

STATE OF NORTH CAROLINA

BEFORE THE SECRETARY OF REVENUE

COUNTY OF WAKE

OF NORTH CAROLINA

IN THE MATTER OF:

The Proposed Assessment of Sales and Use)
 Tax for the period April 1, 1995 through)
 February 28, 2001, by the Secretary of)
 Revenue of North Carolina)
)
 vs.)
)
 Taxpayer)

FINAL DECISION
Docket No. 2005-52

This matter was heard by the Assistant Secretary for Administrative Hearings, Eugene J. Cella, upon written application for hearing by the [Corporation], (Taxpayer) dated June 19, 2002 in the matter of the proposed assessment of tax, penalty and interest for the period April 1, 1995 through February 1, 2001. On February 22, 2005 the undersigned spoke with the Taxpayer’s attorney, [Taxpayer’s Attorney], concerning his letter of February 18, 2005 and the possibility of handling this matter by written communication. [Taxpayer’s Attorney] stated he would speak with his client about its options and call back later that week with the client’s decision. There was no further communication to the undersigned from [Taxpayer’s Attorney] or the Taxpayer. The hearing was held by the Assistant Secretary pursuant to the provisions of G.S. 105-260.1 and was attended by W. Timothy Holmes, Assistant Director, and Richard C. Stewart, Administration Officer, representing the Sales and Use Tax Division. Neither the Taxpayer nor a representative attended the hearing.

ISSUES

The issues to be decided in this matter are as follow:

- (1) Does the Taxpayer owe use tax on the cost of materials and parts used to maintain a helicopter owned by [Hospital #1] and used by the Taxpayer in providing helicopter services to [Hospital #1]?
- (2) Does the Taxpayer owe use tax on the cost of materials and parts used to maintain a helicopter owned and used by the Taxpayer in providing helicopter services to the [Hospital #2]?

- (3) Does the agreement to provide materials and parts for maintenance of the helicopter owned by [Hospital #1] for consideration constitute a retail sale subject to sales tax?

EVIDENCE

The following items were introduced into evidence at the hearing:

1. Copy of memorandum dated May 16, 2001 from the Secretary of Revenue to the Assistant Secretary for Administrative Hearings, designated Exhibit E-1.
2. Copy of the Field Auditor's report dated April 15, 2002 covering the period April 1, 1995 through February 28, 2001, designated Exhibit E-2.
3. Copy of Notice of Sales and Use Tax Assessment dated May 21, 2002, designated Exhibit E-3.
4. Copy of letter dated June 19, 2002, from the Taxpayer's attorney to the Sales and Use Tax Division and the following attachments, designated Exhibit E-4.
 - a. Petition and request for hearing.
 - b. Request to waive or reduce penalties.
 - c. Power of attorney, dated April 25, 2002.
 - d. Power of attorney, dated June 10, 2002.
5. Copy of letter dated July 18, 2002 from the Sales and Use Tax Division to the Taxpayer's attorney, designated Exhibit E-5.
6. Copy of letter dated July 22, 2002 from the Taxpayer's attorney to the Sales and Use Tax Division, designated Exhibit E-6.
7. Copy of letter dated August 6, 2002 from the Taxpayer's attorney to the Sales and Use Tax Division, designated Exhibit E-7.
8. Copy of letter dated August 14, 2002 from the Sales and Use Tax Division to the Taxpayer's attorney, designated Exhibit E-8.
9. Copy of letter dated August 30, 2002 from the Sales and Use Tax Division to the Taxpayer's attorney, Exhibit E-9.
10. Copy of letter dated September 27, 2002 from the Taxpayer's attorney to the Sales and Use Tax Division, designated Exhibit E-10.
11. Copy of letter dated November 1, 2002 from the Taxpayer's attorney to the Sales and Use Tax Division, designated Exhibit E-11.

12. Copy of letter dated November 20, 2002 from the Taxpayer's attorney to the Sales and Use Tax Division, designated Exhibit E-12.
13. Copy of letter dated April 18, 2003 from the Taxpayer's attorney to the examining auditor with the following attachments, designated Exhibit E-13.
 - a. Invoice summary.
 - b. Individual work orders.
 - c. Accounting records.
14. Copy of letter dated June 17, 2003 from the Taxpayer's attorney to the examining auditor with attached Exhibit A, designated Exhibit E-14.
15. Copy of the amended Field Auditor's report dated August 22, 2004 covering the period April 1, 1995 through February 28, 2001, designated Exhibit E-15.
16. Copy of Notice of Amended Sales and Use Tax Assessment dated September 3, 2004, designated Exhibit E-16.
17. Copy of letter dated September 13, 2004 from the Sales and Use Tax Division to the Taxpayer's attorney, designated Exhibit E-17.
18. Copy of letter dated October 8, 2004 with attached copy of Exhibit A from the Taxpayer's attorney to the Sales and Use Tax Division, designated Exhibit E-18.
19. Copy of letter dated November 1, 2004 from the Sales and Use Tax Division to the Taxpayer's attorney, designated Exhibit E-19.
20. Copy of agreement between the Taxpayer and [Hospital #2], designated Exhibit E-20.
21. Copy of agreement between the Taxpayer and [Hospital #1], designated Exhibit E-21.
22. Copy of letter dated February 10, 2005, from the Assistant Secretary of Revenue to the Taxpayer, designated Exhibit E-22.
23. Copy of letter dated February 18, 2005, from the Taxpayer's attorney to the Assistant Secretary of Revenue, designated Exhibit E-23.

FINDINGS OF FACT

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

1. [Taxpayer's Client #1] is defined as [Hospital #1].
2. [Taxpayer's Client #1] is defined as [Hospital #2].
3. The Taxpayer is engaged in business providing helicopter services to [Hospital #1].
4. The Taxpayer is engaged in business providing helicopter services to [Hospital #2].
5. [Hospital #1] owns the helicopter used by the Taxpayer to provide helicopter services to [Hospital #1].
6. The Taxpayer owns the helicopter that it uses to provide helicopter services to [Hospital #2].
7. The Taxpayer charges [Hospital #1] a flat monthly rate and a per hour charge to provide helicopter services.
8. The Taxpayer charges [Hospital #2] a flat monthly rate and a per hour charge to provide helicopter services.
9. The Taxpayer's agreement with [Hospital #1] requires that the Taxpayer provide a crew to fly the helicopter.
10. The Taxpayer's agreement with [Hospital #2] requires that the Taxpayer provide a crew to fly the helicopter.
11. The Taxpayer's agreement with [Hospital #1] requires that the Taxpayer provide all repair and maintenance parts and materials and labor necessary to keep the helicopter operational.
12. The Taxpayer's agreement with [Hospital #2] requires that the Taxpayer provide all repair and maintenance parts and materials and labor necessary to keep the helicopter operational.
13. The Taxpayer did not invoice [Hospital #1] for any parts or materials used by the Taxpayer in maintaining [Hospital #1]'s helicopter in good running order.

14. The Taxpayer did not invoice [Hospital #2] for any parts or materials used by the Taxpayer in maintaining the Taxpayer's helicopter in good running order.
15. There is no language in the Taxpayer's agreement with [Hospital #1] that describes the agreement as a retail sales contract.
16. There is no language in the Taxpayer's agreement with [Hospital #2] that describes the agreement as a retail sales contract.
17. The Taxpayer did not pay any State sales or use tax on the parts and materials when purchased.
18. During the agreement's term, the Taxpayer has possession and control of the helicopter owned by [Hospital #1], and [Hospital #1] cannot independently use or control the helicopter which the Taxpayer operates.
19. During the agreement's term, the Taxpayer had possession and control of the helicopter owned by it, and [Hospital #2] cannot independently use or control the helicopter which the Taxpayer owns and operates.
20. The Taxpayer's agreement with [Hospital #1] requires the Taxpayer to store and maintain a spare parts inventory on site at the North Carolina location where the helicopter is hangared in order to minimize helicopter down time for replacement parts.
21. The Taxpayer's agreement with [Hospital #2] requires the Taxpayer to store and maintain a spare parts inventory on site at the North Carolina location where the helicopter is hangared in order to minimize helicopter down time for replacement parts.
22. The Taxpayer's agreement with [Hospital #1] requires that repair parts are withdrawn from inventory only for repairs to the helicopter and are to be promptly replaced.
23. The Taxpayer's agreement with [Hospital #2] requires that repair parts are withdrawn from inventory only for repairs to the helicopter and are to be promptly replaced.
24. The Taxpayer's agreement with [Hospital #1] requires the Taxpayer to employ mechanics to repair and service the helicopter in North Carolina.
25. The Taxpayer's agreement with [Hospital #2] requires the Taxpayer to employ mechanics to repair and service the helicopter in North Carolina.
26. The Taxpayer did not invoice [Hospital #1] for repair parts and [Hospital #1] made no payment directly to the Taxpayer for repair parts and supplies.

27. The Taxpayer did not invoice [Hospital #2] for repair parts and [Hospital #2] made no payment directly to the Taxpayer for repair parts and supplies.
28. The Taxpayer's hourly flight time billings and monthly fees covered the cost of parts and supplies used in the Taxpayer's contract with [Hospital #1].
29. The Taxpayer's hourly flight time billings and monthly fees covered the cost of parts and supplies used in the Taxpayer's contract with [Hospital #2].
30. The Taxpayer is the purchaser of the parts and materials for the purpose of applying sales and use tax. The retailer of the parts and materials was the person selling to the Taxpayer.
31. A notice of sales and use tax assessment was mailed to the Taxpayer on May 21, 2002.
32. The Taxpayer's representative submitted a letter of objection on June 19, 2002 and timely requested a hearing.
33. A Notice of Amended Sales and Use Tax Assessment was mailed to the Taxpayer on September 3, 2004.

CONCLUSIONS OF LAW

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

1. The Notice of Proposed assessment was issued to the Taxpayer pursuant to G.S. 105-241.1.
2. Repair parts and materials meet the definition of "tangible personal property" defined in G.S. 105-164.3(46).
3. The Taxpayer's storage of repair parts and materials in maintaining [Hospital #1]'s helicopter meets the definition of "storage" defined in G.S. 105-164.3(44).
4. The Taxpayer's storage of repair parts and materials in maintaining the helicopter used in the [Hospital #2] agreement meets the definition of "storage" defined in G.S. 105-164.3(44).
5. Each of the Taxpayer's withdrawals from storage, installation, and consumption during service operations of repair parts and materials in maintaining [Hospital #1]'s helicopter meets the definition of "use" defined in G.S. 105-164.3(49).

6. Each of the Taxpayer's withdrawals from storage, installation, and consumption during service operations of repair parts and materials in maintaining its helicopter to provide helicopter services to [Hospital #2] meets the definition of "use" defined in G.S. 105-164.3(49).
7. G.S. 105-164.6 levies an excise tax at the general rate on the storage, use or consumption in this State of tangible personal property purchased inside or outside this State for storage, use or consumption in this State.
8. The taxable event for assessment of the use tax occurs when possession of the parts and materials is transferred to the purchaser (i.e., the Taxpayer) for storage, use or consumption within North Carolina.
9. Under the [Hospital #1] agreement, the Taxpayer did not make retail sales of parts or materials but rather the Taxpayer used parts and materials to maintain the helicopter while the Taxpayer operated the helicopter.
10. Under the [Hospital #2] agreement, the Taxpayer did not make retail sales of parts or materials, but rather the Taxpayer used parts and materials to maintain the helicopter while the Taxpayer operated the helicopter.
11. In fulfilling the [Hospital #1] agreement to provide helicopter services, the Taxpayer's maintenance is not the sale of tangible personal property.
12. In fulfilling the [Hospital #2] agreement to provided helicopter services, the Taxpayer's maintenance is not the sale of tangible personal property.
13. The Taxpayer owes use tax on the cost price of parts and materials used to maintain the helicopter used in providing helicopter services to [Hospital #1].
14. In the Taxpayer's agreement with [Hospital #2], the Taxpayer provides a crew with the helicopter; thus, no lease of tangible personal property occurs.
15. The Taxpayer does not owe sales tax on parts and materials used to maintain the helicopter used in providing helicopter services to [Hospital #1].
16. The Taxpayer owes use tax on the cost price of parts and materials used to maintain its helicopter which is used in providing helicopter services to [Hospital #2].
17. The Department's Technical Bulletins properly reflect the statutory rules which apply use tax to service providers consuming parts.
18. The service provider is using and consuming the repair parts and other materials in the performance of a service, and therefore tax is due on the purchase price of the repair parts and other materials used in performing the service.

19. The consideration paid by [Hospital #1] to the Taxpayer does not represent payment for the retail sale of parts and materials, but rather represents payment in exchange for the Taxpayer's contractual agreement to provide helicopter services.
20. The assessment as modified is correct.

DECISION

G.S. 105-164.6 provides, in part, that:

“An excise tax at the following percentage rates is imposed on the storage, use, or consumption in this State of tangible personal property purchased inside or outside the State for storage, use or consumption in the State:

“(1) At the applicable percentage rate of the purchase price of each item or article of tangible personal property that is stored, used or consumed in this State. The applicable percentage rate is the rate and the maximum tax, if any, that applies to a sale of the property that is stored, used, or consumed.”

G.S. 105-164.3(36) provides, in pertinent part:

“Sale or selling. – The transfer of title or possession of tangible personal property, conditional or otherwise, in any manner or by any means whatsoever, for a consideration paid or to be paid.”

G.S. 105-164.3(44) provides:

“Storage. – Means and includes any keeping or retention in this State for any purpose by the purchaser thereof, except sale in the regular course of business, of tangible personal property purchased from a retailer.”

G.S. 105-164.3(46) provides:

“Tangible personal property. – Personal property that may be seen, weighed, measured, felt, or touched or is in any other manner perceptible to the senses. The term includes electricity, water, gas, steam, and prewritten computer software.”

G.S. 105-164.3(49) provides:

“Use. – Means and includes the exercise of any right or power or dominion whatsoever over tangible personal property by a purchaser thereof and includes, but is not limited to, 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, but does not include the sale of tangible personal property in the regular course of business.”

Sales and Use Tax Technical Bulletin 28-4, Lump Sum Maintenance Agreements for Computer Hardware and Software, provides in part:

“The vendor or repairer is deemed to be using the repair parts and other materials in the performance of a service and tax is due on the cost price of the repair parts and other materials used in performing the service. If, however, the vendor makes a charge for parts or other materials not covered by the maintenance agreement and bills his customer for the parts or other property, the vendor is liable for collecting and remitting the tax on such transactions.” (Emphasis added)

Sales and Use Tax Technical Bulletin, 23-5, Maintenance of Leased Property, provides in Section C. 2., Optional Maintenance Agreement, that:

“If a lessor enters into a maintenance agreement to maintain leased property at the option of its customer (lessee) for a flat fee whether the agreement is a separate contract or a part of the lease of the property and no separate charge is made to his customer for parts and supplies which are used in maintaining such property, tax is not due on the receipts derived from the maintenance agreement. The lessor is deemed to be using the repair parts or supplies in the performance of a service and tax would be due on the cost price of the repair parts or supplies used in performing the service. If, however, in connection with maintenance

agreements the lessor makes a charge for parts or supplies not covered by the maintenance agreement and bills his customer for the parts or supplies, the lessor would be liable for collecting and remitting the applicable State and any local sales or use tax on such transactions.”

(Emphasis added)

Sales and Use Tax Technical Bulletin 23-6, Equipment Furnished With Operator, states :

“If the owner of tangible personal property furnishes an operator or crew to operate such property, such owner is not deemed to be renting or leasing the property but is rendering a service and the receipts therefrom are not subject to sales or use tax. Persons purchasing repair parts, lubricants and other tangible personal property for use in rendering such service are liable for payment of the applicable State and any local sales or use tax on the purchase price.” (Emphasis added)

Taxpayer's Contract With [Hospital #1]

The Taxpayer's contention that the contractual agreement with [Hospital #1] should be treated as a retail sale is neither supported by the statutes nor by the terms of the agreement. The Taxpayer contends that because the parts and materials were placed on the helicopter owned by [Hospital #1], the contract constitutes a retail sale of tangible personal property to [Hospital #1]. If, the argument continues, the transaction is treated as a sale, [Hospital #1], as a direct pay permit holder, would be responsible to

remit any use tax on the parts and materials and the tax assessed the Taxpayer should be removed from the assessment.

The definition of use includes the withdrawal from in-state storage and affixation to personal property, which the Taxpayer does in withdrawing parts and materials from inventory to service the helicopter. [Hospital #1] transferred possession and control of the helicopter to the Taxpayer under the terms of the agreement. Because Taxpayer must maintain the helicopter in airworthy condition, the helicopter [Hospital #1] receives at the end of the agreement's term will merely be in the same condition as the helicopter was at the beginning of the agreement's term. During the Taxpayer's operation and possession of the helicopter, Taxpayer will use and consume the materials and parts used to maintain the helicopter.

The overall structure and essence of the transaction is that of providing a service rather than making a retail sale. In the written agreement the Taxpayer has with [Hospital #1], there is no mention of a retail sale of tangible personal property and no language that could lead one to construe the document as a sales contract. There is nothing in the document that identifies particular, discrete articles of tangible personal property sold to [Hospital #1] at a stated price. The Taxpayer was not directly reimbursed for the parts and supplies. No invoices for parts and supplies purchased and installed on [Hospital #1]'s helicopter were prepared and tendered to [Hospital #1]. Ultimately, the Taxpayer and not [Hospital #1] will operate the helicopter consuming the parts and materials.

Applying the sales and use tax statutes to the agreement between the Taxpayer and [Hospital #1] results in finding that the Taxpayer is the purchaser of the property and use tax was due when the property was stored in North Carolina. Colonial Pipeline Co. v. Clayton, Commissioner of Revenue, 275 N.C.215. The Department's Technical Bulletins properly reflect the statutory rules which apply use tax to service providers consuming parts. The service provider is using and consuming the repair parts and other materials in the performance of a service, and therefore tax is due on the purchase price of the repair parts and other materials used in performing the service. The consideration paid by [Hospital #1] to the Taxpayer does not represent payment for the retail sale of parts and materials, but rather represents payment in exchange for the Taxpayer's contractual agreement to provide helicopter services.

Taxpayer's Contract With [Hospital #2]

In the [Hospital #2] contract, the Taxpayer owns the helicopter and charges the university a fee for the use of the helicopter with a crew provided.

Although the Taxpayer owns both the helicopter and repair parts and the Taxpayer does not set out specific objections to the assessment of use tax on the parts and materials used in the [Hospital #2] contract, use tax applies to the Taxpayer's purchases of parts and materials on the same bases as set out in the analysis of the [Hospital #1] contract. In fulfilling the agreement to provide helicopter services, the Taxpayer is the user and consumer of the parts and materials necessary to provide the

service of keeping the helicopter operational. See Sales and Use Tax Technical Bulletin 23-6.

Neither the [Hospital #1] nor the [Hospital #2] agreements contain language that could in any way be construed as a retail sales transaction. In these agreements, the Taxpayer is liable for use tax on the cost of the parts and materials used to maintain the helicopters. Wherefore the assessment is sustained in its entirety, and is declared to be final and immediately due and collectable.

Made and entered this 8th day of June, 2005.

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