

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE SECRETARY OF REVENUE
OF NORTH CAROLINA

IN THE MATTER OF:

The Proposed Assessment of Sales and Use)
Tax for the period September 1, 2002 through)
June 30, 2005, by the Secretary of Revenue)
)
)
vs.)
)
Taxpayer)

FINAL DECISION
Docket No. 2006-178

This matter was heard before the Assistant Secretary of Revenue for Administrative Tax Hearings, Eugene J. Cella, in the City of Raleigh, on August 24, 2006, upon application for hearing by the Taxpayer wherein it protested the assessment of tax, penalty, and interest for the period September 1, 2002 through June 3, 2005. The hearing was held by the Assistant Secretary pursuant to the provisions of G.S. 105-260.1. The Taxpayer was represented by [Taxpayer Representative], Attorney, [Officers] of the Corporation. Representing the Sales and Use Tax Division were W. Timothy Holmes, Assistant Director, and Amy A. McLemore, Administration Officer.

Pursuant to G.S. 105-241.1, the Department mailed a Notice of Sales & Use Tax Assessment to the Taxpayer on September 20, 2005. The Taxpayer's representative objected to the assessment in a letter dated October 5, 2005 and timely requested a hearing.

ISSUE

The issue to be decided is as follows:

What rate of tax applies to a screener purchased by the Taxpayer - the general rate of State and local sales or use tax, or the 1% preferential rate of State tax, with a maximum tax of \$80.00 per article?

EVIDENCE

The following items were introduced into evidence by the Department:

- (1) Memorandum dated May 16, 2001 from the Secretary of Revenue to the Assistant Secretary of Administrative Tax Hearings, designated as Exhibit E-1.
- (2) Copy of Auditors Report Sales and Use Tax dated August 30, 2005, covering the period September 1, 2002 through June 30, 2005, designated as Exhibit E-2.
- (3) Copy of Notice of Sales and Use Tax Assessment dated September 20, 2005, designated as Exhibit E-3.
- (4) Letter dated October 5, 2005, from the Taxpayer's Representative to the Department, designated as Exhibit E-4, with the following attachments:
 - (a) Notice of Sales and Use Tax Assessment dated September 20, 2005.
 - (b) Copy of Sales and Use Tax Audit Remarks.
 - (c) Federal Form 2848, Power of Attorney and Declaration of Representative, signed and dated on October 6, 2005.
- (5) Letter dated November 18, 2005, from the Taxpayer's Representative to the Department, with an attached copy of Notice of Penalty Assessment Sales & Use Tax dated November 8, 2005, designated as Exhibit E-5.
- (6) Letter dated January 24, 2006, from the Sales and Use Tax Division to the Taxpayer's Representative, designated as Exhibit E-6.
- (7) Letter dated February 7, 2006, from the Taxpayer's Representative to the Sales and Use Tax Division, designated as Exhibit E-7.
- (8) Letter dated April 11, 2006, from the Sales and Use Tax Division to the Taxpayer's Representative, designated Exhibit E-8.
- (9) Letter dated April 25, 2006, from the Taxpayer's Representative to the Sales and Use Tax Division, designated Exhibit E-9.
- (10) Section 2-1 A. of the North Carolina Sales and Use Tax Technical Bulletins, designated Exhibit E-10.
- (11) Section 4-11 H. of the North Carolina Sales and Use Tax Technical Bulletins, designated Exhibit E-11.
- (12) Copy of Opinion of Attorney General to Mr. Eric L. Gooch, Department of Revenue, 11 N.C.A.G. 511, September 15, 1971, designated Exhibit E-12.

- (13) Copy of Duke Power Company, Inc. v. Clayton, 274 N.C. 505, 164 S.E. 2d 289 (1968), designated Exhibit E-13.
- (14) Letter dated June 7, 2006, from the Assistant Secretary of Revenue to the Taxpayer's Representative, designated Exhibit E-14.
- (15) Letter dated June 23, 2006, from the Taxpayer's Representative to the Assistant Secretary of Revenue, designated Exhibit E-15.
- (16) Telecopier Cover Memorandum dated June 26, 2006, from the Taxpayer's Representative to the Assistant Secretary of Revenue, designated Exhibit E-16.
- (17) Letter dated July 5, 2006, from the Assistant Secretary of Revenue to the Taxpayer's Representative, designated Exhibit E-17.

The following items were introduced into evidence by the Taxpayer during the hearing:

- (18) A photograph of the Taxpayer's screener located in the sand pit, designated as Exhibit TP-1.
- (19) A second photograph of the Taxpayer's screener and the associated hopper, designated as Exhibit TP-2.
- (20) A third photograph showing a closer view of the Taxpayer's screener, designated as Exhibit TP-3.
- (21) A fourth photograph showing the Taxpayer's screener and its hopper from the opposite side, designated as Exhibit TP-4.
- (22) A fifth photograph showing the sand screening process, designated as Exhibit TP-5.
- (23) A sixth photograph showing the sand screening process, designated as Exhibit TP-6.

FINDINGS OF FACT

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

- (1) The Taxpayer regularly operated a quarry ("the sand pit") and sold the extracted sand, rock, and clay.

- (2) The Taxpayer purchased an Extec 6000 screener (“the screener”) for use in the sand pit.
- (3) When the Taxpayer purchased the screener, it paid sales and use tax at the 1% State rate of tax set out in G.S. 105-164.4(a)(1d).
- (4) The Taxpayer did not use the screener to extract sand, rock and clay (“material”) from the sand pit, nor could the screener have been used to extract material from the sand pit.
- (5) The Taxpayer used a trackhoe (i) to extract material from the sand pit, and (ii) to make piles of material, from which front-end loaders loaded out buckets of material.
- (6) After material was extracted, piled and loaded, it was deposited into the hopper of the screener, which was located on the floor of the sand pit.
- (7) The screener merely separated sand from rock, clay and other debris.
- (8) As such, the screener was not an accessory to any equipment used to extract material from the sand pit.
- (9) The screened sand traveled up a conveyor to a stacker, which made sand deposits.
- (10) The sand deposits consisted of mortar-quality sand, which was sold to customers in the brick-and-block-laying business.
- (11) The Taxpayer sold the rock, clay and other debris to buyers who wanted clay-based material for other purposes.
- (12) The Department assessed sales tax on the Taxpayer’s purchase of the screener at the 4½% general State rate, set out in G.S. 105-164.4(a), and the applicable local rate.
- (13) A Notice of Sales and Use Tax Assessment dated September 20, 2005 was mailed to the Taxpayer.
- (14) The Taxpayer’s representative notified the Department on October 5, 2005 that the Taxpayer objected to the assessment and timely requested a hearing.
- (15) It appears as though the Taxpayer made a good faith effort to comply with the applicable taxing statutes.

CONCLUSIONS OF LAW

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

- (1) The 1% State rate of tax set out in G.S. 105-164.4(a)(1d) applies to the sales price of articles listed in G.S. 105-164.4A.
- (2) During the period relevant to the assessment at issue, Subsection (2) of G.S. 105-164.4A provided that sales of mill machinery and mill machinery parts and accessories to manufacturing industries and plants are subject to the 1% State rate of tax.
- (3) Section 4-11 H. of the North Carolina Sales and Use Tax Technical Bulletins (“Section 4-11 H.”) clarifies how subsection (2) of G.S. 105-164.4A applied to quarries, including the Taxpayer’s sand pit.
- (4) Section 4-11 H. provides that “Quarries . . . regularly operated for the production of stone, sand, clay, marble, gravel and similar products for commercial purposes are deemed to be manufacturing plants and industries, and sales to such quarries of production machinery and parts and accessories thereto are subject to the 1% State rate of [tax.]”
- (5) Section 4-11 H. defines “production machinery” as “[p]ower shovels, drills, and similar equipment sold for use in mines or quarries *in the extractive processes*[.]” (Emphasis added).
- (6) Accordingly, extractive processes are the only manufacturing processes performed by quarries, including the Taxpayer’s sand pit.
- (7) The foregoing conclusion is bolstered by the September 15, 1971 Opinion of the Attorney General to Mr. Eric L. Gooch, Department of Revenue, 11 N.C.A.G 511, in which the Attorney General advised that (i) the screening of sand, stone, and coal are not manufacturing processes, and (ii) sand, stone, and coal that have been screened are not manufactured products, but are products of a mine in their original or unmanufactured state.
- (8) Because the screener was not used in the sand pit in an extractive process, the screener is not a piece of production machinery subject to the 1% State rate of tax.
- (9) The Notice of Proposed Assessment for the period September 1, 2002 through June 30, 2005 was properly issued pursuant to G.S. 105-241.1.
- (10) The Taxpayer is liable for the applicable State and county additional tax.

- (11) Based on the Taxpayer's good faith effort to comply with applicable law, the penalties assessed against the Taxpayer are waived pursuant to G.S. 105-237(a).

DECISION

The Taxpayer operated a sand pit during the audit period, and sold sand, rock, and gravel. The Taxpayer purchased a screener for use on the floor of the sand pit and paid its vendor the 1% State rate of tax (maximum tax of \$80.00). The Taxpayer sold the screened, mortar-quality sand to brick-and-block-laying businesses; the clay, rock, and other debris were sold to buyers who wanted clay-based material.

While the screener was located in the sand pit, it was not used to excavate the sand, nor was it an accessory to any equipment used to excavate the sand. The Taxpayer uses a trackhoe to excavate the sand. The screener is used only after extraction of the sand is completed.

The Taxpayer has argued that the screener is production equipment used in its sand mine and is, therefore, subject to the preferential 1% State rate of tax. The Taxpayer further contends that, if the screener itself is not essential to the production process of the mine and is not classified as production equipment, then it is an accessory to production equipment. The Taxpayer argues the screener adds to the marketability of the mortar-quality sand sold to brick-and-block-laying businesses; therefore, it is an accessory to the extraction equipment and is subject to the 1% State rate of tax.

The 1% State rate of tax, with a maximum tax of \$80.00 per article, is a preferential rate of tax that, prior to January 1, 2006, applied only to certain transactions, one of those being sales of mill machinery and mill machinery parts and accessories to manufacturing industries and plants.

Because quarries and mines are special types of manufacturers, Section 4-11 H. of the North Carolina Sales and Use Tax Technical Bulletins provides, in part, that sales to such quarries “. . . of production machinery and parts and accessories thereto are subject to the 1% State rate of sales or use tax, with a maximum tax of \$80.00 per article. . . .” Power shovels, drills, and similar equipment sold for use in mines or quarries in the extractive processes are classified as production machinery. However, the Bulletin specifies that if the equipment in question is not used in the mine or in the production (extraction) processes of the mine or quarry, it does not qualify as production equipment and is subject to the general rate of State tax and any applicable local sales or use tax.

The Opinion of the Attorney General supports the Technical Bulletins, as it specifically advises that the North Carolina Courts have ruled that the crushing, washing, and/or screening of sand, stone, and coal are not manufacturing processes. The Attorney General’s Opinion concludes that sand, stone, and coal that have been screened, crushed, or cleaned are not manufactured products, but are products of a mine in their original or unmanufactured state.

The Taxpayer’s purchase of the screener is not a purchase of mill machinery or an accessory to mill machinery subject to the 1% State rate of tax, but rather is a

purchase of equipment subject to the general State rate of tax and the applicable local rate of tax.

It is the decision of the Assistant Secretary of Revenue that the proposed assessment of additional sales and use tax plus accrued interest is deemed to be correct under the facts and is hereby sustained. Because the Taxpayer did make a good faith attempt to comply with the North Carolina Statutes, I find reasonable cause to waive the penalties. The proposed assessment is hereby declared to be finally determined and immediately due and collectible with interest thereon as permitted by law.

Made and entered this 3rd day of November 2006.

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