

STATE OF NORTH CAROLINA

BEFORE THE ASSISTANT SECRETARY
OF REVENUE FOR ADMINISTRATIVE
TAX HEARINGS

COUNTY OF WAKE

IN THE MATTER OF:

The Proposed Assessment of Additional)
Sales and Use Tax for the Period)
December 1, 2002 through July 31, 2005)
by the Secretary of Revenue of North)
Carolina)
)
vs.)
)
[Taxpayer])

FINAL DECISION
Docket No. 2007-14

This matter was heard before the Assistant Secretary of Revenue, Eugene J. Cella, in the City of Raleigh on March 8, 2007, upon an application for hearing by the taxpayer, wherein it protested the reduction of a sales and use tax refund for the period December 1, 2002 through July 31, 2005. The hearing was held by the Assistant Secretary of Revenue under the provisions of G.S. 105-260.1. Representing the Sales and Use Tax Division were W. Timothy Holmes, Assistant Director, and Ginny Upchurch, Administration Officer. [President of the Corporation], represented the Taxpayer.

Pursuant to G.S. 105-241.1, the Department mailed a Notice of Adjustment to the Taxpayer on January 6, 2006. On December 19, 2005 and February 13, 2006, the Taxpayer's representative protested the reduction to the refund and requested a hearing before the Secretary of Revenue.

ISSUES

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

1. Is the Taxpayer liable for sales tax on the sales price of its optional maintenance agreements?
2. Does the Taxpayer owe use tax on the cost of the parts, supplies and materials used to fulfill its optional maintenance agreements?

EVIDENCE

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

- (1) Copy of Memorandum dated May 16, 2001 from the Secretary of Revenue to the Assistant Secretary of Administrative Hearings, designated Exhibit E-1.
- (2) Copy of a Business Claim for Refund State and County Sales and Use Taxes, Form E-588, dated August 30, 2005, with the Examination Division Sales and Use Tax Remarks, designated Exhibit E-2.
- (3) Copy of a letter dated November 9, 2005 from the Taxpayer to the Sales and Use Tax Division (Division), designated Exhibit E-3.
- (4) Copy of a letter dated November 23, 2005 from the Division to the Taxpayer, designated Exhibit E-4.
- (5) Copy of Auditor's Report Sales and Use Tax dated December 16, 2005 for the period December 1, 2002 through July 31, 2005, designated Exhibit E-5.
- (6) Copy of a letter dated December 19, 2005 from the Taxpayer to the Division, designated Exhibit E-6.
- (7) Copy of Notice of Adjustment Sales and Use Tax dated January 6, 2006, designated Exhibit E-7.
- (8) Copy of an undated letter from the Taxpayer received by the Division on February 13, 2006, designated Exhibit E-8.
- (9) Copy of a letter dated February 28, 2006 from the Division to the Taxpayer, designated Exhibit E-9.
- (10) Copy of a letter dated March 7, 2006, with attachment, from the Taxpayer to the Division, designated Exhibit E-10.
- (11) Copy of a letter dated April 6, 2006 from the Division to the Taxpayer, designated Exhibit E-11.
- (12) Copy of a letter dated June 8, 2006 from the Division to the Taxpayer, designated Exhibit E-12.
- (13) Copy of a letter dated June 27, 2006 from the Taxpayer to the Division and the following attachments:

- (a) Copy of an Equipment Maintenance Agreement used by the Taxpayer, designated Exhibit E-13(a).
 - (b) Copy of one of the Taxpayer's customer's invoices dated October 11, 2004 and related Equipment Maintenance Agreement, designated Exhibit E-13(b).
 - (c) Copy of one of the Taxpayer's customer's invoices dated January 5, 2005 and related Equipment Maintenance Agreement, designated Exhibit E-13(c).
- (14) Copy of a letter dated August 10, 2006 from the Division to the Taxpayer, designated Exhibit E-14.
 - (15) Copy of a letter dated January 24, 2007 from the Assistant Secretary of Administrative Hearings to the Taxpayer, designated Exhibit E-15.
 - (16) Copy of Brief for Tax Hearing prepared by the Division, designated Exhibit E-16.

The following items were introduced into evidence by the Taxpayer's Representative:

- (17) Copy of an invoice dated September 28, 2006 from [Taxpayer's competitor], designated Exhibit TP 1.
- (18) Copy of a letter dated March 27, 2007 and related attachments from the Taxpayer to the Division, designated 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 is engaged in the business of office equipment sales and support in [City], North Carolina.
2. The Taxpayer entered into optional maintenance contracts with customers and agreed to provide parts, materials, supplies and labor necessary to keep the copiers operational.
3. The Taxpayer collected and remitted sales tax on the optional maintenance agreements on a cost-per-copy basis.

4. The Taxpayer erroneously remitted tax that was not collected from customers to the Department on sales of equipment to lessors who had issued Certificates of Resale.
5. The Taxpayer submitted a Claim for Refund to the Department in the amount of \$21,692.40 to recover the tax paid to the Department on copiers and equipment sold or leased to lessors who had issued Certificates of Resale.
6. The Department denied the Taxpayer's Claim for Refund after determining the Taxpayer had failed to accrue and remit tax on the cost of the parts, supplies and materials used to fulfill its optional maintenance agreements with customers.
7. The Department completed an examination of the Taxpayer's records and reduced the Taxpayer's refund request from \$21,692.40 to \$7,052.35.
8. The Taxpayer's collection and remittance of the tax on its optional maintenance agreements is an erroneous collection of tax by the Taxpayer.
9. The Department is unable to refund the tax erroneously collected by the Taxpayer without the Taxpayer first refunding the tax collected to its customers.
10. The tax erroneously collected cannot be used by the Taxpayer to pay the use tax due the Department on the parts, supplies and materials used by the Taxpayer in fulfilling its maintenance agreements.
11. The Taxpayer's Equipment Maintenance and Supplies Agreement states the Taxpayer will ". . . perform maintenance cleaning and make inspections, adjustment, and repairs and replace defective parts without [sic] additional charge to Customer, provided such calls are made during normal business hours. . . ."
12. The Taxpayer's Equipment Maintenance and Supplies Agreement specifically includes black toner, black developer, drums or photoconductors for black copies, filter changes, fuser oil and webs as well as parts, preventative maintenance and labor.
13. The Taxpayer's Equipment Maintenance and Supplies Agreement does not include paper, transparencies, labels or staples.
14. The Taxpayer's customers purchase the paper used in the copiers from whomever they choose and pay the tax on the paper at the time of purchase.
15. The Taxpayer believes the optional maintenance contracts it is offering are cost per copy agreements that are subject to sales tax based on the number of copies allowed each month or quarter. The Taxpayer believes a sale of tangible

personal property has been made when the print button is depressed and a copy is made since toner, developer, a drum and filters are required to produce the copies.

16. In the Taxpayer's cost per copy agreement there is no sale of tangible personal property, only the agreement that the Taxpayer will provide the necessary repair parts, labor and materials to keep the copier operational.
17. The Taxpayer is providing a turnkey service for consideration based upon the number of copies produced and tax is due on the cost of the parts, supplies and materials used to provide the service.
18. It is the Department's opinion that there is no substantial difference in the traditional maintenance agreements and the cost per copy agreements used by the Taxpayer.
19. A Notice of Adjustment was mailed to the Taxpayer on January 6, 2006 showing a net refund of tax in the amount of \$7,052.35 with accrued interest in the amount of \$531.32.
20. The reduction in the Claim for Refund resulted from the Taxpayer's failure to accrue and remit use tax on cost of parts, supplies and materials used in fulfilling its optional maintenance contracts.
21. Taxpayer objected to the assessment 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. The cost per copy optional maintenance fee charged by the Taxpayer does not represent the sale of tangible personal property.
2. The optional maintenance agreements used by the Taxpayer constitute the furnishing of turnkey services for consideration based upon the number of copies produced.
3. Sales and Use Tax Technical Bulletin 23-5 C. states that a lessor is required to remit use tax on the cost of all repair parts and supplies used to maintain the equipment.

4. During the 2005 Legislative Session, Legislation was introduced to tax optional maintenance agreements and service agreements; however, the legislation did not pass.
5. There is no substantial difference in the traditional maintenance agreements and the cost per copy agreements.
6. The Taxpayer owes state and local tax on the cost of the parts, supplies and materials used by the Taxpayer in fulfilling the optional maintenance agreements.
7. The amount of the refund issued to the Taxpayer is correct.

DECISION

Therefore, it is the decision of the Assistant Secretary of Revenue For Administrative Tax Hearings that the amount of the refund issued to the Taxpayer previously is correct.

This 26th day of June 2007.

Eugene J. Cella
Assistant Secretary of Administrative Tax Hearings