

STATE OF NORTH CAROLINA

**BEFORE THE
SECRETARY OF REVENUE**

COUNTY OF WAKE

IN THE MATTER OF:

The Proposed Assessment of Additional Sales)
 and Use Tax for the period October 1, 1996)
 through September 30, 2002, by the Secretary)
 of Revenue of North Carolina)
)
 vs.)
)
 [Taxpayer])

FINAL DECISION
 Docket No. 2004-417

This matter was heard before the Assistant Secretary of Revenue, Eugene J. Cella, in the City of Raleigh, on November 30, 2004, upon application for hearing by the Taxpayer wherein it protested a proposed assessment of tax and interest for the period October 1, 1996 through September 30, 2002. The hearing was held by the Assistant Secretary pursuant to G.S. 105-260.1 and was attended by W. Timothy Holmes, Assistant Director, and M. D. Stephenson, Administration Officer, representing the Sales and Use Tax Division. Neither the Taxpayer nor a representative attended the hearing.

Pursuant to G.S. 105-241.1, the Department mailed a Notice of Proposed Assessment to the Taxpayer on May 2, 2003 assessing additional tax and interest of \$28,889.62 for the period October 1, 1996 through September 30, 2002. The Taxpayer filed a timely protest to the proposed assessment 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 collecting and remitting sales or use tax on sales of solo mailings of printed materials to purchasers in North Carolina?
- (2) Is the Taxpayer liable for the assessment of use tax on its purchases of direct mail advertising materials from its out-of-state franchisor?

EVIDENCE

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

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 sales and use tax audit report for the period October 1, 1996 through September 30, 2002, designated Exhibit E-2.
3. Copy of Notice of Sales and Use Tax Assessment dated May 13, 2003, designated Exhibit E-3.
4. Copy of notation requesting a hearing dated June 1, 2003 from the Taxpayer to the Sales and Use Tax Division on the Notice of Sales and Use Tax Assessment dated May 13, 2003, designated Exhibit E-4.
5. Copy of letter dated June 6, 2003 from the Sales and Use Tax Division (Division) to the Taxpayer, designated Exhibit E-5.
6. Copy of letter dated July 31, 2003 from the Division to the Taxpayer, designated Exhibit E-6.
7. Copy of letter dated September 18, 2003 from the Taxpayer to the examining auditor, designated Exhibit E-7.
8. Copy of letter dated October 20, 2003 from the Division to the Taxpayer, designated Exhibit E-8.
9. Copy of letter dated November 3, 2003 from the Division to the Taxpayer, designated Exhibit E-9.
10. Copy of amended sales and use tax audit report for the period February 1, 2000 through December 31, 2002, designated Exhibit E-10.
11. Copy of Notice of Amended Sales and Use Tax Assessment dated October 12, 2004, designated Exhibit E-11.
12. XXXXXXXXXXXX advertisement and coupon package, with examples, mailed to the typical North Carolina customer, designated Exhibit E-12.
13. Copy of redacted Final Decision of the Assistant Secretary of Revenue for Administrative Tax Hearings, Docket Number 2003-443 dated June 30, 2004, designated E-13.

14. Copy of Sales and Use Tax Technical Bulletin 24-1 dated June 1, 2002, designated Exhibit E-14.
15. Copy of Supreme Court Opinion, Docket Number S-94-428, dated April 5, 1996, Supreme Court of Nebraska, designated Exhibit E-15.
16. Copy of G.S. 25-2-401, Passing of title; reservation for security; limited application of this section, from the Uniform Commercial Code, designated Exhibit E-16.
17. Copy of letter dated September 22, 2004 from the Assistant Secretary of Revenue for Administrative Tax hearings to the Taxpayer, designated E-17.

FINDINGS OF FACT

Based on the foregoing evidence of record, the Assistant Secretary of Revenue for Administrative Tax Hearings makes the following findings of fact:

- (1) The Taxpayer is an independent franchisee of [Direct Mail Franchisor] (franchisor). The franchisor is headquartered in California, engaged in the business of selling advertising materials and providing direct mail advertising services.
- (2) The franchisee is located in [a city in North Carolina].
- (3) A "XXXXXXXXXXXX" is a direct mail advertising envelope containing coupons and advertisements from various retailers which is printed by XXXXXXXXXXXX, and regularly mailed in bulk to recipients in the Taxpayer's North Carolina territory. Recipients are not charged for the XXXXXXXXXXXX envelopes.
- (4) The Taxpayer has two separate transactions with customers. In some cases, it provides "solo" or individual printed items for customers and functions as a retail printing business. In other cases, it provides direct mail advertising services using XXXXXXXXXXXX envelopes.
- (5) The Taxpayer solicits clients to advertise in the XXXXXXXXXXXX and the clients either supply their own draft of their printed advertisement or the advertisement draft is prepared by the Taxpayer.
- (6) In the case of the "solo" printed advertisement the Taxpayer's clients purchased printed advertising materials. The Taxpayer then mailed the advertising materials on their customers' behalf to recipients designated by the customers.

- (7) The franchisor prints and ships from California the packages of envelopes containing franchisee customers' advertisements by truck to a U. S. Post Office distribution center in North Carolina where such envelopes are sorted by postal zip code and delivered to the appropriate post offices for distribution.
- (8) The Taxpayer is billed by the franchisor for each XXXXXXXXXXXX distribution.
- (9) The Taxpayer did not remit sales tax on sales of single, solo mailings of printed material, or use tax on group printed advertising matter (XXXXXXXXXX envelopes) it purchased. The Department assessed tax on the Taxpayer's sales of solo mailings and purchases of XXXXXXXXXXXX envelopes.
- (10) Separately stated postage charges are not subject to sales or use tax prior to January 1, 2002. The Department did not tax the Taxpayer's postage charges prior to January 1, 2002.
- (11) The Notice of Proposed Assessment was mailed to the Taxpayer on May 2, 2003.
- (12) The assessment was amended on October 12, 2004 to exclude purchases of direct mail advertising shipped directly into North Carolina by U. S. Postal Service trucks prior to January 1, 2002.
- (13) The Taxpayer timely notified the Department that it objected to the assessment and timely requested a hearing.

CONCLUSIONS OF LAW

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

- (1) G.S. 105-164.3(36) defines "Sale or selling," in part, as "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."
- (2) G.S. 105-164.3(46) defines "Tangible personal property" to include "Personal property that may be seen, weighed, measured, felt or touched or is in any other manner perceptible to the senses. . . ."
- (3) The stuffed envelopes purchased by the Taxpayer constitute tangible personal property that can be weighed, measured, felt and touched.
- (4) The Taxpayer's solo printing are taxable "retail sales" of tangible personal property under G.S. 105-164.3(34).

- (5) The Taxpayer is liable for the applicable State and local sales tax on its “net taxable sales” of individual solo printing as defined by G.S. 105-164.3(24).
- (6) G.S. 105-164.3(4), prior to January 1, 2002, provides that “‘cost price’ means the actual cost of articles of tangible personal property without any deductions therefrom on account of the cost of materials used, cash discounts, labor or service costs, transportation charges or any expenses whatsoever.”
- (7) Effective January 1, 2002, G.S. 105-164.3(33) provides that “The term [purchase price] has the same meaning as the term ‘sales price’ when applied to an item subject to use tax.”
- (8) The definition of “purchase” means “Acquired for a consideration whether . . . [t]he acquisition was effected by a transfer of title or possession, or both, or a license to use or consume . . . and . . . [t]he consideration is a price or rental in money. ”
- (9) 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.”
- (10) The transactions between the franchisor and the Taxpayer involving the transfer of tangible printed matter for consideration, which the Taxpayer used in North Carolina to fulfill advertising contracts, constitute taxable “purchases” for “use” by the Taxpayer within the meaning of G.S. 105-164.3(32) and G.S. 105-164.3(49), respectively.
- (11) The Taxpayer is liable for the applicable State and local use tax on its purchases of XXXXXXXXXXXX envelopes used in direct mail advertising in North Carolina.
- (12) The Notice of Proposed assessment was issued to the Taxpayer pursuant to G.S. 105-241.1.

DECISION

The Taxpayer is an independent franchisee of XXXXXXXXXXXX, headquartered in California. The XXXXXXXXXXXX is an envelope containing coupons and advertisements from various retailers that is mailed to residents in a specific territory on a periodic basis without charge to the addressees/recipients. The Taxpayer solicits clients who either supply their own advertisement draft or have an advertisement draft prepared by the Taxpayer which is included in the XXXXXXXXXXXX by the franchisor.

The advertisements are printed and stuffed into envelopes in California, then sent by truck to a postal distribution center in North Carolina to be mailed to donees. The franchisor bills the Taxpayer for the stuffed envelopes including all charges for postage, shipping and handling. Under these circumstances, the Taxpayer provides an advertising service and should not charge their clients sales tax for advertising in the XXXXXXXXXXXX. However, the Taxpayer is liable for tax on the "cost price" or "purchase price" of the stuffed envelopes purchased and delivered to the U. S. Post Office in North Carolina for use in performing the Taxpayer's advertising services.

The Taxpayer also prints some advertising and mails it on behalf of local businesses to their designated recipients, which constitute retail sales of taxable tangible personal property. The Taxpayer's sales price of printed materials sold to customers as "solo mailings" that were mailed to the customers' North Carolina addressees are properly subject to sale tax. Separately stated postage charges prior to January 1, 2002 are not subject to tax and are not included in the Taxpayer's

assessment. After January 1, 2002, such postage charges became part of the “sales price” of printed matter under the amended definition of the term in the Statute.

An assessment of tax is presumed to be correct, and the burden is upon a Taxpayer who takes exception to an assessment to overcome that presumption. Notice of time and place of the hearing was mailed to the Taxpayer’s last known address by first-class mail, postage prepaid, on September 22, 2004, and has not been returned by the postal service. The Taxpayer received notice of time and place of the hearing but neither the Taxpayer nor anyone representing the Taxpayer appeared at the hearing. No evidence was presented at the hearing that would tend to contradict the assessment or overcome the presumption of correctness.

Therefore, the proposed assessment of tax, penalty and interest, as amended, is deemed to be correct under the law and the facts and is hereby sustained and declared to be final and immediately due and collectible with interest as allowed by law.

This 22nd day of February 2005.

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