Technocom Bus. Sys., Inc. v. N.C. Dep't of Revenue, 2011 NCBC 1.

STATE OF NORTH CAROLINA WAKE COUNTY	IN THE GENERAL COURT OF JUSTICE SUPERIOR COURT DIVISION 10 CVS 004398
TECHNOCOM BUSINESS SYSTEMS INCORPORATED, Petitioner, v. NORTH CAROLINA DEPARTMENT OF REVENUE, Respondent.	**CORRECTED ORDER ON PETITION FOR REVIEW OF FINAL DECISION**

{1} This matter comes before the Court on a Petition for Judicial Review of a Final Agency Decision in a contested tax case arising under N.C. Gen. Stat. § 105-241.15. Technocom Business Systems, Inc. filed this appeal pursuant to N.C. Gen. Stat. § 150B-45.

{2} The Court has considered the Official Record in Contested Case, the briefs on appeal, and the oral arguments of counsel. For the reasons discussed below, the Court hereby REVERSES the decision of Office of Administrative Hearings and the Final Agency Decision of the Department of Revenue. The Court remands this case to the Office of Administrative Hearings and instructs it to GRANT partial summary judgment for Petitioner, leaving open the amount of the tax credit to which Petitioner is entitled.

Everett Gaskins & Hancock, LLP by Ed Gaskins; The Wooten Law Firm by Louis E. Wooten, III for Petitioner Technocom Business Systems, Inc.

North Carolina Department of Justice by Tenisha S. Jacobs for Respondent North Carolina Department of Revenue.

Tennille, Judge.

I.

PROCEDURAL BACKGROUND

{3} Respondent, the North Carolina Department of Revenue ("Department"), conducted an audit of Petitioner for the tax period beginning June 1, 2002 and ending September 31, 2005. Based on that audit, it issued a Notice of Final Determination ("Final Determination") of the tax owed by Petitioner on September 26, 2008.

{4} Pursuant to N.C. Gen Stat. § 150B-23(a) and N.C. Gen Stat. § 105-241.15, on November 18, 2008, Petitioner, Technocom Business Systems, Inc. ("Technocom"), filed in the Office of Administrative Hearings a Petition for Contested Case Hearing in which it sought a public hearing and an appeal of the Final Determination issued by the Department. It claimed that it was not liable for the taxes, penalties, or interest as set forth in the Final Determination and that the Department is required to credit the excess of any of the sales tax previously paid under the mistaken belief that the transactions in question were taxable sales, less the newly assessed use tax liability.

{5} Technocom filed a Motion for Partial Summary Judgment on May 1, 2009 and a Brief in Support of the Motion on May 8, 2009 in which it argued it was entitled to the requested credit, but it left unresolved the amount of credit that was due. The Department filed a Motion for Summary Judgment on May 1, 2009 and a Brief in Support of the Motion on May 7, 2009 in which it argued that Technocom is not entitled to a credit under the North Carolina Revenue Laws. The case, *Technocom Bus. Sys., Inc. v. N.C. Dep't of Revenue*, OAH No. 08 REV 2880 (Administrative Hearing Feb. 23, 2010), was heard in the Office of Administrative Hearings by The Honorable Robin Adams Anderson, Temporary Administrative Law Judge, on May 12, 2009. Judge Anderson issued a Decision Granting Summary Judgment For Respondent on November 16, 2009.

{6} The Department received Judge Anderson's decision and the official record of the case on November 25, 2009. Pursuant to N.C. Gen. Stat. § 150B-36, the Department submitted its Exceptions to the Decision Granting Summary Judgment

For Respondent on December 28, 2009. On January 19, 2010, Technocom filed its Exceptions to the Decision Granting Summary Judgment for Respondent and supporting documents.

{7} On February 23, 2010, the Department issued its Final Agency Decision. It upheld the decision of the Administrative Law Judge granting summary judgment for Respondent. The Department's Final Determination on the audit, dated September 26, 2008, was sustained as to the tax, penalties, and interest shown due, plus interest accruing until the tax is paid in full.

{8} Pursuant to N.C. Gen. Stat. § 150B-45 and § 105-241.16, Technocom filed a Petition for Judicial Review of the Final Agency Decision in the Superior Court of Wake County and a Notice of Designation pursuant to N.C. Gen Stat. § 7A-45.4(a)(7) on March 18, 2010. It asks this Court to reverse the decision of the Office of Administrative Hearings and the Final Decision issued by the Department of Revenue and to remand the case to the Office of Administrative Hearings with instructions to grant partial summary judgment in its favor.

{9} This action was designated a mandatory complex business case by Order of the Chief Justice of the Supreme Court of North Carolina dated March 19, 2010 and subsequently was assigned to the undersigned Chief Special Superior Court Judge for Complex Business Cases by Order of the Chief Special Superior Court Judge for Complex Business Cases dated March 22, 2010.

{10} The Court heard oral argument on December 10, 2010.

II.
FACTS
A.
THE PARTIES

{11} Technocom is an S Corporation organized under the laws of the State of North Carolina, having its principal place of business in Matthews, North Carolina.

{12} Respondent is the North Carolina Department of Revenue.

B.

THE AUDITS

{13} Technocom first registered for North Carolina sales and use tax purposes on January 1, 1987. For over twenty years, it has been selling and servicing office equipment, primarily copiers. As part of its business, Technocom entered into certain optional long term maintenance agreements for servicing the office equipment purchased or leased by its customers ("Service Agreements"). Its obligations under the Service Agreements include cleaning and replacing parts and supplies covered by the agreements' terms. Technocom purchased these parts and supplies from various vendors who generally do not charge it sales tax on those purchases.

{14} The Department conducted an initial audit of Technocom for the period June 1, 1987 through May 31, 1990. Following the audit, the auditor and Technocom agreed that Technocom would remit sales tax to the Department based on a percentage of the sale price of each Service Agreement. (R. at 119.) Regular maintenance agreements would be taxed at twenty-five percent (25%) of the total amount charged, and total coverage agreements would be taxed at forty percent (40%) of the total amount charged. (R. at 119.)

{15} These charges were fixed costs to Technocom's customers.

{16} Between 1990 and 2005, Technocom treated the provision of parts and supplies to its customers under the Service Agreements as taxable sales, and it charged its customers sales tax on the parts and supplies provided. (*See* R. 69–70; 119–21.) Technocom's customers paid the sales tax, and Technocom remitted the tax to the Department. Both Technocom and its customers shared the same belief: the tax that properly would be remitted to the Department as a result of the sale of the Service Agreements was for parts and supplies provided under the Service Agreements.

{17} The Department conducted a second audit of Technocom for the period January 1, 1992 through November 30, 1994, and a third audit for the period April 1, 1996 through March 31, 1999. (R. at 118.) In a report from the third audit dated

September 10, 1999, Department officials compared the amount of sales tax Technocom charged and remitted on a representative sample of Service Agreements with the tax that would have been due on the wholesale price of the actual parts and supplies used to service its customers' machines under those Service Agreements. (R. at 120.) "In each case, the tax remitted to the Department was either much more than was due or much less than was due." (R. at 120.) The percentages to which the Department and Technocom originally agreed after the first audit in 1990 did not bear any relationship to the actual activity associated with the Service Agreements. (R. at 120.) Additionally, in 1999 Technocom had software with "an excellent inventory tracking system" (R. at 120.), which, presumably, would have allowed Technocom to verify the parts and supplies provided to each customer pursuant to the Service Agreements.

{18} Still, when the Department averaged its representative sample transactions, it determined that despite the variance in the supply of parts to its customers under the Service Agreements, Technocom owed no additional tax liability. (R. at 120.)

{19} In 1999, the Department changed its advice with respect to the Service Agreements. Its auditors advised Technocom that

> going forward, tax should be accrued and remitted based on the cost of parts and supplies withdrawn from inventory and used to fulfill maintenance agreement obligations. No tax should be charged on the sale of the maintenance agreements. This is the manner which is prescribed in the North Carolina General Statutes and the Sales and Use Tax Technical Bulletins.

(R. at 120.)

{20} Technocom failed to implement the Department's advice and continued to charge its customers sales tax on a percentage of the total amount charged for the optional Service Agreements. It remitted those taxes to the Department.

{21} In 2005, the Department conducted a fourth audit of Technocom for the period June 1, 2002 through September 31, 2005. It issued a Final Determination of tax due on September 26, 2008. Consistent with its position in the 1999 audit,

the Department determined that the Service Agreements were not transactions involving the sale of personal property, and they were not subject to North Carolina sales tax. It determined that because Technocom used or consumed tangible personal property in connection with its office equipment service business, the supply of parts to its customers under the Service Agreements is subject to a use tax.

{22} Though Technocom had already remitted the sales tax on the sale of maintenance services under the Service Agreements, the Department assessed Technocom with a use tax on the parts and materials it used to fulfill its maintenance obligations under the same Service Agreements.

{23} In a letter to Mr. Upchurch at the Department of Revenue, Technocom CFO Francis T. Piet acknowledged that Technocom did not follow the Department's advice provided after the 1999 audit. (R. at 69.) It continued to charge sales tax on its maintenance contracts until December 31, 2005. (R. at 70.) It established and implemented a process to calculate a use tax based on the actual parts and supplies used to fulfill its Service Agreements in January 2006. Technocom accepts that its failure to follow the Department's instructions was "bad business practice" and it blames "[t]urnover in key positions accompanied by poor consultant advice" for the direct disconnect in the manner in which it calculated and submitted taxes to the State. (R. at 70.)

{24} Technocom does not dispute that the provision of parts and supplies to its customers pursuant to its Service Agreements should be characterized as taxable uses. It seeks a credit in the amount of sales taxes previously paid in connection with the sale of its Service Agreements against the use tax it admits it owes and has paid. The Department refused to issue the credit.

{25} The result of the Department's position is that Petitioner has now paid both a sales tax and a use tax on the same transactions. Petitioner is, for all practical purposes, precluded from recovering its excess payment unless it receives a credit. In all probability, the statute of limitations has run on a refunded claim or would run by the time Petitioner repaid its customers the sales tax and then sued

for a refund. *See* N.C. Gen. Stat. 105-261.6. That remedy would also require this small company to pay out the tax a third time before it recouped its first sales tax payments. The result of the Department's position is harsh at best and potentially fatal at worst.

III.
LEGAL STANDARD

{26} When a "trial court exercises judicial review of an agency's final decision, it acts in the capacity of an appellate court." *N.C. Dep't of Env't & Natural Res. v. Carroll*, 358 N.C. 649, 662, 599 S.E.2d 888, 896 (2004). The administrative body making the initial ruling determines the weight and sufficiency of the evidence and the credibility of the witnesses, draws inferences from the facts, and appraises conflicting and circumstantial evidence. *State ex rel. Comm'r of Ins. v. N.C. Rate Bureau*, 300 N.C. 381, 406, 269 S.E.2d 547, 565 (1980). After the administrative law judge's decision and after reviewing the official record, the applicable agency makes a "final decision" in the case. *See* N.C. Gen. Stat. § 150B-36(b) (Lexis 2010). When reviewing the final agency decision, the nature of the error alleged determines the court's appropriate standard of review. *Hillard v. N.C. Dep't of Correction*, 173 N.C. App. 594, 596, 620 S.E.2d 14, 17 (2005). Where a party "contends legal error in the agency's decision, the trial court must review *de novo*." *Id.*

{27} Here, Technocom contends that the Department erred in affirming the decision of the Office of Administrative Hearings granting summary judgment in favor of the Department and requests that this Court grant partial summary judgment in its favor. Because summary judgment is a matter of law, the appropriate standard of review for this Court is *de novo*. *Id.* at 597, 620 S.E.2d at 17.

{28} Under the *de novo* standard of review, the Court "considers the matter anew and freely substitutes its own judgment for the agency's judgment." *Mann Media, Inc., v. Randolph County Planning Bd.*, 356 N.C. 1, 13, 565 S.E.2d 9, 17

(2002) (internal brackets omitted). Under section 150B-51(b) of the Administrative Procedures Act, a court may affirm the agency's decision, "remand the case to the agency or to the administrative law judge for further proceedings," or "may also reverse or modify the agency's decision . . . ." N.C. Gen. Stat. § 150B-51(b) (Lexis 2010). "In reviewing a final agency decision allowing . . . summary judgment, . . . the court may enter any order allowed by G.S. 1A-1, Rule 12(c) or Rule 56. If the order of the court does not fully adjudicate the case, the court shall remand the case to the administrative law judge for such further proceedings as are just." N.C. Gen. Stat. § 150B-51(d) (Lexis 2010).

{29} A trial court must grant summary judgment "when there is no genuine issue of material fact and any party is entitled to a judgment as a matter of law. Summary judgment is appropriate if . . . the facts are not disputed and only a question of law remains . . . ." *Wal-Mart Stores East v. Hinton*, 197 N.C. App. 30, 37, 676 S.E.2d 634, 641 (2009). Here, both parties have filed motions for summary judgment. As the parties agree on the material facts of this dispute, a summary disposition of the claims is proper and appropriate.

IV.
ANALYSIS

{30} At issue on this appeal is whether the North Carolina Revenue Laws authorize Technocom to offset its use tax liability on the parts and supplies it provided to customers (when fulfilling its obligations under the optional Service Agreements) with the sales taxes based on the sales of those same Service Agreements it had previously remitted in error to the Department.

{31} The sales and use taxes contained within the North Carolina Sales and Use Tax Act ("Tax Act" or "Act"), N.C. Gen. Stat. §§ 105-164.1 *et seq.*, are "complementary and functional parts of one system of taxation." *Johnson v. Gill*, 224 N.C. 638, 644, 32 S.E.2d 30, 33 (1944). The purpose of this two-part scheme is, in part, "to equalize the tax burden on all state residents." *In re Assessment of*

Additional North Carolina & Orange County Use Taxes, 312 N.C. 211, 215, 322 S.E.2d 158, 158 (1984) *appeal dismissed*, 472 U.S. 1001, 105 S. Ct. 2693 (1985).

> This [equalization] is achieved through imposition of the use tax in certain situations where the sales tax is not applicable. The sales tax cannot constitutionally be imposed upon interstate sales since it would then be a tax upon the privilege of doing interstate business, and would constitute a burden upon interstate commerce in violation of the Commerce Clause of the United States Constitution. *Atwater-Waynick Hosiery Mills, Inc. v. Clayton*, 268 N.C. 673, 151 S.E.2d 574 (1966). Imposing a tax upon the retail sale of goods within the state without imposing a complementing tax on the in-state use of goods purchased outside the state might encourage North Carolina residents to shop in other states to avoid paying North Carolina sales tax. Therefore, the Act imposes a use tax on items purchased outside the state and thus not subject to sales tax, which are brought into the state for "storage, use or consumption" here. "Its chief function is to prevent the evasion of a sales tax by persons purchasing tangible personal property outside of North Carolina for storage, use or consumption within the state." *Johnston v. Gill*, 224 N.C. 638, 643-44, 32 S.E. 2d 30, 33 (1944).

Id.

{32} The assessment of a sales and a use tax "may often bring about the same result," but the taxes are different in conception. *Id.* at 215, 322 S.E.2d at 159. "They are assessments upon different transactions and are bottomed on distinguishable taxable events." *Id.* (internal quotations removed). Though dissimilar in conception and application, the sales tax and the use tax are two sides of the same coffered coin. A particular taxable transaction involving personal property can be characterized either as a sale or as a use, but each transaction generates income for the state.

{33} The Tax Act defines a "Use" as the "exercise of any right, power, or dominion whatsoever over tangible personal property, digital property, or a service by the purchaser of the property or service. The term includes withdraw from storage, distribution, . . . and exhaustion or consumption of the property or service by the owner or purchaser," but it does not include "a *sale* of property or a service in the regular course of businesses." N.C. Gen Stat. § 105-164.3 (49) (Lexis 2010) (emphasis added). The sales price for tangible personal property, digital property,

or services sold, leased, or rented includes "charges by the retailer for any services necessary to complete the sale." N.C. Gen Stat. § 105-164.3 (37) (Lexis 2010). Because the Service Agreements Technocom sold to its customers as part of the sale or lease of office equipment were optional and did not involve services necessary to complete the underlying sale of the machines, they were not included in the sales price as defined in the Tax Act. Therefore, they do not constitute a "sale" as defined in the Act, and the receipts derived from the optional Service Agreements are not subject to sales tax.

{34} N.C. Gen Stat. § 105-164.6(b) imposes liability on Technocom for its *use* of the parts and supplies provided to its customers under its optional Service Agreements. Technocom does not dispute that point. It acknowledges that the Department's assessment of a use tax is proper. It argues that it should be granted a credit for the sales tax it erroneously charged its customers and remitted to the Department against the amount of use tax assessed on the actual supply of tangible personal property under the Service Agreements.

{35} Two North Carolina statutes provide rules for determining when taxpayers are entitled to receive a monetary benefit for taxes paid in excess of their obligations. N.C. Gen. Stat. § 105-164.41, titled "Excess payments; refunds," states a general principle: that the Department should return to taxpayers the tax paid in excess of what is owed. It reads:

> If upon examination of any return . . . , it appears that an amount of tax has been paid in excess of that properly due, then the amount in excess shall be credited against any tax or installment thereof then due from the taxpayer, under any other subsequent return, or shall be refunded to the taxpayer by the Secretary . . . .

N.C. Gen. Stat. § 105-164.41 (Lexis 2010).

{36} Another more specific statute, N.C. Gen. Stat. § 105-164.11, titled "Excessive and erroneous collections," applies when taxpayers request refunds for collections of erroneous sales tax from purchasers on "exempt or nontaxable sales." Subsection (a), titled "Remittance of Over-Collections to Secretary," reads:

> When the tax collected for any period is in excess of the total amount that should have been collected, the total amount collected must be paid over to the Secretary. When tax is collected for any period on exempt or nontaxable sales the tax erroneously collected shall be remitted to the Secretary and no refund shall be made to a taxpayer unless the purchaser has received credit for or has been refunded the amount of tax erroneously charged. This provision shall be construed with other provisions of this Article and given effect so as to result in the payment to the Secretary of the total amount collected as tax if it is in excess of the amount that should have been collected.

N.C. Gen. Stat. § 105-164.11(a) (Lexis 2010).

{37} The Department argues that the only statute applicable to these facts is Section 105-164.11(a). At oral argument, it argued in the alternative that even if Section 105-164.41 also applies to these facts, the more specific provision should prevail over the more general. Technocom characterizes Section 105-164.11(a) as an exception to the general rule contained in Section 105-164.41, and it argues that because Section 105-164.11(a) does not apply to these facts, the general statue authorizing a credit or a refund for excess payments should govern this dispute.

{38} Section 105-164.41 is applicable to these facts. It requires that when a taxpayer remits a payment in excess of its tax obligation, the Department must either credit the excess against any tax then due from the taxpayer or pay the taxpayer a refund for the excess amount. The Department does not dispute that Technocom paid more total tax for the audit period than it was obligated to pay. After Technocom remitted the sales tax to the Department in error, the Department assessed a use tax on top of the erroneously collected sales tax, which Technocom paid. The tax credit made available in Section 105-164.41 applies to "any" tax owed by the taxpayer. Barring a contrary statutory directive, Technocom is authorized to receive a credit for the sales tax it remitted against the use tax assessed.

{39} The question disputed by the parties is whether Section 105-164.11(a) also applies to these facts, and if so, whether that provision serves to bar Technocom's request for a credit. The well-known doctrine of *generalia specialibus non derogant* (literally, "[g]eneral words do not derogate from special," Black's Law Dictionary

684 (6th ed. 1990)) applies here. Under the doctrine, when a matter falls under a specific statutory provision, then it must be governed by that provision and not by a more general provision. This view of the statutory interplay is consistent with the Department's alternative argument and with Technocom's argument that Section 105-164.11(a) creates an exception to the general rule contained in Section 105-164.41. If Section 105-164.11(a) is applicable to these facts, then it governs the outcome. If it is not applicable, then the more general provision governs the outcome, and the Department must provide Technocom a credit for the amount of sales tax previously remitted during the audit period.

{40} The Department argues that the plain reading of Section 105-164.11(a) demonstrates it applicability to this case. First, the statute requires that a taxpayer remit the sales tax collected on "exempt or nontaxable sales" to the Secretary. Second, the statute allows the taxpayer to receive a refund for the tax collected erroneously on "exempt or nontaxable sales" only when the purchaser receives a refund or a credit for the amount of tax improperly charged by the retailer. There is no dispute that Technocom treated the provision of parts and supplies to its customers under the optional Service Agreements as taxable sales, that it invoiced and collected sales tax from its customers on those transactions, and that it remitted the total sales tax collected to the Department. There is also no dispute that the sales tax collected on these transactions was improper. The Department's argument is simple: because a use tax is owed on these transactions and not a sales tax, the transactions must be "exempt or nontaxable sales" as contemplated by the statute. If that is true, then Section 105-164.11(a) applies here to the exclusion of Section 105-164.41. If Section 105-164.11(a) applies, then Technocom must provide its customers with a refund or a credit for the amount of sales tax improperly charged before the Department could issue a credit to Technocom. The Department argues that because Technocom does not intend to pass on the "monetary benefit" to its customers, Section 105-164.11(a) prevents it from issuing a credit. Thus, the question of who, if anyone, is getting a "monetary benefit" lies at the heart of this dispute.

{41} The Department also argues that this outcome is in keeping with the purpose of the sales tax refund statute, which is to return the erroneously collected taxes to the purchasers who actually paid the tax. It argues because "the money in question is unquestionably that of [a] third party, logic dictates that [the] taxpayer can not [sic] use it to pay [its own] debt." (Resp't's Principal Br. 11 (quoting *M & B Drilling & Constr. Co. v. State Bd. of Equalization*, 706 P.2d 243, 245 (Wyo. 1985) (internal brackets removed)).) In essence, the statute protects customers from paying the tax obligations of their sellers and prevents sellers from benefitting from a tax windfall. (*See* Resp't's Principal Br. 11–12.) This Court agrees that the statute provides that protection and serves to divert any "windfall" to the Department.

{42} Technocom argues that the exempt and nontaxable refund limitation in Section 105-164.11(a) does not prohibit the Department from crediting the sales tax it previously overpaid on the sales of the Service Agreements because those transactions are not "exempt or nontaxable sales" under the statute. It argues that Section 105-164.11(a) does apply by its express terms. Technocom stressed in its papers and at oral argument that because the parties have stipulated that the transactions at issue here are taxable uses, the Department cannot simultaneously characterize them as sales, exempt or otherwise, for the purposes of a credit. This argument misses the mark. It is *Technocom's* treatment of the transactions as sales that resulted in the erroneous payment of tax. That both parties now agree that the proper legal characterization of the transactions is a use rather than a sale does not transform the original sales tax payment into a non-erroneous use tax liability.

{43} Additionally, since Technocom seeks a credit rather than a refund, it argues that the statute does not apply. Technocom argues that the language of the statute, which prevents only refunds to retailers who do not pass on the benefit to customers and which makes no mention of tax credits, implies its inapplicability. Section 105-164.11(a) cannot be so limiting. If it were, retailers who charge customers sales tax on the first weekend in August in violation of N.C. Gen. Stat. § 105-164.13C could evade the force of the statute by simply requesting a tax credit

against any other tax owed rather than claiming a refund for the tax charged. This interpretation would allow the devious and the oblivious retailers to retain the tax windfall the Department rightly cautions against. The term "refund" contained in Section 105-164.11(a) must include a credit against tax owed. Any other interpretation would render an exception within Section 105-164.11(a) so large as to render the statute moot. If Section 105-164.11(a) is inapplicable here, as Technocom suggests, it must be based on other grounds.

{44} The Department rightly states that the purpose of Section 105-164.11(a) is to prevent retailers from obtaining windfalls on the backs of their customers. (Resp't's Principal Br. 11.) The meaning of the phrase "exempt or nontaxable sales" in Section 105-164.11(a) must be consistent with the purpose of the statute correctly described by the Department. If purchasers bear the cost of tax that is not actually owed, then those purchasers, rather than retailers who might benefit from their own sharp dealing or willful negligence with respect to their customers' and their own tax obligations, should receive a refund based on the error. If a refund is due under Section 105-164.11(a), and a retailer fails to make provisions for its customers to receive the monetary benefit, the statute allows the windfall to remain with the State. Again, this construction prevents retailers from benefitting from their own folly. It also prevents retailers from paying their own tax obligations with their customers' money. It would be inconsistent with the purpose of the statute, however, for "exempt or nontaxable sales" to include transactions that do not generate a windfall and that do not result in the unfair treatment of customers.

{45} What is crucial to this case is determining whether there is an actual windfall generated by Technocom's actions and whether Technocom's customers should be entitled to a tax refund when they originally bargained for a fixed price contract by which Technocom bears the long term risk of equipment failure.

{46} The Court first addresses the issue of the windfall. Technocom invoiced its customers for sales tax on the sale of its Service Agreements. It remitted that tax to the Department as invoiced. After the tax was remitted, the Department assessed a use tax. The use tax became due when Technocom pulled from inventory the parts

and supplies it purchased from out of state vendors and used them to conduct maintenance on its customers' machines. These customers already had contracted for this maintenance and already had been invoiced for it. Even though use taxes and sales taxes should be based on "distinguishable taxable events," *In re Assessment*, 312 N.C. at 215, 322 S.E.2d at 159, Technocom has paid the Department both a use tax and a sales tax deriving from the same transactions. It is true that the Department only assessed the use tax and that Technocom willingly paid sales tax that was not due. This fact, however, has no bearing on whether a windfall has been generated. If Technocom were to receive a credit for the sales tax it already paid from the beginning of the audit period, both parties to this dispute would be in the same position they would be in if Technocom had remitted the use taxes owed to the Department during the same period. Even though Technocom wrongfully remitted sales tax to the Department (in fact, <u>because</u> Technocom wrongfully remitted sales tax to the Department) before the use tax was assessed, it has no claim that would result in a windfall. The credit simply would make Technocom whole. The only windfall generated under these circumstances is the one created by the Department of Revenue for the Department of Revenue.

{47} Secondly, the Court must be concerned about the status of Technocom's customers who paid sales tax on transactions on which only a use tax was due. If Technocom paid its own tax obligation on the backs of its customers, then any excess tax payments, windfall or not, should belong to them. As noted above, Technocom's customers contracted for a fixed price service contract. If only routine maintenance ultimately is required on the leased or purchased machine(s) during the life of a particular Service Agreement, the amount of tax generated from parts actually supplied to that customer under that contract likely would be less than the sales tax originally paid by the customer on the sale of the Service Agreement or in accord with that amount. If, however, a leased or purchased machine developed chronic maintenance problems or a catastrophic mechanical failure, Technocom would be obligated to provide parts and supplies under a particular Service Agreement that would generate more actual tax obligation for Technocom than its

customers' initial sales tax payments covered. In that case, the customers would benefit from the original percentages taxed at twenty-five (25) or forty (40) percent.

{48} The Department's findings in its 1999 audit demonstrate this. During the 1999 audit, the Department determined that "[i]n each case, the tax remitted to the Department was either much more than was due or much less than was due." (R. at 120.) The percentages to which the Department and Technocom originally agreed after the first audit in 1990 did not bear any relationship to the actual activity associated with the maintenance agreements. (R. at 120.) This outcome is to be expected under a contract to service office equipment. Some machines deteriorate faster than others. Some machines receive more use than others. Some employees display a tendency to punish technological devices when frustrated by their complicated displays and complex workings despite well crafted corporate policies designed to encourage the ethical treatment of office equipment.

{49} The Service Agreements for the long term maintenance of office equipment allow Technocom's customers to predict their costs over time. They serve as insurance policies against the failure of a leased or purchased machine by allocating the risk of mechanical failure into that fixed cost. Technocom bears the continued risk of mechanical failure, which may result in more parts and more supplies to provide than average. During the contract negotiations, the customers who purchased the Service Agreements did not benefit whether the tax due to the Department was characterized as a use or a sale. Thus, Technocom's customers should not expect reimbursement for a tax based on a contract that already allocates each party's respective risk to mechanical failure and the resulting tax due.

{50} Transactions that do not generate a windfall and that do not result in the unfair treatment of customers are not included in the meaning of "exempt or nontaxable sales" in Section 105-164.11(a). Because the transactions at issue here are not "exempt or nontaxable sales," Section 105-164.11(a) is not applicable. The general provision contained in Section 105-164.41 governs the outcome, and

Technocom is entitled to a credit against the sales tax paid to the Department during the audit period.

{51} This result is supported by the language of Article V, Section 2(1) of the North Carolina Constitution. It states, that the "power of taxation shall be exercised in a just and equitable manner . . . ." To read Section 105-164.11(a) as requiring Technocom to reimburse its customers before receiving a credit for taxes paid twice on the same transactions when there is no windfall to the company and when its customers did not expect to receive a tax-free service under the Service Agreements raises questions of equity.

{52} The Department cites *Acton Constr. Co. v. Comm'r of Revenue*, 391 N.W.2d 828 (Minn. 1986) to argue for a different result. Both the facts and the law in that case differ than that before this Court. The most obvious and most important distinction is that *Acton Construction Co.* involved a Minnesota court ruling on a Minnesota statute containing different language than the language in Section 105-164.11(a). Also, the decision in *Acton Construction Co.* affected the tax refund for forty-five (45) Minnesota general contractors who paid a sales tax that was no longer owed after a decision of the Minnesota Supreme Court changed the state's tax rules for general contractors. *See* 391 N.W.2d at 830 n.1, 831. The contractors only paid a sales tax. They were not forced to pay a use tax in addition to the sales tax originally submitted. Thus, there was no double taxation. Had the Court ruled in the contractors' favor, they would have benefitted from a windfall. Additionally, the court rejected the argument that a fixed price contract had already allocated the risk of changes in tax liability. *Id.* at 832 n.5. Here, by contrast, the Service Agreements allocated the risk of office equipment mechanical failure and the known tax ramifications that would result from that failure.

{53} It is important to note that this opinion is narrowly drawn. It does not cover situations, for example, when a retailer collects sales tax in error when the state is precluded from collecting a use tax on the same transaction. If a retailer were to collect sales tax erroneously on a tax-free weekend in violation of N.C. Gen. Stat. § 105-164.13C, under this decision, the retailer would not be able to seek a

credit for that tax paid unless it reimbursed its customers. N.C. Gen. Stat. § 105-164.13C creates a tax holiday for both sales and use taxes. The state could not charge the retailer a use tax for that transaction. Thus, without reimbursing its customers, the retailer would improperly receive a windfall on a refund generated by those erroneous collections, and the retailers' customers would be paying a tax un-owed. Those transactions were "exempt or nontaxable sales" before this decision, and they remain so today.

V. CONCLUSION

{54} For the forgoing reasons, the Court REVERSES the decision of the Office of Administrative Hearings and the Final Agency Decision of the Department of Revenue. The Court remands this case to the Office of Administrative Hearings and instructs it to GRANT partial summary judgment for Petitioner. The Office of Administrative Hearings should determine the amount of tax credit to which Petitioner is entitled.

IT IS SO ORDERED, this 4th day of January, 2011.