, arranges for the printing, publishing, and distribution of advertising materials, and causes the materials to be distributed along with other businesses’ advertisement in [Franchisor Trade Name] envelopes in this State. The Taxpayer bills its clients’ fees for direct mail advertising services.
- (5) The Taxpayer’s clients develop drafts for their advertisements, with which the Taxpayer assists and subsequently submits to the franchisor for approval. If the draft conforms to the franchisor’s requirements, the advertisement is approved to be included in the [Franchisor Trade Name] envelopes.
- (6) The Taxpayer’s clients select the Neighborhood Trade Areas (postal carrier routes) where its advertising inserts will be delivered in [Franchisor Trade Name] envelopes.
- (7) The Taxpayer supplies the franchisor with the postal carrier routes where each of its clients’ advertisements will be distributed in envelopes to the Neighborhood Trade Areas.
- (8) The Taxpayer’s franchisor, who operates as a retailer selling taxable advertising materials within 17 N.C.A.C. 07B .0901(b), prints envelopes to contain clients’ advertising materials, sells such materials to the Taxpayer and other franchisees, and distributes such materials to recipients in North Carolina. The envelopes are imprinted with national advertising sold by the franchisor, in addition to address information.

- (9) The franchisor ships the envelopes into North Carolina under a process known as “Plant Verified Drop Shipment,” which is regulated under U.S. Postal Service Publication 804.
- (10) Under Plant Verified Drop Shipment, the franchisor maintains a detached mail unit staffed by a postal employee at its place of business. The detached mail unit is not open to provide postal services to the public and exists solely to process the franchisor’s envelopes. The employee at the detached mail unit applies postage using the franchisor’s Postal Permit Number, collects postage charges, verifies that the envelopes meet postal requirements and are properly prepared for delivery under U.S. Postal Service Regulation, places the envelopes on pallets, shrink-wraps the pallets to seal the groups of envelopes, and completes U.S. Postal Service Forms 3602, 3602-RX, and 3602-HRX.
- (11) The Postal Service Forms 3602, 3602-RX, and 3602-HRX are not “Bills of Lading,” are not subject to the Federal Bill of Lading Act, and do not prove that the Taxpayer did not receive title or take possession, whether constructive or otherwise, over the advertising materials in North Carolina.
- (12) The advertising materials are distributed in two steps. First, the franchisor hires a contract or common carrier to ship the envelopes from its dock in [another state] to a Sectional U.S. Post Office located in [City], North Carolina. The carrier has physical possession of the printed advertising materials from the franchisor’s shipping dock to the dock of the [N.C. City] Sectional U.S. Post Office. Second, the advertising materials are transferred from the carriers’ trucks to the U. S. Postal Service at its [N.C. City] facility. The [N.C. City] Sectional Post Office then distributes the materials to appropriate Postal Offices, based on zip codes entered on the envelopes, for delivery to North Carolina residents as directed by the Taxpayer.
- (13) The franchisor and/or carrier are responsible for risk of loss from damage or destruction of the printed materials while in the possession and custody of the carrier during transportation between [another state] and the [N.C. City] Sectional Post Office, per U.S. Postal Service Publication 804. The risk of loss is insured under a “personal property in transit” endorsement on the holding company’s property insurance policy, but this policy only covers such losses when the advertising materials are damaged or destroyed while in transit on the carriers’ trucks. Such insurance coverage terminates when the advertising materials are transferred from the carrier to the U.S. Postal Service.
- (14) The franchisor in [another state] does not commit envelopes to the U. S. Mail outside of North Carolina. The U. S. Postal Service does not have possession, control, or bear the risk of loss of advertising materials while in transit between the franchisor’s dock and the dock of the Sectional U.S. Post Office in [City], North Carolina.

- (15) The U.S. Postal Service assumes possession and custody of the envelopes upon receipt at its Sectional Post Office in [City] North Carolina.
- (16) The franchisor conveys printed advertising material in exchange for consideration paid by the Taxpayer.
- (17) No persuasive evidence is entered in the record to show the Taxpayer does not take title to the advertising materials included in the envelopes when such materials are transferred from the carrier's trucks at the Sectional U.S. Postal Service facilities in [City], North Carolina.
- (18) The Taxpayer completes *inter vivos* gifts of the advertising materials upon delivery through and by the U.S. Postal Service to addressees in North Carolina.
- (19) The "Breakdown of Charges" issued by the franchisor to the Taxpayer in connection with each mailing of envelopes constitutes an invoice, bill of sale, or original source document recording the sale of the advertising materials.
- (20) The contract between the Taxpayer and franchisor includes provisions for the franchisor to both render services and to sell tangible personal property. The contract contains a provision requiring the materials to be delivered to designated addresses, and in the event the materials are not delivered as specified due to fault of the franchisor or the Postal Service the franchisee is entitled to a specific performance remedy of requiring the franchisor to re-mail the envelopes. This specific performance remedy does not result in the franchisor's assumption of any business risks or other risks of loss in the event the materials are damaged or destroyed while in the custody of and are being transported by the U.S. Postal Service.
- (21) The Taxpayer's purchases of tangible personal property from the franchisor are drop-shipped to North Carolina recipients to fulfill the Taxpayer's advertising contracts with North Carolina advertisers. This transaction is a three-party transaction and is distinguishable from a two-party transaction involving catalogs purchased from an out-of-state printer and imported directly by U.S. Mail into the State.
- (22) The franchisor did not collect and remit sales or use tax on its taxable retail sales in North Carolina prior to January 1, 2002. It is my understanding that the franchisor was not "engaged in business" in North Carolina prior to this date.
- (23) The Notice of Proposed assessment was mailed to the Taxpayer on April 1, 2003.
- (24) The Taxpayer notified the Department that it objected to the assessment and requested a hearing.

## CONCLUSIONS OF LAW

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

- (1) The advertising materials enclosed in the envelopes constitute “tangible personal property” within G.S. §105-164.3(46).
- (2) The transactions at issue between the franchisor and Taxpayer involving the transfer of advertising materials for consideration represents a “sale” of “tangible personal property” within G.S. §105-164.3(36).
- (3) The Taxpayer “purchases” the advertising materials from its vendor/franchisor, within G.S. §105-164.3(32) by acquiring title or constructive possession, or both, to such materials.
- (4) When the Taxpayer stipulates mailing requirements to the franchisor, it exercises dominion over the advertising materials purchased by controlling the distribution. The Taxpayer subsequently takes constructive possession and/or title to such advertising materials upon transfer at the U. S. Post Office in North Carolina where they are then committed to the U. S. Mail. The Taxpayer’s *inter vivos* gifts of the advertising materials upon delivery through and by the U.S. Postal Service to addressees in North Carolina fulfill the statutory definition of “use” in this State within G.S. §105-164.3(49), and the Taxpayer was the ultimate “consumer” thereof within G.S. §105-164.3(5).
- (5) The Sales and Use Tax Law does not exempt the Taxpayer’s purchases of tangible personal property for use in this State, before or after January 1, 2002, and there is no applicable exclusion or exception from the tax.
- (6) The Taxpayer is liable for use tax imposed by G.S. §105-164.6 on its purchase price of tangible personal property for use in this State.
- (7) 17 N.C.A.C. 07B .0901(a) provides authority for the imposition of the tax upon the Taxpayer’s purchases during all material times of the assessment period.
- (8) The change in Sales and Use Tax Technical Bulletin 7-1 regarding purchases of advertising materials by a retailer from an out-of-state printer for distribution in this State does not affect the Taxpayer’s three-party transactions. The applicable Technical Bulletin setting forth the proper application of sales tax to the Taxpayer’s transactions is Technical Bulletin Section 24-1A.3 which is prima facie correct pursuant to G.S. §105-264.
- (9) *D. H. Holmes v. McNamara*, 486 U.S. 24, 108 S. Ct. 1619, 1006 Ed.2d 21 (1988) dealt with the application of use tax to purchases of catalogs in a two-



party transaction between a retailer and an out-of-state printer that were mailed from out-of-state. This case and the Department's unpublished administrative policies regarding it are distinguishable from the Taxpayer's three-party transactions involving goods transported from out-of-state by a carrier other than the U.S. Postal Service, delivered to a North Carolina Post Office, and then distributed. The Taxpayer's transactions are factually different from those covered in Holmes.

- (11) The application of tax to transactions that are factually different does not result in disparate treatment.
- (12) The Notice of Proposed assessment was properly issued to the Taxpayer and a hearing in this matter was conducted under G.S. §105-241.1.

### **DECISION**

The Taxpayer is a franchisee of [Franchisor]. The franchisor's holding company is [Holding Company]. The Taxpayer is granted exclusive rights to sell advertising and arrange for the distribution of direct mail advertising materials through packages known as [Franchisor Trade Name] Envelopes (envelopes) within a specific territory in North Carolina. The franchisor publishes, prints, and assembles the envelopes containing advertising materials that are distributed to potential customers (recipients in North Carolina).

The advertisements are printed, stuffed into envelopes, addressed, sorted, and postage is applied in [another state] using the franchisor's Postal Permit Number. The franchisor prepares the mail and ships it under the U. S. Postal Service procedure known as Plant Verified Drop Shipment. A Detached Mail Unit is maintained at the franchisor's facility where a U.S. Postal Service employee is stationed. The postal employee confirms the amount of postage due, receives payment for the postage from

the franchisor, stacks trays of envelopes onto pallets, and shrink-wraps the trays on the pallets. The franchisor then selects and hires a contract or common carrier to ship the prepared envelopes from its printing plant in [another state] to the [N.C. City] Sectional U.S. Postal facility. U. S. Postal Service documents (Forms 3602, 3602-RX, and 3602-HRX) are completed at the time the postage is paid. Once the advertising materials reach the [N.C. City] Sectional U.S. Post Office in North Carolina, they are unloaded from the carriers' trucks and at that point committed to the custody of the U.S. Postal Service. The envelopes are subsequently transported to area U.S. Post Offices for final delivery to the North Carolina recipients. The Taxpayer receives a "Breakdown of Charges" from the franchisor in connection with each mailing which serves as an invoice for the sale of the advertisements.

The Taxpayer objects to the assessment contending (1) that it did not purchase tangible personal property for use in North Carolina because it did not take title or possession of the envelopes and (2) that it actually purchased only non-taxable advertising services based on the nature of the Franchise Agreement between the franchisor and the Taxpayer.

With reference to its first position, the Taxpayer claims that its transactions were not taxable because of the Department policy regarding retailers' purchases of catalogs from nonresident printers mailed from outside this State and distributed in this State prior to January 1, 2002. The Taxpayer claims that because the distribution of envelopes to the public is a seamless, uninterrupted process, where the materials are

mailed from out-of-state and title and possession of the envelopes passes directly from the franchisor to the recipient it did not “purchase” the advertising for “use” in this State. The Taxpayer states that it never took possession or became the owner of the printed advertising materials and argues that the U.S. Postal Service documents (Forms 3602, 3602-RX, and 3602-HRX) constitute “bills of lading” subject to the Federal Bill of Lading Act, 49 USC 801. That Act regulates the transportation of property consigned to common and contract carriers, and the Taxpayer indicates the owner of the property in transit on a carrier’s truck must be identified on the bill of lading under the Federal Bill of Lading Act. The Taxpayer contends that since it is not identified as the owner on the aforementioned postal documents, it could not have become the owner. Therefore, it was not the purchaser, user or consumer. The Taxpayer also argues that only the franchisor may re-call envelopes in transit and therefore only the franchisor has control over the envelopes until they reach the recipient’s mailbox.

The Postal Forms completed by the Taxpayer are not bills of lading, but rather are procedural U.S. Post Office forms. Therefore the Federal Bill of Lading Act does not apply to them. U.S. Postal Service delivery of mail is subject to 39 USC 52, instead of the Federal Bill of Lading Act (49 USC 801). When the envelopes reach the [N.C. City] Sectional Postal Facility and are removed from the franchisor-hired carriers’ trucks and turned over to the post office, the envelopes are segregated by zip code and transported by postal trucks to the Post Offices that handle mail for each zip code. This is not an uninterrupted, seamless movement of the advertising materials purchased by the Taxpayer. Rather, there are two distinct steps in distribution of the envelopes. One

step involves the transportation by a carrier hired by the [another state] franchisor to the Sectional Post Office in [N.C. City], North Carolina. The second step involves the transportation by the Postal Service to North Carolina residents. It is clear that the franchisor and/or the carrier it hires bears the risk of loss of the advertising materials during the first step of transportation, indicating the franchisor has title during this time. In fact, the holding company's transit endorsement insures against such risk of loss. However, the documents and evidence presented does not lead me to conclude that the franchisor had exclusive control over the materials, risk of loss, or title to the advertising materials during the second step of distribution.

Surface transportation by the Postal Service is subject to different Federal law from that of the contract or common carriers hired by the franchisor. G.S. §105-164.3(32) defines "purchase" to include acquisition effected by a transfer of title or possession, or both, and ownership is not a requirement. Therefore, whether or not the taxpayer became the "owner" and was required to be named on particular documents to show ownership under the Federal Bill of Lading Act is not necessarily relevant. No evidence in the record indicates the franchisor has exclusive ability to re-call the envelopes after they are delivered to the U. S. Post Office in [City], North Carolina.

The Taxpayer also claims that the [Franchisor Trade Name] envelopes are mailed directly from [another state] to the recipient. The Taxpayer cites *D. H. Holmes v. McNamara*, information published by the Department and the legislature regarding the effect of the January 1, 2002 law change [particularly in the definition of "use" under

G.S. §105-164.3(49)], cases that were overturned by Holmes, such as District of Columbia v. W. Bell & Co, Inc., 420 A.2d 1208 (1980), and provides copies of catalogs shipped into North Carolina from out-of-state printers in support of its position. The Taxpayer refers to the Sales and Use Tax Division's policy of not proposing to assess tax on catalogs or other printed matter sold to North Carolina retailers by out-of-state printers and committed to the U. S. Mail outside of North Carolina prior to January 1, 2002. All of the above pertains to two-party transactions, which are factually distinguishable from the Taxpayer's three-party advertising business transactions and do not support claims that distribution from out-of-state is not a taxable "use" in North Carolina prior to January 1, 2002. Effective January 1, 2002, the definition of "use" in G.S. §105-164.3(49) includes ". . . any withdrawal from storage, distribution, installation, affixation to real or personal property, or exhaustion or consumption of tangible personal property by the owner or purchaser thereof, . . ." (emphasis added).

The transactions in Holmes were two-party transactions between a retailer and an out-of-state printer where catalogs were purchased by the retailer, printed, and shipped by the printer from outside the State via U.S. Mail directly to in-state designees. The Taxpayer argues that while Holmes stood to gain economically from the distribution of catalogs in Louisiana, it stood to recognize no economic advantage from the importation of the envelopes into North Carolina. I disagree. It is evident that the Taxpayer has a profit motive in importing the materials in this State. The Taxpayer's profit comes from the difference between advertising fees charged to in-State

advertising clients and the actual cost of advertising materials purchased from its franchisor/supplier. That the Taxpayer could be held in breach of its in-State advertising contracts if the materials are not delivered to the intended recipients contradicts the Taxpayer's position.

The nature of the three-party transaction between the Taxpayer (franchisee), its advertising clients, and the franchisor distinguish the Taxpayer's transactions from those in Holmes. Additionally, in the Holmes case, the catalogs were placed in the possession and custody of the U.S. Postal Service by the printer outside the State of Louisiana and title passed outside the State. In this case, the franchisor retains title until the goods are delivered by their carrier to the [N.C. City] Sectional Post Office in North Carolina, which is another distinction from the Holmes case. Although the Department might not have assessed transactions identical to those covered in Holmes prior to January 1, 2002, no position has been published by the Department. The General Assembly was also silent on the issue; however, when G.S. §105-164.3(49) was amended the Department of Revenue was directed to impose tax upon transactions factually identical to those in Holmes effective January 1, 2002. The Taxpayer's transactions are different from those covered by the Holmes case. Therefore, any position taken by the Department on transactions factually identical to those included in Holmes would have no relevance to this case. The information the Taxpayer presents is not persuasive and does not overcome administrative authority that applies the use tax to the Taxpayer's purchases of taxable advertising materials under 17 N.C.A.C. 07B .0901(a).

The Taxpayer argues that since the Franchise Agreement between it and the franchisor provides that the franchisor will re-mail when the advertising materials are not delivered or are delivered to incorrect zip codes due to an error of the franchisor or the U.S. Postal Service, the Taxpayer never has risk of loss to the envelopes while in transit. The Taxpayer's submits that because it never has the risk of loss of the advertising materials it never takes title to the materials. The contractual provision in question does not cause the franchisor to assume the level of risk of loss as asserted, and it does not prove the Taxpayer does not have risk of loss or title to the materials. Under U.S. Postal Service Publication 804, the franchisor and their carriers are responsible for the risk of loss of the advertising materials while in transit on the carriers' trucks. The Taxpayer and the Department are in agreement on this point. However, the Department disagrees with the Taxpayer's position regarding who has the risk of loss of the materials after they are delivered to the [N.C. City] Sectional U.S. Post Office.

The Department takes the position that the carrier completes its contract with the franchisor upon delivery of the envelopes to the Sectional U.S. Post Office in [City], North Carolina. Since the transportation contract and the Franchise Agreement do not specify otherwise, the Department asserts that the provisions of the UCC should be employed to determine the transfer of title in this case, and that the consignment of advertising materials from the franchisor to their hired carrier terminates upon delivery of the advertising materials to the U.S. Post Office. It is the Department's position that

at that point the franchisor completes its performance with reference to its physical delivery of the advertising materials within G.S. §25-2-401(2). The Department has held that the Postal Service and the Taxpayer subsequently become subject to any risk of loss due to destruction or damage to the materials, which indicates the Taxpayer receives title to the materials, in absence of persuasive proof to the contrary.

The Taxpayer presented an affidavit issued by the holding company's employee attempting to show the franchisor had title during all phases of transportation, including times when the advertising materials were in the possession of the contract or common carrier and when the materials were in the possession of the U.S. Postal Service. The provisions of the Affidavit stating the franchisor had the risk of loss of and title to the advertising materials during all phases of transportation, including while in the possession of the U.S. Postal Service, is not persuasive authority. The Transit Endorsement of the holding company's property insurance policy also is not persuasive because coverage terminates when the advertising materials are taken off of the carrier's trucks in [N.C. City]. No other information has been furnished that demonstrates the Taxpayer did not take title. Therefore, it is finally determined that the Taxpayer takes title upon delivery of the advertising materials by the franchisor's carrier to the [N.C. City] Sectional U.S. Post Office and subsequently transfers title to the materials to in-State recipients as *inter vivos* gifts.

The advertising materials included in the envelopes are delivered to North Carolina addressees pursuant to instructions the Taxpayer gives when the order for



each client's advertisements is placed with the franchisor. The Taxpayer exercises constructive possession of the advertising materials through controlling the distribution of its advertising clients' materials to selected Neighborhood Trade Areas (postal carrier routes). Considering that the Taxpayer has constructive possession, title, exercises dominion over the materials, and completes gifts thereof to designated recipients in this State, the Taxpayer "uses" the property purchased in this State and is the ultimate "consumer" who must bear the burden of the tax due on its purchases.

The Taxpayer's second position is that it purchases and sells advertising services and does not purchase printed material from the franchisor, based on the preamble of the Franchise Agreement and Val Pak of Central Connecticut North, Inc. v. Commissioner, 44 Conn. Supp. 133, 670 A.2d. (343) Conn. 1994. The above court case is not instructive, because (1) the Connecticut definition of "use" stipulates ownership of the property is required, which is not applicable in North Carolina, and (2) the case deals with an assessment of use tax on the purchases of materials during the first part of the assessment period and an assessment of a newly-enacted sales tax on advertising services during the second part of the assessment period, which is also factually distinguishable from the Taxpayer's transactions.

The Taxpayer asserts that the relationship between the parties is that the franchisor is the publisher of free distribution envelopes and the Taxpayer sells the advertising in the envelopes in its geographic area. The Taxpayer contends that there is no transfer of title of the envelopes to it in North Carolina. The Taxpayer argues that

title transfers only when actual possession passes directly from the franchisor to the recipient. Further, they contend that they never “use” the envelopes because they do not purchase them. I disagree. The franchise agreement provides for sales of “mailings,” in addition to providing services, and the franchisor controls the pricing of advertising materials. The transactions in question are taxable retail sales. The Taxpayer is liable for use tax on its purchases of such materials from the out-of-state franchisor since the franchisor did not collect and remit the applicable tax due. The information and evidence presented in this case does not support the Taxpayer’s position.

In conclusion, the consideration paid by the Taxpayer to the franchisor represents a purchase of taxable tangible personal property for use in fulfilling advertising contracts in this State. The Taxpayer purchases advertising materials from the franchisor, receives title and/or has constructive possession over the materials, exercises dominion over the materials, and when the material is transferred to designated recipients the Taxpayer uses the materials in this State. The Taxpayer’s purchases of advertising materials for such use in North Carolina are taxable under 17 N.C.A.C. 07B .0901(a), and the use taxes levied by G.S. §105-164.6 and applicable local levies are appropriately due.

Therefore the proposed assessment of tax and interest is deemed correct under the law and the facts and is hereby sustained. Because the failure to pay the tax is not the result of a negligent or intentional act by the Taxpayer, I find reasonable cause to

waive the penalties. The proposed assessment of tax and accrued interest is hereby declared to be finally determined and immediately due and collectible with interest as allowed by law.

This 14th day of July, 2005.

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Eugene J. Cella  
Assistant Secretary of Revenue For  
Administrative Tax Hearings