

**STATE OF NORTH CAROLINA**  
**COUNTY OF WAKE**

**BEFORE THE**  
**SECRETARY OF REVENUE**

**IN THE MATTER OF:**

The Proposed Assessment of Sales and Use )  
Tax for the period June 1, 1998 through )  
May 31, 2001, by the Secretary of )  
Revenue of North Carolina )  
 )  
vs. )  
 )  
[Taxpayer] )

**FINAL DECISION**  
Docket No. 2001-659

This matter was heard before the Assistant Secretary of Administrative Hearings, Eugene J. Cella, in the City of Raleigh, on May 2, 2002, upon application for hearing by the Taxpayer, wherein he protested the proposed assessment of tax, penalty and interest for the period June 1, 1998 through May 31, 2001. The hearing was held by the Assistant Secretary pursuant to the provisions of G.S. 105-260.1. Representing the Sales and Use Tax Division were W. Timothy Holmes, Assistant Director, and Richard C. Stewart, Administration Officer. The Taxpayer was represented by [an attorney].

Pursuant to G.S. 105-241.1, the Department mailed a Notice of Sales and Use Tax Assessment on July 25, 2001 to the Taxpayer, assessing tax, penalty and interest in the amount of \$150,637.57. The Taxpayer's accountant, on behalf of the Taxpayer, objected to the assessment in a letter dated July 16, 2001 and timely requested a hearing before the Secretary of Revenue.

**ISSUE**

The issue to be decided in this matter is as follows:

Is the Taxpayer selling mulch in the capacity of a producer which is exempt from sales and use tax pursuant G.S. 105-164.13(3)?

**EVIDENCE**

The following items were introduced 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 the face sheet of the audit report dated July 13, 2001 and copy of audit remarks, designated Exhibit E-2.
3. Copy of Notice of Sales and Use Tax Assessment dated July 25, 2001, designated Exhibit E-3.
4. Copy of letter dated July 16, 2001 from the Taxpayer's accountant to the Department of Revenue with the following attachments, designated Exhibit E-4:
  - a. Facsimile transmittal sheet from Revenue Officer to the Taxpayer.
  - b. Copy of Sales and Use Tax Technical Bulletin 9-1 dated June 1, 1996.
5. Copy of letter dated August 14, 2001 from the Sales and Use Tax Division to the Taxpayer's accountant, designated Exhibit E-5.
6. Copy of letter dated August 29, 2001 from the Taxpayer's accountant to the Sales and Use Tax Division, designated Exhibit E-6.
7. Copy of letter dated November 6, 2001 from the Assistant Secretary of Revenue to the Taxpayer, designated Exhibit E-7.
8. Copy of letter dated December 11, 2001 from the Assistant Secretary of Revenue to the Taxpayer, designated Exhibit E-8.
9. Copy of letter dated February 14, 2002 from the Assistant Secretary of Revenue to the Taxpayer, designated Exhibit E-9.
10. Copy of letter dated March 19, 2002 from the Assistant Secretary of Revenue to the Taxpayer, designated Exhibit E-10.
11. Copy of the Brief for Tax Hearing prepared by the Sales and Use Tax Division, designated Exhibit E-11.

The following evidence was presented by the Taxpayer's attorney at the hearing:

12. Copy of a brief for tax hearing presented by the Taxpayer's attorney, designated Exhibit TP-1.

### **FINDINGS OF FACT**

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

1. The Taxpayer was engaged in business making retail sales of mulch during the audit period.
2. The Taxpayer purchased wood chips from lumber mills and ground the wood chips into mulch for sale to landscapers, builders and other end users.

3. The Taxpayer did not collect or remit sales tax on its retail sales of mulch during the audit period.
4. The Department assessed sales tax on the Taxpayer's retail sales of mulch.
5. The Notice of Sales and Use Assessment was mailed to the Taxpayer on July 25, 2001.
6. The Taxpayer protested the assessment and timely requested a hearing before the Secretary of Revenue.

### **CONCLUSIONS OF LAW**

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

1. The Taxpayer was a retailer and at all material times engaged in the business of making retail sales of tangible personal property subject to sales tax.
2. The Taxpayer is not a producer of a product of the forest or mines in its original or unmanufactured state.
3. The Taxpayer is liable for the applicable State and county additional tax assessed.
4. An assessment of tax is presumed to be correct.
5. The burden is upon a taxpayer who takes exception to an assessment to overcome that presumption.
6. No evidence was presented at the hearing that would overcome the presumption of correctness.
7. The Notice of Proposed Assessment for the period of June 1, 1998 through May 31, 2001 was issued to the Taxpayer pursuant to G.S. 105-241.1.

### **DECISION**

The Taxpayer was engaged in the business of making retail sales of mulch, potting soil, sand and stone. The Taxpayer purchased wood chips from lumber mills and ground the wood chips into mulch for sale to landscapers, builders and other end users. No tax was collected or remitted on the Taxpayer's retail sales of the mulch during the audit period. The Department assessed tax on the Taxpayer's retail sales of the mulch.

The Taxpayer objected to the assessment of additional tax, penalty, and interest assessed and accrued relating to its sales of mulch. Originally, the objection was based on the

premise that the Taxpayer received erroneous written and verbal advice from an employee of the Department. However, at the hearing the Taxpayer's attorney conceded that the Department was not estopped from assessing the additional tax due as a result of erroneous advice from an employee of the Department [because the advice given was not erroneous]. The attorney advised that the Taxpayer now objects to the assessment on the basis that the Taxpayer's sales of mulch, as products of the forest in their original or unmanufactured state by the producer in his capacity as producer, are exempt from tax pursuant to G.S. 105-164.13(3). In support of his client's position, the attorney cited Duke Power Company v. Clayton, 274 N.C. 505, 164 S.E.2d 289 (1968). The North Carolina Supreme Court ruled in this case that coal sold to Duke Power by the mining company was exempt from tax under G.S. 105-164.13 (3) as a product of the mine sold by the producer in its unmanufactured state, notwithstanding that the coal was crushed and impurities removed by the mining company. The Taxpayer's argument follows that he is a producer of a product of the forest and that the grinding of wood chips into mulch, like the crushing and cleaning of coal, is not a manufacturing process and is not a reason to invalidate the application of the exemption.

G.S. 105-164.13(3) sets out two conditions of a sales transaction that must be met for the exemption to apply. The first condition is that the tangible personal property sold must be a product of the forest or mine in its original or unmanufactured state. In a case previously heard by a former Assistant Secretary of Revenue (Docket No. 94-160), a vendor put forth the argument that grinding of wood into mulch does constitute a manufacturing process and he, therefore, was entitled to the preferential rate of tax on his purchases of grinding equipment. The Assistant Secretary of Revenue agreed with the vendor that the grinding process changed the form or properties of the raw material (wood) into a new and different product and that he met the requirements of the statutes to qualify for the preferential rate of tax for manufacturing equipment. Given this precedent, it would be difficult to rule that the mulch sold by the Taxpayer is in an unmanufactured state.

The second requirement is that the product of the forest or mine must be sold by the producer in the capacity of producer. The Taxpayer did not grow the trees from which the wood chips were derived. Instead, he purchased wood chips from lumber mills, which he ground into mulch and sold at retail. Therefore, the Taxpayer is at least one step removed from being the producer of a product of the forests. In Duke Power v. Clayton, the coal, a product of the mine, was being sold by the producer or his agent. This distinction is fatal to the Taxpayer's contention that his sales of mulch are exempt under G.S. 105-164.13(3).

I find, therefore, that the Taxpayer has provided no additional information upon which to base an amendment to the assessment and has not met his burden of overcoming the presumption of correctness of the assessment. The proposed assessment of tax, penalty and interest is deemed correct under the law and the facts and is hereby sustained.

Therefore, the assessment is sustained in its entirety, and is declared to be final and immediately due and collectible.

This 19<sup>th</sup> day of June, 2002.

Signature \_\_\_\_\_

Eugene J. Cella  
Assistant Secretary of Administrative Hearings