

STATE OF NORTH CAROLINA

BEFORE THE SECRETARY OF REVENUE

COUNTY OF WAKE

OF NORTH CAROLINA

IN THE MATTER OF:

The Proposed Assessment of Sales and Use Tax for the period September 1, 1998 through May 31, 2004, by the Secretary of Revenue of North Carolina

FINAL DECISION
Docket No. 2006-114

vs.

Taxpayer

This matter was heard by the Assistant Secretary of Administrative Hearings, Eugene J. Cella, upon application for hearing by (Taxpayer), wherein they protested the proposed assessment of tax, penalty and interest for the period September 1, 1998 through May 31, 2004. The hearing was held by the Assistant Secretary pursuant to the provisions of G.S. 105-260.1 and was attended by W. Timothy Holmes, Assistant Director, and Richard C. Stewart, Administration Officer, representing the Sales and Use Tax Division. The Taxpayer was represented by attorney [attorney] and [president], president of the corporation.

Pursuant to G.S. 105-241.1, the Department mailed a Notice of Proposed Assessment to the Taxpayer on October 19, 2004, and on October 16, 2004, the Taxpayer requested a hearing before the Secretary of Revenue.

ISSUES

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

- (1) Is the Taxpayer a manufacturer subject to the preferential 1% rate of State tax with a maximum tax of \$80.00 per article on purchases of equipment used to fabricate gutters, cornices and downspouts used in fulfilling its performance contracts?
- (2) Is the Department barred from assessing the additional tax due as a result of erroneous verbal advice rendered by an employee of the Department of Revenue?

EVIDENCE

The following items were introduced 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 the Auditor's report Sales and Use Tax dated October 5, 2004 covering the period September 1, 1998 through May 31, 2004, designated Exhibit E-2.
3. Copy of Notice of Sales and Use Tax Assessment dated October 19, 2004, designated Exhibit E-3.
4. Copy of letter dated October 16, 2004, from the Taxpayer to the Sales and Use Tax Division ("Division"), designated Exhibit E-4.
5. Copy of letter dated November 18, 2004 from the Division to the Taxpayer, designated Exhibit E-5.
6. Copy of Power of Attorney from the Taxpayer's representative dated November 22, 2004, Exhibit E-6.
7. Copy of letter dated January 7, 2005 from the Division to the Taxpayer, designated Exhibit E-7.
8. Copy of letter dated January 28, 2005, with attachments from the Taxpayer's representative to the Division, designated Exhibit E-8.
9. Copy of letter dated February 4, 2005, from Division to the Taxpayer's representative, Exhibit E-9.
10. Copy of letter dated June 2, 2005, from the Taxpayer's representative to the Division with the following attachments:
 - (a) Invoices to [Taxpayer's sister corporation], customers;
 - (b) Invoices to [Taxpayer] customers;
 - (c) Invoices from suppliers of raw materials to [Taxpayer's sister corporation];
 - (d) Invoices from suppliers of raw materials to [Taxpayer], designated Exhibit E-10.
11. Copy of letter dated June 30, 2005 from the Division to the Taxpayer's representative, designated Exhibit E-11.
12. Copy of letter dated November 21, 2005, from the Taxpayer's representative to Division, designated Exhibit E-12.

13. Copy of letter dated December 6, 2005, from the Division to the Taxpayer's representative, designated Exhibit E-13.
14. Copy of letter dated January 26, 2006, and attached Offer In Compromise, Form General 74, from the Taxpayer's representative to the Division, designated Exhibit E-14.
15. Copy of the letter dated February 1, 2006 from the Taxpayer's representative to the Division with the following attachments:
 - a. Offer in Compromise, Form Gen. 74;
 - b. Collection Information Statement for Business, Form RO-1063;
 - c. Balance sheet;
 - d. Income statement;
 - e. Aging summary;
 - f. 2000 corporate income tax return;
 - g. 1999 corporate income tax return, designated Exhibit E-15.
16. Copy of letter dated February 7, 2006 from the Division to the Taxpayer's representative, designated Exhibit E-16.
17. Copy of Sales and Use Tax Technical Bulletin 34-15, dated July 1, 2005, designated Exhibit E-17.
18. Copy of letter dated April 6, 2006 from the Assistant Secretary of Administrative Hearings to the Taxpayer's representative, designated Exhibit E-18.
19. Copy of Tax Review Board Decision No. 169 dated October 29, 1980, designated Exhibit E-19.
20. Copy of Sales and Use Tax Technical Bulletin 2-1, dated July 1, 2005, designated Exhibit E-20.
21. Copy of Sales and Use Tax Technical Bulletin 31-5, dated July 1, 2005, designated Exhibit E-21.

The parties introduced the following documents into evidence during or after the hearing:

22. Copy of Court of Appeals 61 N.C. App. 725; 301 S.E.2d 511; 1983 N.C. App., designated Exhibit TP-1.
23. Copy of North Carolina Administrative Code Section .0200, dated September 30, 1977, designated Exhibit TP-2.
24. Copy of G.S. 105-264, designated Exhibit TP-3.

25. Copy of Taxpayer's brief for hearing, designated Exhibit TP-4.
26. Copy of Division's Brief for Tax Hearing, designated Exhibit ST-1.

FINDINGS OF FACT

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

1. The Taxpayer at all material times was engaged in business installing gutters, downspouts, cornices, and slate and tile roofs for homeowners and businesses.
2. The Taxpayer operates as a contractor in its installation of gutters, downspouts, cornices and slate and tile roofs for homeowners and businesses.
3. The Taxpayer did not make any retail or wholesale sales of tangible personal property which it fabricated using its equipment.
4. [name deleted] owns 100% of the stock in [Taxpayer], the Taxpayer.
5. [name deleted] owns 100% of the stock in [Taxpayer's sister corporation].
6. The Taxpayer purchased raw materials which it used to make gutters, downspouts, cornices and other similar items used in fulfilling its performance contracts.
7. [Taxpayer's sister corporation] purchased raw materials which were wrought into gutters, downspouts, and cornices and similar kinds of tangible personal property for sale to contractors and other users and consumers.
8. The Taxpayer used the equipment it purchased to fabricate tangible personal property used in fulfilling its performance contracts.
9. The equipment the Taxpayer purchased to fabricate tangible personal property for use in fulfilling its performance contracts was also used to fabricate tangible personal property for sale at retail by Taxpayer's sister corporation].
10. The Taxpayer stated that it provided the labor used in fabricating tangible personal property that was sold at retail by [Taxpayer's sister corporation].

11. The Taxpayer has provided no proof that the equipment in question was used primarily by the Taxpayer to manufacture articles that were sold by [Taxpayer's sister corporation].
12. The Taxpayer is not a manufacturing industry or plant.
13. The Taxpayer did not request or receive a written ruling from the Department regarding the application of tax on its purchases of equipment purchased and used by it and by [Taxpayer's sister corporation].
14. The Taxpayer paid 1% State tax with a maximum tax of \$80.00 per article on its purchases of the equipment used by both the Taxpayer and [Taxpayer's sister corporation].
15. The Department completed the field auditor's report on October 5, 2004 covering the period September 1, 1998 through May 31, 2004.
16. The Taxpayer was assessed the difference between the 1% State tax with a maximum tax of \$80.00 per article paid and the general rate of State tax and the applicable local tax on its purchases of the equipment used by both the Taxpayer in performance contracts and [Taxpayer's sister corporation] in fabricating tangible person property for sale.
17. The Department proposed an assessment of additional tax, penalty and interest in the amount of \$102,246.84 for the period September 1, 1998 through May 31, 2004.
18. The Notice of Sales and Use Tax Assessment was mailed to the Taxpayer on October 19, 2004.
19. The Taxpayer objected to the assessment by letter dated October 16, 2004 and made a timely request for hearing.

CONCLUSIONS OF LAW

Based on the foregoing finds of fact, the Assistant Secretary makes the following conclusions of law:

1. In the context of G.S. 105-164.4A (2), a "manufacturing industry or plant" is an entity which manufactures articles for sale or some equivalent commercial purpose.
2. In the context of G.S. 105-164.4A (2), "mill machinery" is machinery used by a "manufacturing industry or plant" to create articles for sale or some equivalent

commercial purpose, not which is used to create an article for use in the conduct of its creator's own business.

3. The Taxpayer is not a "manufacturing industry or plant" as that term is used in G.S. 105-164.4A (2) for the reason that its dominant and principal business is that of a contractor.
4. Contractors are liable for the sales or use tax on their purchases of materials used in fulfilling their performance contracts.
5. Contractors are not manufacturers even if they transform raw materials into a new and different product when it is used in fulfilling performance contracts.
6. The preferential rate of tax extended to manufacturing industries or plants under G.S. 105-164.4A (2) does not apply to contractors.
7. The Taxpayer has the burden of showing that the lower rate of tax applies.
8. A statute taxing transactions at a preferential rate is to be construed against the claim of special or preferential treatment.
9. The assessment of tax is presumed to be correct and the burden is upon the Taxpayer to show the extent, if any, to which the assessment is in error.
10. G.S. 105-264 does provide Taxpayers with a measure of protection from the assessment of additional tax based on erroneous advice given by the Department. However, the advice must be in writing in response to a Taxpayer's request and the Taxpayer must furnish adequate and accurate information to the Department on which the advice is based. The State is not barred from collecting sales or use tax on transactions even if erroneous verbal advice was given the Taxpayer by agents of the Department.
11. The Notice of Proposed assessment was issued to the Taxpayer pursuant to G.S. 105-241.1.
12. The Taxpayer is liable for the general rate of State tax and applicable county tax assessed.

DECISION

The Taxpayer is a contractor and enters into performance contracts to install gutters, downspouts, cornices and slate and tile roofs. The Taxpayer has a sister

corporation, _____, which makes retail sales of tangible personal property, such as gutters, downspouts, cornices and like items. Both the Taxpayer and [sister corporation] are 100% owned by [owner name deleted]. The Taxpayer purchased equipment that it uses in fabricating those articles needed in fulfilling its contracts and also for fabricating gutters, downspouts, cornices and like items which are sold at retail by [sister corporation].

At issue is whether or not the Taxpayer is entitled to the preferential rate of tax of 1% with a maximum tax of \$80.00 on its purchases of equipment, which is used to fabricate articles for both the Taxpayer and the Taxpayer's sister corporation.

G.S. 105-164.4A (2) provides, in part, for a 1% rate of tax with a maximum tax of \$80.00 for:

“(Repealed effective January 1, 2006) Manufacturing machinery. –
Sales of mill machinery or mill machinery parts and accessories to manufacturing industries and plants, and sales to contractors and subcontractors purchasing mill machinery or mill machinery parts and accessories for use by them in the performance of contracts with manufacturing industries and plants. . . .”

The Taxpayer puts forth three arguments in support of its protest to the assessment. First, the Taxpayer argues that the process of fabricating gutters, downspouts and cornices from raw materials constitutes the manufacture of a new and

different product and that, as held in Duke Power v. Clayton, Comr. of Revenue, 274 N.C. 505, 164 S.D.2d 289 (1989), this processing makes him a manufacturer and entitled to the preferential rate. The Taxpayer also cites Oscar Miller Paving Company v. North Carolina Tax Review Board, 61 NC App 725, 301 S.E.2d 511 (1983), where the Court of Appeals found that an asphalt contractor was entitled to the preferential rate of tax.

Neither of these cases supports the Taxpayer's position. Duke Power did not address the issue of whether or not a contractor is a manufacturer when it fabricates articles for use in its performance contracts. Likewise, in Oscar Miller Paving Company the Court of Appeals made no ruling regarding contractors operating in the capacity of manufacturers.

A statute taxing transactions at a preferential rate of tax is to be construed against the claim of special or preferential treatment and the burden is on the Taxpayer to show that he comes within the exception. A "manufacturing industry or plant" as the term is used in G.S. 105-164.4A (2), is an entity which manufactures articles for sale or some equivalent commercial purpose. In the context of G.S. 105-164.4A (2), "mill machinery" is the machinery used by the manufacturer to create an article which is to be sold or put to some equivalent commercial purpose, not machinery which is used to create an article for use in its own business. The Taxpayer is a contractor, not a "manufacturing industry or plant". The Taxpayer manufactured gutters, downspouts and cornices, but used these items in the conduct of its own business, not for sale to others.

Secondly, the Taxpayer contends that the equipment was purchased with the dual purposes of manufacturing the items it uses in its performance contracts while at the same time allowing [sister corporation] to market items for retail sale to other contractors. The Taxpayer states that while [sister corporation] purchased the raw materials, it was the Taxpayer that used the equipment and paid for the labor used to manufacture the finished product.

The Taxpayer did not make any retail or wholesale sales of tangible personal property. The Taxpayer has not provided any evidence that the equipment in question was used primarily by to fabricate articles for sale by [sister corporation] to others. Even if the Taxpayer had been able to do so, the statute requires that the machinery be sold to the manufacturing industry or plant and, in this situation, the machinery or equipment was sold to the Taxpayer, a contractor. G.S. 105-164.4A (2) provides a preferential rate of tax on sales to a particular class of taxpayer and the Taxpayer simply does not belong to that class and is, therefore, not entitled to the preferential rate.

Lastly, the Taxpayer claims that he received erroneous advice from Department personnel in applying tax to the equipment in question and therefore should not be held liable for additional tax due since he relied on the Department's advice. This issue is well settled. The Legislature has given taxpayers a measure of protection from erroneous advice given by employees of the Department in G.S. 105-264. Taxpayers are entitled to rely on written advice by the Department based on written requests for information to the extent the advice was reasonably relied upon by the taxpayer and the additional assessment did not result from the taxpayer's failure to provide adequate or

accurate information. However, there is no statutory protection for verbal information given by an agent of the Department. The Taxpayer introduced no evidence that he had ever submitted a written request for ruling or received a written ruling on the application of tax to the equipment in question.

Since the Taxpayer has an otherwise good record of tax compliance and no previous penalty waivers, the penalties are hereby waived. The additional assessment of tax and interest is sustained.

Made and entered this 24th day of August, 2006.

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