

**STATE OF NORTH CAROLINA**

**BEFORE THE ASSISTANT SECRETARY  
OF REVENUE FOR ADMINISTRATIVE  
TAX HEARINGS**

**COUNTY OF WAKE**

**IN THE MATTER OF:**

The Proposed Assessment of Sales and Use )  
 Tax for the period January 1, 2002 through )  
 December 31, 2004, by the Secretary of )  
 Revenue )  
 )  
 )  
 vs. )  
 )  
 [Taxpayer] )

**FINAL DECISION**  
 Docket No. 2007-12

This matter was heard before the Assistant Secretary of Revenue for Administrative Tax Hearings, Eugene J. Cella, in the City of Raleigh, on March 13, 2007, upon application for hearing by the Taxpayer wherein it protested the assessment of tax, penalty, and interest for the period January 1, 2002 through December 31, 2004. The hearing was held by the Assistant Secretary pursuant to the provisions of G.S. 105-260.1. The Taxpayer was represented by [employee of the company], President, [employee of the company], Controller of a related firm, [an LLC], and [employee], Tax Manager. 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 August 8, 2006. The Taxpayer's representative objected to the assessment in a letter dated September 6, 2006 and timely requested a hearing.

**ISSUE**

The issue to be decided is as follows:

Are the bakery items the Taxpayer prepares and then sells in its thrift stores sales of prepared food subject to the general State rate and applicable local rate of sales or use tax?

## 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 June 1, 2006, covering the period January 1, 2002 through December 31, 2004, designated as Exhibit E-2.
- (3) Copy of Notice of Sales and Use Tax Assessment dated August 8, 2006, designated as Exhibit E-3.
- (4) Copy of letter dated September 6, 2006, from the Taxpayer to the Department, designated as Exhibit E-4.
- (5) Copy of letter dated October 12, 2006, from the Sales and Use Tax Division to the Taxpayer, designated as Exhibit E-5.
- (6) Copy of letter dated October 31, 2006, from the Taxpayer to the Sales and Use Tax Division, designated as Exhibit E-6.
- (7) Copy of letter dated November 15, 2006, from the Sales and Use Tax Division to the Taxpayer, designated as Exhibit E-7.
- (8) Copy of Form E-505 Supplement dated January 2002, which was mailed to all registered taxpayers in January 2002, designated Exhibit E-8.
- (9) Copy of Important Notice – Sales and Use Tax Legislative Changes, which was posted on the Department’s website in July of 2003, designated Exhibit E-9.
- (10) Copy of Important Notice – Food, which was posted to the Department’ website in July of 2003, designated Exhibit E-10.
- (11) Copy of Form E-505 dated October 2003, which was mailed to all registered taxpayers in October 2003, designated Exhibit E-11.
- (12) Copy of letter dated January 24, 2007, from the Assistant Secretary of Revenue to the Taxpayer, designated Exhibit E-12.
- (13) Copy of the Department’s Brief for Tax Hearing, Docket Number 2007-12, designated as Exhibit E-13.

The following item was introduced into evidence by the Taxpayer during the hearing:

- (14) Draft of a proposed Senate Bill labeled Senate DRS35064-MC-52 (2/12), designated as 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 is engaged in the business of preparing and selling bakery items, such as bread products, pastries, doughnuts, and snack products.
- (2) The Taxpayer has a baking plant in [City], North Carolina, and also owns and operates several thrift stores, in which it sells baked goods it has prepared, as well as other bakery items prepared by other companies.
- (3) The North Carolina thrift stores owned by the Taxpayer receive and sell products from outside suppliers, but approximately 15% of the Taxpayer's thrift store sales were sales of bread and other food items (i.e., food products) prepared by its plant in [North Carolina City].
- (4) The Taxpayer charged and collected the 2% local food tax on its sales of bakery items it prepared and sold in its thrift stores.
- (5) The Taxpayer did not, however, charge or collect the State rate of sales tax on its sales of bakery items it prepared and sold in its thrift stores.
- (6) The Department assessed the Taxpayer for the State and county sales tax it failed to collect and remit to the Department on its prepared food sales made on or after July 15, 2003.
- (7) The Taxpayer was given credit in the audit assessment for the 2% food tax it collected on the sales of prepared food that are in question.
- (8) The Taxpayer notified the Department on September 6, 2006 that it objected to the assessment and timely requested a hearing.
- (9) The Taxpayer challenges only the sales tax liability assessed on the bakery items that it prepared and sold in its thrift stores located in the State of North Carolina. (Exhibits E-4 and E-6)

- (10) The Taxpayer has requested a waiver of the penalties included in the assessment.
- (11) Form E-505 Supplement dated January 2002 was mailed to all registered taxpayers notifying them of changes in the tax rates of food in effect up to that date.
- (12) A notice regarding all major legislative changes made to the sales and use tax statutes by the 2003 General Assembly was posted to the Department's website in July of 2003.
- (13) A notice which detailed the change in the taxation of food effective July 15, 2003 was posted to the Department's website in July of 2003.
- (14) Form E-505, which provides information regarding all legislative changes made to the sales and use tax statutes by the 2003 General Assembly, including information regarding the change in taxation of food, was issued by the Department and mailed to all registered taxpayers in October of 2003.
- (15) A Notice of Sales and Use Tax Assessment dated August 8, 2006 was mailed to the Taxpayer.

### **CONCLUSIONS OF LAW**

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

- (1) G.S. 105-164.3(10) defines the term "food," in part, as "Substances that are sold for ingestion or chewing by humans and are consumed for their taste or nutritional value. The substances may be in liquid, concentrated, solid, frozen, dried, or dehydrated form. . . ."
- (2) Effective July 15, 2003, G.S. 105-164.3(28) defines the term "prepared food," in part, to be "Food that meets at least one of the following conditions...
  - a. It is sold in a heated state or is heated by the retailer.
  - b. It consists of two or more foods mixed or combined by the retailer for sale as a single item.
  - c. It is sold with eating utensils provided by the retailer, such as plates, knives, forks, spoons, glasses, cups, napkins, and straws."

The term does not include food that a retailer sliced, repackaged, or pasteurized but did not heat, mix, or sell with eating utensils.

- (3) Effective July 15, 2003, G.S. 105-164.13B was amended to provide that sales and purchases of food products are exempt from the State rate of sales and use tax and subject only to a 2% local rate of sales and use tax, unless the food item in question is an alcoholic beverage, a dietary supplement, food sold through a vending machine, prepared food, a soft drink, or candy not sold for home consumption and not eligible for purchase under the Federal Food Stamp Program.
- (4) Effective July 15, 2003, baked goods that are both prepared and sold by the same entity are sales of prepared food within the meaning of G.S. 105-164.3(28) and are subject to the State and applicable county tax.
- (5) The bread and other food items the Taxpayer baked or otherwise prepared in its [North Carolina City] baking plant and then sold in its company-owned thrift stores on or after July 15, 2003 are sales of prepared food and are subject to the State and applicable local tax.
- (6) The Notice of Proposed Assessment for the period January 1, 2002 through December 31, 2004 was properly issued pursuant to G.S. 105-241.1.
- (7) The Taxpayer is liable for the applicable State and county additional tax.
- (8) 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**

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.

This 7th day of June 2007.

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Eugene J. Cella  
Assistant Secretary of Administrative Hearings