

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 April 1, 2001)
 through March 31, 2004, by the Secretary of)
 Revenue of North Carolina)
)
 vs.)
)
 Taxpayer)

FINAL DECISION
 Docket No. 2005-209

This matter was heard before the Assistant Secretary of Revenue, Eugene J. Cella, in the City of Raleigh, on December 8, 2005, upon application for hearing by the Taxpayer wherein he protested the proposed assessment of tax, penalty and interest for the period April 1, 2001 through March 31, 2004. The hearing was held by the Assistant Secretary of Revenue pursuant to G.S. 105-260.1. The Sales and Use Tax Division was represented by W. Timothy Holmes, Assistant Director, and Danny R. Fulcher, Administration Officer. 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 September 21, 2004 assessing additional tax, penalty and interest of \$81,453.48 for the period April 1, 2001 through March 31, 2004. 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 tangible personal property purchased by the Taxpayer for storage, use or consumption in this State subject to use tax?
- (2) Is the machinery purchased by the Taxpayer and used in its sand pits subject to the 1% preferential rate of State tax, \$80.00 maximum tax per article, or subject to the general State and applicable local sales and use tax?

EVIDENCE

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

- E-1 Copy of Memorandum dated May 16, 2001, from the Secretary of Revenue to the Assistant Secretary of Administrative Hearings, designated Exhibit E-1.
- E-2 Copy of Auditor's Sales and Use Tax Report dated August 13, 2004, covering the period April 1, 2001 through March 31, 2004, designated Exhibit E-2.
- E-3 Copy of Notice of Sales and Use Tax Assessment dated September 21, 2004, designated Exhibit E-3.
- E-4 Copy of letter dated September 28, 2004 from the taxpayer to the Department with the attached copy of Notice of Sales and Use Tax Assessment dated September 21, 2004, designated Exhibit E-4.
- E-5 Copy of letter dated October 19, 2004 from the Sales and Use Tax Division (Division) to the Taxpayer, designated Exhibit E-5.
- E-6 Copy of letter dated December 8, 2004 from the Division to the Taxpayer, designated Exhibit E-6.
- E-7 Copy of letter dated December 23, 2004 from the Taxpayer to the Division with the attached copy of letter dated September 8, 2004 from the Taxpayer to the Revenue Field Auditor (auditor), designated Exhibit E-7.
- E-8 Copy of facsimile dated December 28, 2004 from the Taxpayer to the Division with the attached copy of a letter dated September 8, 2004 from the Taxpayer to the auditor, designated Exhibit E-8.
- E-9 Copy of facsimile dated January 5, 2005 from the auditor to the Division with the attached copy of a subcontract agreement between the Taxpayer and [a construction company], dated May 26, 2004, designated Exhibit E-9.
- E-10 Copy of letter dated January 18, 2005 from the Division to the Taxpayer, designated Exhibit E-10.
- E-11 Copy of letter dated February 21, 2005 from the Division to the Taxpayer, designated Exhibit E-11.
- E-12 Copy of letter dated March 22, 2005 from the Division to the Taxpayer, designated Exhibit E-12.

- E-13 Copy of Sales and Use Tax Technical Bulletin 2-1 A.1. (June 1, 2002), designated Exhibit E-13.
- E-14 Copy of Sales and Use Tax Technical Bulletin 4-11 H. (June 1, 2002), designated Exhibit E-14.
- E-15 Copy of Manufacturers' Certificate, Form E-575, dated September 12, 2002, issued by the Taxpayer to [Company] received via facsimile March 30, 2005, designated Exhibit E-15.
- E-16 Copy of Farmer's Certificate, Form E-599, dated January 1, 2002, issued by the Taxpayer to [an equipment dealer] received via facsimile March 30, 2005, designated Exhibit E-16.
- E-17 Copy of the Taxpayer's U. S. Corporate Income Tax Return, Form 1120, for the year 2002 received via facsimile March 30, 2005, designated Exhibit E-17.
- E-18 Copy of letter dated April 5, 2005, from the Taxpayer to the Division with the attached copy of letter dated December 23, 2004 from the Taxpayer to the Division, designated Exhibit E-18.
- E-19 Copy of letter dated April 13, 2005, from the Division to the Taxpayer, designated Exhibit E-19.
- E-20 Copy of letter dated June 16, 2005, from the Assistant Secretary of Administrative Hearings to the Taxpayer, designated Exhibit E-20.
- E-21 Copy of letter dated September 12, 2005, from the Taxpayer's representative to the Division, designated Exhibit E-21.
- E-22 Copy of letter dated September 13, 2005, from the Assistant Secretary of Administrative Hearings to the Taxpayer, designated Exhibit E-22.

FINDINGS OF FACT

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

1. During the audit period the Taxpayer at all material times was engaged in business as a grading and landscape contractor operating on a contractual basis.
2. The Taxpayer is the owner of seven pits from which it removes sand for use in fulfilling performance contracts with its customers.

3. The Taxpayer was not registered for sales and use tax purposes at the time the audit was conducted although it was previously registered for the period April 1, 2001 through September 30, 2002.
4. The Department completed an examination of the Taxpayer's business records and the Department proposed an assessment additional tax, penalty and interest for the audit period.
5. Additional tax was proposed for the audit period based on the Taxpayer's failure to remit use tax on expense items and on the difference in the 1% preferential rate of State tax, \$80.00 maximum per article, and the general State tax plus applicable local sales and use tax due on certain equipment used in the Taxpayer's pits.
6. The Taxpayer issued farmer's certificates and manufacturer's certificates to vendors of equipment used in its sand pits during the audit period.
7. The Taxpayer's subcontract agreement reflects that the Taxpayer agreed to furnish all labor, materials, and equipment necessary to perform all work required to prepare the construction site for building.
8. The subcontract is a performance or construction type contract in which the Taxpayer used sand which was obtained from pits it owned.
9. The subcontract does not reflect that the Taxpayer agreed to sell a specified quantity of tangible personal property to the owners.
10. The primary source of revenue for the Taxpayer is derived from the contracting business, and there has been no evidence presented of any retail sales of sand, topsoil or any other tangible personal property generated from the Taxpayer's pits.
11. The Taxpayer's corporate income tax return specifies the method of accounting as completed contract, the business activity as contractor, and the product or service as grading.
12. A Notice of Proposed Assessment was mailed to the Taxpayer on September 21, 2004.
13. The Taxpayer notified the Department that it protested the assessment and requested a hearing.
14. At the request of the Taxpayer, the hearing was rescheduled from September 13, 2005, to December 8, 2005.

CONCLUSIONS OF LAW

1. The Taxpayer was engaged in business during the audit period as defined in G.S. 105-164.3(9).
2. Sales and Use Tax Technical Bulletin 31-1 A. states that "Contractors are deemed to be consumers of tangible personal property which they use in fulfilling contracts and, as such, are liable for payment of the general rate of State tax and any applicable local sales or use tax on such property unless the property is subject to a lesser rate or exempt form tax by statute."
3. When a statute allows a lower rate of tax than the general rate applied, a partial exemption is created and the Taxpayer claiming an exemption bears the burden of proof that he comes within that exemption.
4. The Taxpayer is engaged in business as a contractor and not as a retailer.
5. The Taxpayer does not qualify for the reduced rate of tax available to a mine or quarry operator [G.S. 105-164.4A(2)] or to a farmer on the purchase of machinery [G.S. 105-164.4A(1)].
6. The equipment purchased by the Taxpayer is subject to the general rate of State and applicable local sales and use tax.
7. The Taxpayer is liable for the 4½% State and applicable local sales and use tax.
8. A notice of proposed assessment was issued to the Taxpayer pursuant to G.S. 105-241.1.

DECISION

It is the Taxpayer's position that the equipment in question should be subject to the 1% State rate of tax with an \$80.00 maximum per article since it is using the equipment solely for mining purposes in its own pits. The Taxpayer issued vendors either Form E-575, a Manufacturers' Certificate, or Form E-599, an Agricultural Certificate, in order to purchase the equipment at the preferential rate of tax.

The reduced rate of tax on purchases of machinery and equipment is available to mining operations but in order for an operation to be considered a mining operation there should be evidence of sales of the product of the mine. The Department asked the Taxpayer to provide invoices which evidence that it made retail sales of sand; however, none were ever furnished.

Under the provisions of G.S. 105-164.4A (1) the farmer must use the machines and machinery in planting, cultivating, harvesting or curing of farm crops. The Agricultural Certificate is for use only by farmers for use in connection with purchases, leases or rentals of farm machinery and parts and accessories thereto for the uses or purposes set forth by the Statute and is not valid when executed by a non-farmer. The Taxpayer does not engage in farming and therefore does not qualify for the reduced rate of tax for equipment used in its mining operations.

The Taxpayer's subcontract agreement (Exhibit E-9) is a performance or construction type contract. The document reflects that the Taxpayer agreed to furnish all labor, materials and equipment necessary to perform all work required to prepare the construction site for building. The terms of the contract do not state that the Taxpayer agreed to sell a specific quantity of tangible personal property such as sand to the owners. Therefore, in accordance with the provisions of G.S. 105-164.6 the Taxpayer is a user or consumer with respect to the contract and is liable for remitting the general rate of State tax and the applicable local use tax on purchases of tangible personal property for use in the performance of such contracts.

[Taxpayer] is a grading contractor whose principal and primary business activity is in the grading and landscaping industries. Its primary source of revenue is derived from the contracting business, and there has been no evidence presented of any retail sales of sand, topsoil or other tangible personal property generated from its pits. The corporate income tax return specifies the method of accounting as completed contract, the business activity as contractor, and the product or service as grading. It has been the Department's long-standing policy to consider the principal business activity in which the Taxpayer is engaged in determining the applicability of the preferred tax rate on equipment. This policy is based on an opinion of the Supreme Court of North Carolina's decision in *Henderson v. Gill*, 49 229 N C 313 (1948). The Court stated that the distinction made by the Department between the primary business engaged in by the Taxpayer and its incidental business was not an "arbitrary or capricious distinction."

It is clear that the Taxpayer is engaged in business as a contractor and not as a retailer. Since the primary business of the Taxpayer is grading contractor, it does not qualify for the reduced rate of tax available to a mine or quarry operator or to a farmer on the purchase of its machinery. The Taxpayer has produced no evidence that it would subject to the reduced rate of tax.

Therefore, the proposed assessment is deemed correct under the law and the facts and is hereby sustained in its entirety. The proposed assessment is declared to be finally determined and immediately due and collectible.

Made and entered this _____ day of _____, 2006.

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