STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE NORTH CAROLINA DEPARTMENT OF REVENUE
OAH NO: 08 REV 2880

[Taxpayer],	)	
Petitioner,	)	
	)	**FINAL AGENCY DECISION**
v.	)	
	)	
N. C. Department of Revenue,	)	
Respondent.	)	

THIS MATTER came before the North Carolina Department of Revenue ("Department") for final agency decision pursuant to N.C. Gen. Stat. § 150B-36. This matter came before Temporary Administrative Law Judge Robin Adams Anderson ("ALJ") in the Office of Administrative Hearings ("OAH") upon Petitioner seeking review of a Notice of Final Determination issued to Petitioner by Respondent. The ALJ heard Petitioner's motion for partial summary judgment and Respondent's motion for summary judgment on May 12, 2009 and held a telephone conference on July 15, 2009. The ALJ's Decision Granting Summary Judgment for Respondent ("Decision") was filed on November 16, 2009. The official administrative record was transmitted by OAH to the Department on November 25, 2009. On January 14, 2010, the parties agreed to extend the time frame within which the Final Agency Decision must be issued to and including February 23, 2010. After a full review of the entire record of this matter, including the official record as defined in N.C. Gen. Stat. § 150B-37(a), and upon consideration of the motions of the parties, as well as the briefs, exceptions, written arguments, proposed orders, and other documents filed or submitted by the parties, the Department makes the following Final Agency Decision.

Deletions from the Issue, Findings of Fact, and Conclusions of Law of the ALJ are marked with ~~strikethroughs~~ and additions/modifications are in **bold**.

ISSUE

The issue to be resolved in this matter is whether Petitioner is entitled to offset its use tax liability on parts and supplies purchased and used to fulfill its obligations under optional maintenance contracts with sales tax it erroneously collected from its customers ~~on the provision of such parts and supplies pursuant to those~~ **as a percentage of the total amount charged for its** optional maintenance contracts.

FINDINGS OF FACT

With regard to the ALJ's Findings of Fact and based upon the pleadings, answers to interrogatories, admissions on file, exhibits, affidavits, briefs, and other evidence in the Record, the Department decides as follows:

The Department adopts the summary of the undisputed facts as set forth in Findings of Fact Nos. 1 through 8 in the Decision of the ALJ as follows:

1. Petitioner is a North Carolina corporation engaged in the business of selling and leasing office equipment.

2. Petitioner also services the office equipment it sells and leases pursuant to maintenance agreements it enters into with its customers.

3. Petitioner's obligations under the maintenance agreements include providing maintenance and cleaning, as well as replacing items covered by the terms of the agreement.

4. Petitioner's maintenance agreements are not mandatory.

5. During the period of June 1, 2002 through August 31, 2005, Petitioner purchased various parts and supplies from vendors.

6. Petitioner did not pay sales or use tax on these purchases.

7. Petitioner used the parts and supplies in North Carolina to satisfy its maintenance obligations under the agreements.

8. Petitioner's use of parts and supplies in North Carolina to satisfy its maintenance obligations under the agreements constitutes a taxable use of tangible personal property within the meaning of N.C. Gen. Stat. § 105-164.3(49).

The Department takes exception to Findings of Fact Nos. 9 and 10 because these Findings of Fact are contrary to the preponderance of admissible evidence presented in this matter. The Department finds there is sufficient evidence to revise Findings of Fact Nos. 9 and 10 because Petitioner admitted and Respondent determined that Petitioner charged sales tax to its customers based on a percentage of the total amount billed for its optional maintenance agreements. *See* Affidavit of [Petitioner's Representative], ¶ 5; Petitioner's Prehearing Statement, ¶ 2; Petitioner's Memorandum in Support of Motion for Partial Summary Judgment, pp. 1-2; Respondent's Notice of Filing Discovery, Exhibit 2, Attachment 1: Letter from Petitioner dated March 23, 2006, p. 1; Respondent's Notice of Filing Discovery, Exhibit 3, Petitioner's Admission, ¶ 1; Affidavit of Andrew Sabol, III, Exhibit 2, Auditor's Report dated September 10, 1999, p. 3. For this reason, the Department **rejects** Findings of Fact Nos. 9 and 10 as set forth in the ALJ's Decision. The Department **revises** and **rewrites** said Findings of Fact to summarize the undisputed facts as follows:

9. Petitioner **treated its contracts with customers for optional maintenance agreements as "taxable sales" and** charged its customers sales tax **which was a percentage equal to either 25% or 40% of the total amount charged for these optional maintenance agreements** ~~on the parts and supplies provided under the maintenance agreements~~.

10. Petitioner's invoices to its customers reflected a charge for sales tax ~~attributable to the parts and supplies provided under the maintenance agreements~~ **which amount was based on a percentage of the total amount billed for the optional maintenance agreements**.

The Department adopts the summary of the undisputed facts as set forth in Findings of Fact Nos. 11 through 13 in the Decision of the ALJ as follows:

11. Petitioner's customers paid the sales tax to Petitioner as reflected on Petitioner's invoices and Petitioner remitted the tax to Respondent.

12. In an audit report dated September 10, 1999, Respondent advised Petitioner that it was liable for use tax on its purchases of parts and supplies it used to fulfill its obligations under the maintenance agreements.

13. Respondent further advised Petitioner, in the same audit report, that it should not collect sales tax from its customers on optional maintenance agreements.

The Department takes exception to Finding of Fact No. 14 because this Finding of Fact is contrary to the preponderance of admissible evidence presented in this matter. The Department finds there is sufficient evidence to revise Finding of Fact No. 14 because Petitioner admitted and Respondent determined that Petitioner charged sales tax to its customers based on a percentage of the total amount charged for its optional maintenance agreements. *See* Affidavit of [Petitioner's Representative], ¶ 5; Petitioner's Prehearing Statement, ¶ 2; Petitioner's Memorandum in Support of Motion for Partial Summary Judgment, pp. 1-2; Respondent's Notice of Filing Discovery, Exhibit 2, Attachment 1: Letter from Petitioner dated March 23, 2006, p. 1; Respondent's Notice of Filing Discovery, Exhibit 3, Petitioner's Admission, ¶ 1; Affidavit of Andrew Sabol, III, Exhibit 2, Auditor's Report dated September 10, 1999, p. 3. For this reason, the Department **rejects** Finding of Fact No. 14 as set forth in the ALJ's Decision. The Department **revises** and **rewrites** said Finding of Fact to summarize the undisputed facts as follows:

14. Petitioner failed to implement Respondent's written advice and continued to charge its customers sales tax on **a percentage of the total amount charged** ~~the parts and supplies provided pursuant to the~~ **for the optional** maintenance agreements.

The Department adopts the summary of the undisputed facts as set forth in Findings of Fact Nos. 15 through 23 in the Decision of the ALJ as follows:

15. Petitioner admits that it "improperly collected sales tax on amounts charged under its maintenance agreements" and that it should have paid use tax in connection with the parts and supplies it provided under the optional maintenance agreements.

16. Upon examination, Respondent assessed Petitioner for use tax on its purchases of parts and supplies used to satisfy its obligations under the maintenance agreements.

17. On September 26, 2008, Respondent issued its Notice of Final Determination on the disputed sales and use tax assessment for the period at issue. (Exhibit A of Affidavit of [Petitioner's Representative]).

18. On November 18, 2008, Petitioner timely filed its Petition for Contested Case Hearing.

19. On January 2, 2009, Respondent filed its Prehearing Statement.

20. On January 5, 2009, Petitioner filed its Prehearing Statement.

21. On May 1, 2009, Petitioner filed its Motion for Partial Summary Judgment and submitted a supporting Memorandum on May 7, 2009 and Supplemental Memorandum on May 18, 2009.

22. On May 1, 2009, Respondent filed its Motion for Summary Judgment and submitted a supporting Brief on May 7, 2009 and a Memorandum in Response to Petitioner's Supplemental Memorandum on May 21, 2009.

23. On May 12, 2009, the Court heard oral argument from Petitioner and Respondent on the parties' respective motions.

CONCLUSIONS OF LAW

With regard to the ALJ's Conclusions of Law and based upon the foregoing Findings of Fact, the Department decides as follows:

The Department adopts Conclusions of Law Nos. 1 through 5 of the ALJ's Decision as follows:

1. There is no genuine issue as to any material fact.

2. Sales and use taxes are "assessments upon different transactions and are bottomed upon distinguishable taxable events." *Johnston v. Gill*, 224 N.C. 638, 643, 32 S.E.2d 30, 33 (1944).

3. Sales tax is imposed upon retailers engaged in the business of selling tangible personal property in the State as a privilege tax for the right to engage in that business. N.C. Gen. Stat. § 105-164.4. Specifically, the tax is imposed on the retailer's net taxable sales or gross receipts, as applicable. *Id.*

4. Pursuant to N.C. Gen. Stat. § 105-164.7, the retailer adds "to the sales price the amount of [sales] tax due" and is liable for the "collection" and "payment" of such tax to the Secretary of Revenue.

5. Even though the legal incidence of the sales tax is on the retailer, it is designed to be passed on to the customer. *See Henderson v. Gill*, 229 N.C. 313, 316, 49 S.E.2d 754, 756 (1948) (recognizing that merchants are "statutory agents" for the collection of sales tax, which is "definitely imposed upon the consumer").

The Department determines that a portion of Conclusion of Law No. 6 is erroneous in that the portion of the statute quoted varies from the actual punctuation found in the statute. Therefore, the Department modifies Conclusion of Law No. 6 as follows:

6. By contrast, the use tax is imposed on "tangible personal property purchased inside or outside this State for storage, use**,** or consumption in this State." N.C. Gen. Stat. § 105-164.6(a).

The Department adopts Conclusion of Law No. 7 of the ALJ's Decision as follows:

7. Unlike the sales tax, both the legal incidence and liability for payment of the use tax is upon "the person who purchases . . . tangible personal property." N.C. Gen. Stat. § 105-164.6(b).

The Department determines that a portion of Conclusion of Law No. 8 is erroneous in that the citation of the Sales and Use Technical Bulletin should be consistent throughout this decision. Therefore, the Department modifies Conclusion of Law No. 8 as follows:

8. Because Petitioner's customers are not required to purchase the maintenance agreements, Petitioner's maintenance agreements are optional. *See* Sales and Use Tax Technical Bulletin § 23-5**(**C**)**.**(**1**)**(a).

The Department adopts Conclusion of Law No. 9 of the ALJ's Decision as follows:

9. Optional maintenance agreements are not subject to sales tax. *See* N.C. Gen. Stat. § 105-164.3(37) (the term "sales price" includes only those "charges by the retailer for any services necessary to complete the sale"); Sales and Use Tax Technical Bulletin § 23-5(C).

The Department determines that a portion of Conclusion of Law No. 10 is erroneous in that the word "of" should be included for better understanding of the Conclusion of Law and the citation of the Sales and Use Technical Bulletin should be consistent throughout this decision. Therefore, the Department modifies Conclusion of Law No. 10 as follows:

10. Instead, Petitioner is liable for use tax on its purchases **of** parts and supplies used to fulfill its obligations under the optional maintenance agreements. Sales and Use Tax Technical Bulletin § 23-5**(**C**)**~~.~~**(**1**)**.

The Department adopts Conclusion of Law No. 11 of the ALJ's Decision as follows:

11. Based on Petitioner's use of parts and supplies in North Carolina to fulfill its obligations with its customers, Petitioner is liable for use tax on the parts and supplies under the plain language of N.C. Gen. Stat. § 105-164.6.

The Department determines that a portion of Conclusion of Law No. 12 is erroneous as it is not based on the Findings of Fact. Therefore, the Department modifies Conclusion of Law No. 12 as follows:

12. Because optional maintenance agreements are not subject to sales tax, the sales tax Petitioner collected from its customers ~~on the parts and supplies provided pursuant to~~ **as a percentage of the total amount charged for** the maintenance agreements constitutes an erroneous collection of tax.

The Department adopts Conclusion of Law No. 13 of the ALJ's Decision as follows:

13. N.C. Gen. Stat. § 105-164.11 specifically provides that no refund of erroneously collected sales tax shall be made to "a taxpayer unless the purchaser has received credit for or has been refunded the amount of tax erroneously charged."

The Department **rejects** Conclusion of Law No. 14 because it is erroneous as a matter of law and hereby sets forth its reasons below:

Petitioner "admits that it 'improperly collected sales tax on amounts charged under its maintenance agreements' and that it should have paid use tax in connection with the parts and supplies it provided under the optional maintenance agreements." *See* ALJ's Decision, Finding of Fact No. 15. The only statute that specifically addresses excessive and erroneous collections of sales tax is N.C. Gen. Stat. § 105-164.11.

N.C. Gen. Stat. § 105-164.11 clearly and unambiguously provides that when "tax is collected for any period on . . . nontaxable sales the tax erroneously collected shall be remitted to the Secretary [of Revenue]." Significantly, this statute only allows a taxpayer to seek a refund of erroneously collected tax it remitted to the Secretary where certain conditions are satisfied. Specifically, N.C. Gen. Stat. § 105-164.11 provides that no refund shall be made "unless the purchaser has received credit for or has been refunded the amount of tax erroneously charged." N.C. Gen. Stat. § 105-164.11 therefore requires Petitioner's erroneous collections of tax to be

credited or refunded to its customers, who actually paid the tax, prior to seeking any such refund from the Respondent. Thus, N.C. Gen. Stat. § 105-164.11 does not allow Petitioner to offset its use tax liability on the parts and supplies it purchased in order to perform maintenance contracts with sales tax it erroneously charged and collected from its customers on optional maintenance agreements. Consequently, to conclude that "N.C. Gen. Stat. § 105-164.11 fails to address whether Petitioner may offset its use tax liability on the parts and supplies with sales tax it erroneously collected from its customers" is erroneous as a matter of law.

For the reasons set forth above, the Department **reverses** Conclusion of Law No. 14 as set forth in the ALJ's Decision and **revises** it to read as follows:

14. **N.C. Gen. Stat. § 105-164.11 therefore requires Petitioner's erroneous collections of sales tax to be credited or refunded to its customers, who actually paid the tax, prior to Petitioner seeking any such refund from Respondent. Thus,** N.C. Gen. Stat. § 105-164.11 ~~fails to address whether~~ **prohibits** Petitioner ~~may~~ **from** offset**ting** its use tax liability on the parts and supplies with sales tax it erroneously collected from its customers.

The Department adopts Conclusions of Law Nos. 15 and 16 of the ALJ's Decision as follows:

15. No other provision in the Revenue Act, including N.C. Gen. Stat. § 105-164.41, allows Petitioner to offset its use tax liability on the parts and supplies with sales tax it erroneously collected from its customers.

16. For the foregoing reasons, Respondent is entitled to judgment as a matter of law.

DECISION

The Department hereby decides that Respondent was entitled to summary judgment as a matter of law. The Department therefore upholds the Decision of the ALJ in the above captioned case granting Respondent's Motion for Summary Judgment, to the extent it is not revised by this Final Agency Decision. The Final Determination dated September 26, 2008 issued by Respondent to Petitioner is sustained as to the tax, penalties, and interest shown due, plus interest accruing, until the tax is paid in full.

APPEAL

Pursuant to N.C. Gen. Stat. § 150B-45, a party wishing to appeal the final decision of the Department in a contested tax case arising under N.C. Gen. Stat. § 105-241.15 may commence such an appeal by filing a Petition for Judicial Review in the Superior Court of Wake County within 30 days after being served with a written copy of this Final Agency Decision. A taxpayer who files a petition for judicial review must pay the amount of tax, penalties, and interest the

final decision states is due. N.C. Gen. Stat. § 105-241.16. The Department will calculate accrued interest and provide a payoff amount upon request.

Under N.C. Gen. Stat. § 150B-47, the Department is required to file the official record in the contested case under review, any exceptions, proposed findings of fact, or written arguments submitted to the Department, as well as the Department's Final Agency Decision, with the Clerk of Wake County Superior Court within 30 days of receipt of the Petition for Judicial Review. Consequently, a copy of the petition must be sent to the following address: North Carolina Department of Revenue, ATTN: Janice W. Davidson, 1429 Rock Quarry Road, Suite 105, Raleigh, North Carolina 27610, at the time the appeal is initiated to insure timely filing of the record.

This the 23rd day of February, 2010.

NORTH CAROLINA DEPARTMENT OF REVENUE

/s/ Janice W. Davidson

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Janice W. Davidson, Esq.
Agency Legal Specialist, II.
North Carolina Department of Revenue