

THE STATE OF SOUTH CAROLINA

In The Court of Appeals

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SC Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

S. Phillip Lenski, Administrative Law Judge

Case No. 14-ALJ-17-0552-CC

Appellate Case No. 2021-000031

Lowe's Home Centers, LLC

Appellant,

v.

South Carolina Department of Revenue

Respondent.

RECORD ON APPEAL
Volume 4 of 12

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North American Industry Classification System

You are here: [Census.gov](#) | [Business & Industry](#) | [economy/www/index.html](#) | [NAICS](#) | [economy/www/naics/index.html](#) | [NAICS Search/Tools](#)

2012 NAICS Definition

T = Canadian, Mexican, and United States industries are comparable.

444110 Home Centers

This industry comprises establishments known as home centers primarily engaged in retailing a general line of new home repair and improvement materials and supplies, such as lumber, plumbing goods, electrical goods, tools, housewares, hardware, and lawn and garden supplies, with no one merchandise line predominating. The merchandise lines are normally arranged in separate departments.

Cross-References.

- Establishments primarily engaged in retailing a general line of new hardware items, such as tools and builders' hardware are classified in Industry [444130](#) ((/cgi-bin/sssd/naics/naicsrch?code=444130&search=2012)), Hardware Stores.

2002 NAICS	2007 NAICS	2012 NAICS	Corresponding Index Entries
444110	444110	444110	Home centers, building materials
444110	444110	444110	Home improvement centers

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236118

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Industry Statistics Portal NAICS - Census

Definition This U.S. industry comprises establishments primarily responsible for the remodeling construction (including additions, alterations, reconstruction

<http://www.census.gov/econ/isip/sampler.php?naicscode=236118&naicslevel=6>

Residential Remodelers 2002 - Census

Residential Remodelers 2002 2002 Economic Census Construction Industry Series Issued November 2005 EC02-231-236118 (RV) U.S. Department of Commerce.....

<http://www.census.gov/prod/2002/2002231236118.pdf>

except 1930, as part of the decennial quarters that s .

Residential remodelers 236118 99,791 90,513 355

109 12,523 10,678 .

<http://www.census.gov/compendia/statab/2012/tables/t2s0961.pdf>

North American Industry Classification System (NAICS) Main

Introduction to NAICS The North American Industry Classification System (NAICS) is the standard used by Federal statistical agencies in classifying business

<http://www.census.gov/eos/www/naics/>

State Government Finances Viewable Data - Census

State Government Finances Viewable Data, U.S. Census Bureau

<http://www.census.gov/govstate/09431nat.html>

Economic Census - Publications - U.S. Census Bureau

Economic Census ** Publications released after June 23, 2014 can be found at our new site EC02-231-236118 - Residential Remodelers 2002 - Revised

http://www.census.gov/prod/www/economic_census.html

Table 925 Construction—Establishments, Employees, and ..

Residential remodelers . 236118 55,434 61,247 204 224 6,521 7,293

Nonresidential building construction 2362 43,299 42,693 702 706 32,575 33,641 Industrial

<http://www.census.gov/compendia/statab/2008/tables/05s0925.pdf>

County Business Patterns (CBP) Home Page - US Census Bureau

County Business Patterns (CBP), Puerto Rico Business Patterns, Metro Business Patterns and ZIP Code Business Patterns (ZBP)

<http://www.census.gov/econ/cbp/index.html>

Construction--Establishments, Employees, and Payroll by

236118 00 99791 00 90513 00 355 13 309 04 12523 21 10677 88 2362 00

16332 00 45307 00 766 96 743 02 44257 18 44466 21 23621 00 3963 00

3572 00 98 92 77.92 5057.46

<http://www.census.gov/compendia/statab/2012/tables/t2s0961.xls>

Section 20 Construction and Housing

Residential remodelers

236118 99,791 90,513 355

109 12,523 10,678 .

<http://www.census.gov/prod/2011pubs/t2s0961.construct.pdf>

2012 NAICS

236118 Residential Remodelers

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NAICS Code 236118 Residential Remodelers

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residential buildings, single-family, and multifamily. Included in this industry are remodeling general contractors, for-sale remodelers, remodeling design-build firms, and remodeling project construction management firms.

Cross References

Establishments primarily engaged in--Building single-family houses for others as general contractors--are classified in U.S. Industry 236115, New Single-Family Housing Construction (except For-Sale Builders); Building multifamily buildings for others as general contractors--are classified in U.S. Industry 236116, New Multifamily Housing Construction (except For-Sale Builders); Building houses or other residential buildings, on their own account for sale as speculative builders or merchant builders--are classified in U.S. Industry 236117, New Housing For-Sale Builders; Remodeling nonresidential buildings--are classified in Industry Group 2362, Nonresidential Building Construction, based on the type of structure being remodeled; Performing specialized construction work on houses or other residential buildings generally on a subcontract basis--are classified in Subsector 238, Specialty Trade Contractors; and Constructing and leasing residential buildings on their own account--are classified in Industry 531110, Lessors of Residential Buildings and Dwellings.

SIC CODES

- 1521 General Contractors-Single-Family Houses
- 1522 General Contractors-Residential Buildings, other than Single-Family
- 1531 Operative Builders
- 8741 Management Services

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- 236118 Residential Remodelers

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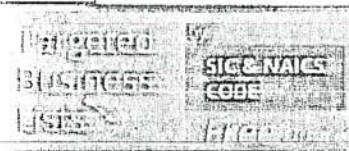
Island Kitchen And Bath

Remodeling, kitchen, bathroom, plumbing, electrical, tile, painting
SIC Code: 1521
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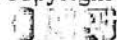


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North American Industry Classification System

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2012 NAICS Definition

T = Canadian, Mexican, and United States Industries are comparable.

236115 New Single-Family Housing Construction (except For-Sale Builders)

This U.S. Industry comprises general contractor establishments primarily responsible for the entire construction of new single-family housing, such as single-family detached houses and town houses or row houses where each housing unit (1) is separated from its neighbors by a ground-to-roof wall and (2) has no housing units constructed above or below. This industry includes general contractors responsible for the on-site assembly of modular and prefabricated houses. Single-family housing design-build firms and single-family construction management firms acting as general contractors are included in this industry.

Cross-References. Establishments primarily engaged in--

- Building single-family houses on their own account for sale as speculative builders or merchant builders--are classified in U.S. Industry [236117](http://cql-bin/sss/naics/naicsrch?code=236117&search=2012) (<http://cql-bin/sss/naics/naicsrch?code=236117&search=2012>), New Housing For-Sale Builders;
- Remodelling or repairing existing houses and other residential buildings--are classified in U.S. Industry [236118](http://cql-bin/sss/naics/naicsrch?code=236118&search=2012) (<http://cql-bin/sss/naics/naicsrch?code=236118&search=2012>), Residential Remodelers;
- Performing manufactured (mobile) home set up and tie-down work--are classified in Industry [238990](http://cql-bin/sss/naics/naicsrch?code=238990&search=2012) (<http://cql-bin/sss/naics/naicsrch?code=238990&search=2012>), All Other Specialty Trade Contractors;
- Performing specialized construction work on houses and other residential buildings, generally on a subcontract basis--are classified in Subsector [238](http://cql-bin/sss/naics/naicsrch?code=238&search=2012) (<http://cql-bin/sss/naics/naicsrch?code=238&search=2012>), Specialty Trade Contractors; and
- Constructing and leasing residential buildings on their own account--are classified in Industry [531110](http://cql-bin/sss/naics/naicsrch?code=531110&search=2012) (<http://cql-bin/sss/naics/naicsrch?code=531110&search=2012>), Lessors of Residential Buildings and Dwellings.

2002 NAICS	2007 NAICS	2012 NAICS	Corresponding Index Entries
236115	236115	236115	Cabin construction general contractors
236115	236115	236115	Condominium, single-family, construction general contractors
236115	236115	236115	Construction management, single-family building
236115	236115	236115	Cottage construction general contractors
236115	236115	236115	Custom builders (except for-sale), single-family home
236115	236115	236115	Duplex (i.e., side-by-side) construction general contractors
236115	236115	236115	Home builders (except for-sale), single-family
236115	236115	236115	Housing, single-family, construction general contractors
236115	236115	236115	Log home construction general contractors
236115	236115	236115	Low income housing, single-family, construction general contractors
236115	236115	236115	Modular house assembly on site by general contractors
236115	236115	236115	Panelized single-family house assembly on site by general contractors
236115	236115	236115	Precut single-family housing assembly on site by general contractors
236115	236115	236115	Premanufactured housing assembly on site by general contractors
236115	236115	236115	Residential construction, single-family, general contractors
236115	236115	236115	Row house (i.e., single-family type) construction general contractors
236115	236115	236115	Single-family attached housing construction general contractors
236115	236115	236115	Single-family detached housing construction general contractors
236115	236115	236115	Single-family homes built on land owned by others, general contractors of
236115	236115	236115	Single-family house construction by general contractors
236115	236115	236115	Time-share condominium construction general contractors
236115	236115	236115	Town house (i.e., single-family type) construction by general contractors
236115	236115	236115	Vacation home, single-family, construction by general contractors

North American Industry Classification System

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2012 NAICS Definition

T = Canadian, Mexican, and United States industries are comparable.

236117 New Housing For-Sale Builders

This U.S. industry comprises establishments primarily engaged in building new homes on land that is owned or controlled by the builder rather than the homebuyer or investor. The land is included with the sale of the home. Establishments in this industry build single and/or multifamily homes. These establishments are often referred to as merchant builders, but are also known as production or for-sale builders.

Cross-References. Establishments primarily engaged in--

- Building single-family houses for others as general contractors--are classified in U.S. Industry [236115 \(/cql-bin/sssd/naics/naicsrch?code=236115&search=2012\)](http://www.census.gov/business-and-industry/naics/2012/236115), New Single-Family Housing Construction (except For-Sale Builders);
- Building multifamily residential buildings for others as general contractors--are classified in U.S. Industry [236116 \(/cql-bin/sssd/naics/naicsrch?code=236116&search=2012\)](http://www.census.gov/business-and-industry/naics/2012/236116), New Multifamily Housing Construction (except For-Sale Builders);
- Remodeling or repairing existing houses and other residential buildings, either for others or on own account for sale--are classified in U.S. Industry [236118 \(/cql-bin/sssd/naics/naicsrch?code=236118&search=2012\)](http://www.census.gov/business-and-industry/naics/2012/236118), Residential Remodelers;
- Performing specialized construction work on houses or other residential buildings, generally on a subcontract basis--are classified in Subsector [238 \(/cql-bin/sssd/naics/naicsrch?code=238&search=2012\)](http://www.census.gov/business-and-industry/naics/2012/238), Specialty Trade Contractors; and
- Constructing and leasing residential buildings on their own account--are classified in Industry [531110 \(/cql-bin/sssd/naics/naicsrch?code=531110&search=2012\)](http://www.census.gov/business-and-industry/naics/2012/531110), Lessors of Residential Buildings and Dwellings.

2002 NAICS	2007 NAICS	2012 NAICS	Corresponding Index Entries
236117	236117	236117	Apartment building for-sale builders
236117	236117	236117	Cabin for-sale builders
236117	236117	236117	Condominium for-sale builders
236117	236117	236117	Cooperative apartment for-sale builders
236117	236117	236117	Cottage for-sale builders
236117	236117	236117	Custom builders, for-sale builders, multifamily buildings
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236117	236117	236117	Panelized housing, residential, assembled on site by for-sale builders
236117	236117	236117	Panelized multifamily housing assembled on site by for-sale builders
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Residential Remodelers	236118	Construction management, residential remodeling

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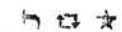
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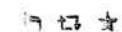
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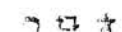


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236118 Residential Remodelers

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This U.S. industry comprises establishments primarily responsible for the remodeling construction (including additions, alterations, reconstruction, maintenance, and repair work) of houses and other residential buildings, single-family, and multifamily. Included in this industry are remodeling general contractors, for-sale remodelers, remodeling design-build firms, and remodeling project construction management firms.

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Cross-References. Establishments primarily engaged in--

- Building single-family houses for others as general contractors--are classified in U.S. Industry 236115, New Single-Family Housing Construction (except For-Sale Builders);
- Building multifamily buildings for others as general contractors--are classified in U.S. Industry 236116, New Multifamily Housing Construction (except For-Sale Builders);
- Building houses or other residential buildings, on their own account for sale as speculative builders or merchant builders--are classified in U.S. Industry 236117, New Housing For-Sale Builders;
- Remodeling nonresidential buildings--are classified in Industry Group 2362, Nonresidential Building Construction, based on the type of structure being

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JOINT EXHIBIT 27

Valuation Services

VS Section

STATEMENTS ON STANDARDS FOR VALUATION SERVICES

VS Section 100

Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset

Source: Statement on Standards for Valuation Services No. 1

June 2007

Foreword

Why Issued

Valuations of businesses, business ownership interests, securities, or intangible assets (hereinafter collectively referred to in this Foreword as *business valuations*) may be performed for a wide variety of purposes including the following:

1. Transactions (or potential transactions), such as acquisitions, mergers, leveraged buyouts, initial public offerings, employee stock ownership plans and other share based plans, partner and shareholder buy-ins or buyouts, and stock redemptions
2. Litigation (or pending litigation) relating to matters such as marital dissolution, bankruptcy, contractual disputes, owner disputes, dissenting shareholder and minority ownership oppression cases, and employment and intellectual property disputes
3. Compliance-oriented engagements, including (a) financial reporting and (b) tax matters such as corporate reorganizations; S corporation conversions; income, estate, and gift tax compliance; purchase price allocations; and charitable contributions
4. Planning oriented engagements for income tax, estate tax, gift tax, mergers and acquisitions, and personal financial planning

In recent years, the need for business valuations has increased significantly. Performing an engagement to estimate value involves special knowledge and skill.

Given the increasing number of members of the AICPA who are performing business valuation engagements or some aspect thereof, the AICPA Consulting Services Executive Committee has written this standard to improve the consistency and quality of practice among AICPA members performing

business valuations. AICPA members will be required to follow this standard when they perform engagements to estimate value that culminate in the expression of a conclusion of value or a calculated value.

The Consulting Services Executive Committee is a body designated by AICPA Council to promulgate professional standards under the "General Standards Rule" (ET sec. 1.300.001 and 2.300.001) and the "Compliance with Standards Rule" (ET sec. 1.310.001 and 2.310.001) of the AICPA Code of Professional Conduct (the code).

Introduction and Scope

.01

This statement establishes standards for AICPA members (hereinafter referred to in this statement as *members*) who are engaged to, or, as part of another engagement, estimate the value of a **business**, **in a business ownership interest**, **security**, or **intangible asset** (hereinafter collectively referred to in this statement as **subject interest**). For purposes of this statement, the definition of a business includes not-for-profit entities or activities.

.02

As described in this statement, the term **engagement to estimate value** refers to an engagement or any part of an engagement (for example, a tax, litigation, or acquisition-related engagement) that involves estimating the value of a subject interest. An engagement to estimate value culminates in the expression of either a **conclusion of value** or a **calculated value** (see paragraph .21). A member who performs an engagement to estimate value is referred to, in this statement, as a **valuation analyst**.

.03

Valuation analysts should be aware of any governmental regulations and other professional standards applicable to the engagement, including the code and the Statement on Standards for Consulting Services (SSCS) No. 1, *Consulting Services: Definitions and Standards* (CS sec. 100), and the extent to which they apply to engagements to estimate value. Compliance is the responsibility of the valuation analyst.

.04

In the process of estimating value as part of an engagement, the valuation analyst applies **valuation approaches** and **valuation methods**, as described in this statement, and uses professional judgment. The use of professional judgment is an essential component of estimating value.

Exceptions From This Statement

.05

This statement is not applicable to a member who participates in estimating the value of a subject interest as part of performing an attest engagement defined by the "Independence Rule" of the code (ET sec. 1.200.001) (for example, as part of an audit, review, or compilation engagement).

.06

This statement is not applicable when the value of a subject interest is provided to the member by the client or a third party, and the member does not apply valuation approaches and methods, as discussed in this statement.

.07

This statement is not applicable to internal use assignments from employers to employee members not in public practice, as that term is defined in the code (ET sec. 0.400.42). See also Valuation Interpretation No. 1, "Scope of Applicable Services" (VS sec. 9100), illustrations 24 and 25 (VS sec. 9100 par. .78–.81).

.08

This statement is not applicable to engagements that are exclusively for the purpose of determining economic damages (for example, lost profits) unless those determinations include an engagement to estimate value. See also Interpretation No. 1, illustrations 1, 2, and 3 (VS sec. 9100 par. .06–.11).

.09

This statement is not applicable to mechanical computations that do not rise to the level of an engagement to estimate value; that is, when the member does not apply valuation approaches and methods and does not use professional judgment. See Interpretation No. 1, illustration 8 (VS sec. 9100 par. .20–.23).

This statement is not applicable when it is not practical or not reasonable to obtain or use relevant information; as a result, the member is unable to apply valuation approaches and methods that are described in this statement. in 2

Jurisdictional Exception

.10

If any part of this statement differs from published governmental, judicial, or accounting authority, or such authority specifies valuation development procedures or valuation reporting procedures, then the valuation analyst should follow the applicable published authority or stated procedures with respect to that part applicable to the valuation in which the member is engaged. The other parts of this statement continue in full force and effect (Interpretation No. 1 [VS sec. 9100 par. .01–.89]).

Overall Engagement Considerations

Professional Competence

.11

The "General Standards Rule" of the code (ET sec. 1.300.001 and 2.300.001) states that a member shall "undertake only those *professional services* that the *member* or the *member's firm* can reasonably expect to be completed with professional competence." Performing a valuation engagement with professional competence involves special knowledge and skill. A valuation analyst should possess a level of knowledge of valuation principles and theory and a level of skill in the application of such principles that will enable him or her to identify, gather, and analyze data, consider and apply appropriate valuation approaches and methods, and use professional judgment in developing the estimate of value (whether a single amount or a range). An in-depth discussion of valuation theory and principles, and how and when to apply them, is not within the scope of this statement.

.12

In determining whether he or she can reasonably expect to complete the valuation engagement with professional competence, the valuation analyst should consider, at a minimum, the following:

- a. Subject entity and its industry
- b. Subject interest
- c. **Valuation date**
- d. Scope of the valuation engagement
 - i. Purpose of the valuation engagement
 - ii. **Assumptions and limiting conditions** expected to apply to the valuation engagement (see paragraph .18)
 - iii. Applicable **standard of value** (for example, *fair value* or *fair market value*) and the applicable **premise of value** (for example, going concern)
 - iv. Type of valuation report to be issued (see paragraph .48), intended use and users of the report, and restrictions on the use of the report
- e. Governmental regulations or other professional standards that apply to the subject interest or to the valuation engagement

Nature and Risks of the Valuation Services and Expectations of the Client

.13

In understanding the nature and risks of the *valuation services* to be provided, and the expectations of the client, the valuation analyst should consider the matters in paragraph .12, and in addition, at a minimum, the following:

- a. The proposed terms of the valuation engagement
- b. The identity of the client
- c. The nature of the interest and ownership rights in the business, business interest, security, or intangible asset being valued, including **control** characteristics and the degree of **marketability** of the interest
- d. The procedural requirements of a valuation engagement and the extent, if any, to which procedures will be limited by either the client or circumstances beyond the client's or the valuation analyst's control
- e. The use of and limitations of the report, and the conclusion or calculated value
- f. Any obligation to update the valuation

Objectivity and Conflict of Interest

.14

The code requires objectivity in the performance of all professional services, including valuation engagements. Objectivity is a state of mind. The principle of objectivity imposes the obligation to be impartial, intellectually honest, disinterested, and free from conflicts of interest. Where a potential conflict of interest may exist, a valuation analyst should make the disclosures and obtain consent as required by the "Conflicts of Interest" interpretation (ET sec. 1.110.010 and 2.110.010) under the "Integrity and Objectivity Rule" (ET sec. 1.100.001 and 2.100.001).

Independence and Valuation

.15

If valuation services are performed for a client for which the valuation analyst or valuation analyst's firm also performs an attest engagement (defined by the "Independence Rule" of the code), the valuation analyst should meet the requirements included in the interpretations of the "Nonattest Services" subtopic (ET sec. 1.295) under the "Independence Rule" (ET sec. 1.200.001) so as not to impair the member's independence with respect to the client.

Establishing an Understanding With the Client

.16

The valuation analyst should establish an understanding with the client, preferably in writing, regarding the engagement to be performed. If the understanding is oral, the valuation analyst should document that understanding by appropriate memoranda or notations in the working papers. (If the engagement is being performed for an attest client, the "General Requirements for Performing Nonattest Services" interpretation [ET sec. 1.295.040] of the "Independence Rule" [ET sec. 1.200.001] requires the engagement understanding to be in writing.) Regardless of whether the understanding is written or oral, the valuation analyst should modify the understanding if he or she

encounters circumstances during the engagement that make it appropriate to modify that understanding.

.17

The understanding with the client reduces the possibility that either the valuation analyst or the client may misinterpret the needs or expectations of the other party. The understanding should include, at a minimum, the nature, purpose, and objective of the valuation engagement, the client's responsibilities, the valuation analyst's responsibilities, the applicable assumptions and limiting conditions, the type of report to be issued, and the standard of value to be used.

Assumptions and Limiting Conditions

.18

Assumptions and limiting conditions are common to valuation engagements. Examples of typical assumptions and limiting conditions for a business valuation are provided in appendix A, "Illustrative List of Assumptions and Limiting Conditions for a Business Valuation" (par. .80). The assumptions and limiting conditions should be disclosed in the valuation report (see paragraphs .52l, .68g, and .71m).

Scope Restrictions or Limitations

.19

A restriction or limitation on the scope of the valuation analyst's work, or the data available for analysis, may be present and known to the valuation analyst at the outset of the valuation engagement or may arise during the course of a valuation engagement. Such a restriction or limitation should be disclosed in the valuation report (see paragraphs .52m, .68e, and .71n).

Using the Work of Specialists in the Engagement to Estimate Value

.20

In performing an engagement to estimate value, the valuation analyst may rely on the work of a third party specialist (for example, a real estate or equipment appraiser). The valuation analyst should note in the assumptions and limiting conditions the level of responsibility, if any, being assumed by the valuation analyst for the work of the third party specialist. At the option of the valuation analyst, the written report of the third party specialist may be included in the valuation analyst's report.

Development

Types of Engagement

.21

There are two types of engagements to estimate value—a *valuation engagement* and a

calculation engagement. The valuation engagement requires more procedures than does the calculation engagement. The valuation engagement results in a conclusion of value. The calculation engagement results in a calculated value. The type of engagement is established in the understanding with the client (see paragraphs .16 and .17):

- a. **Valuation engagement.** A valuation analyst performs a valuation engagement when (1) the engagement calls for the valuation analyst to estimate the value of a subject interest and (2) the valuation analyst estimates the value (as outlined in paragraphs .23–.45) and is free to apply the valuation approaches and methods he or she deems appropriate in the circumstances. The valuation analyst expresses the results of the valuation as a conclusion of value; the conclusion may be either a single amount or a range.
- b. **Calculation engagement.** A valuation analyst performs a calculation engagement when (1) the valuation analyst and the client agree on the valuation approaches and methods the valuation analyst will use and the extent of procedures the valuation analyst will perform in the process of calculating the value of a subject interest (these procedures will be more limited than those of a valuation engagement) and (2) the valuation analyst calculates the value in compliance with the agreement. The valuation analyst expresses the results of these procedures as a calculated value. The calculated value is expressed as a range or as a single amount. A calculation engagement does not include all of the procedures required for a valuation engagement (see paragraph .46).

Hypothetical Conditions

.22

Hypothetical conditions affecting the subject interest may be required in some circumstances. When a valuation analyst uses hypothetical conditions during a valuation or calculation engagement, he or she should indicate the purpose for including the hypothetical conditions and disclose these conditions in the valuation or calculation report (see paragraphs .52n, .71a, and .74).

Valuation Engagement

.23

In performing a valuation engagement, the valuation analyst should do the following:

- Analyze the subject interest (paragraphs .25–.30)
- Consider and apply appropriate valuation approaches and methods (paragraphs .31–.42)
- Prepare and maintain appropriate documentation (paragraphs .44–.45)

.24

Even though the list in paragraph .23 and some requirements and guidance in this statement are presented in a manner that suggests a sequential valuation process, valuations involve an ongoing

process of gathering, updating, and analyzing information. Accordingly, the sequence of the requirements and guidance in this statement may be implemented differently at the option of the valuation analyst.

Analysis of the Subject Interest

.25

The analysis of the subject interest will assist the valuation analyst in considering, evaluating, and applying the various valuation approaches and methods to the subject interest. The nature and extent of the information needed to perform the analysis will depend on, at a minimum, the following:

- Nature of the subject interest
- Scope of the valuation engagement
- Valuation date
- Intended use of the valuation
- Applicable standard of value
- Applicable **premise of value**
- Assumptions and limiting conditions
- Applicable governmental regulations or other professional standards

.26

In analyzing the subject interest, the valuation analyst should consider financial and nonfinancial information. The type, availability, and significance of such information vary with the subject interest.

Nonfinancial Information

.27

The valuation analyst should, as available and applicable to the valuation engagement, obtain sufficient nonfinancial information to enable him or her to understand the subject entity, including the following:

- Nature, background, and history
- Facilities
- Organizational structure
- Management team (which may include officers, directors, and key employees)
- Classes of **equity** ownership interests and rights attached thereto
- Products or services, or both

- Economic environment
- Geographical markets
- Industry markets
- Key customers and suppliers
- Competition
- **Business risks**
- Strategy and future plans
- Governmental or regulatory environment

Ownership Information

.28

The valuation analyst should obtain, where applicable and available, ownership information regarding the subject interest to enable him or her to

- determine the type of ownership interest being valued and ascertain whether that interest exhibits control characteristics.
- analyze the different ownership interests of other owners and assess the potential effect on the value of the subject interest.
- understand the classes of equity ownership interests and rights attached thereto.
- understand the rights included in, or excluded from, each intangible asset.
- understand other matters that may affect the value of the subject interest, such as the following:
 - *For a business, business ownership interest, or security:* Shareholder agreements, partnership agreements, operating agreements, voting trust agreements, buy-sell agreements, loan covenants, restrictions, and other contractual obligations or restrictions affecting the owners and the subject interest.
 - *For an intangible asset:* Legal rights, licensing agreements, sublicense agreements, nondisclosure agreements, development rights, commercialization or exploitation rights, and other contractual obligations.

Financial Information

.29

The valuation analyst should obtain, where applicable and available, financial information on the subject entity such as the following:

- Historical financial information (including annual and interim financial statements and key financial statement ratios and statistics) for an appropriate number of years
- Prospective financial information (for example, budgets, forecasts, and projections)
- Comparative summaries of financial statements or information covering a relevant time period
- Comparative common size financial statements for the subject entity for an appropriate number of years
- Comparative common size industry financial information for a relevant time period
- Income tax returns for an appropriate number of years
- Information on compensation for owners including benefits and personal expenses
- Information on key man or officers' life insurance
- Management's response to inquiry regarding the following:
 - Advantageous or disadvantageous contracts
 - Contingent or off-balance-sheet assets or liabilities
 - Information on prior sales of company stock

.30

The valuation analyst should read and evaluate the information to determine that it is reasonable for the purposes of the engagement.

Valuation Approaches and Methods

.31

In developing the valuation, the valuation analyst should consider the three most common valuation approaches:

- **Income (income-based) approach**
- **Asset (asset-based) approach** (used for businesses, business ownership interests, and securities) or **cost approach** (used for intangible assets)
- **Market (market-based) approach**

.32

The valuation analyst should use the valuation approaches and methods that are appropriate for the valuation engagement. General guidance on the use of approaches and methods appears in paragraphs .33–.41, but detailed guidance on specific valuation approaches and methods and their applicability is outside the scope of this statement.

.33

Income Approach. Two frequently used valuation methods under the income approach include the **capitalization of benefits method** (for example, earnings or cash flows) and the **discounted future benefits method** (for example, earnings or cash flows). When applying these methods, the valuation analyst should consider a variety of factors, including but not limited to, the following:

- a. *Capitalization of benefits (for example, earnings or cash flows) method.* The valuation analyst should consider the following:
 - i. **Normalization** adjustments
 - ii. Nonrecurring revenue and expense items
 - iii. Taxes
 - iv. Capital structure and financing costs
 - v. Appropriate capital investments
 - vi. Noncash items
 - vii. Qualitative judgments for risks used to compute discount and **capitalization rates**
 - viii. Expected changes (growth or decline) in future benefits (for example, earnings or cash flows)
- b. *Discounted future benefits method (for example, earnings or cash flows).* In addition to the items in item a, the valuation analyst should consider the following:
 - i. Forecast or projection assumptions
 - ii. Forecast or projected earnings or cash flows
 - iii. **Terminal value**
- c. For an intangible asset, the valuation analyst should also consider, when relevant, the following:
 - i. Remaining useful life
 - ii. Current and anticipated future use of the intangible asset
 - iii. Rights attributable to the intangible asset
 - iv. Position of intangible asset in its life cycle
 - v. Appropriate discount rate for the intangible asset
 - vi. Appropriate **capital or contributory asset charge**, if any
 - vii. Research and development or marketing expense needed to support the intangible asset in its existing state
 - viii. Allocation of income (for example, **incremental income**, **residual income**, or **profit split income**) to intangible asset

- ix. Whether any tax amortization benefit would be included in the analysis
- x. Discounted multi-year excess earnings
- xi. Market royalties
- xii. Relief from royalty

Asset Approach and Cost Approach

.34

A frequently used method under the asset approach is the adjusted net asset method. When using the adjusted net asset method in valuing a business, business ownership interest, or security, the valuation analyst should consider, as appropriate, the following information related to the premise of value:

- Identification of the assets and liabilities
- Value of the assets and liabilities (individually or in the aggregate)
- Liquidation costs (if applicable)

.35

When using methods under the cost approach to value intangible assets, the valuation analyst should consider the type of cost to be used (for example, reproduction cost or replacement cost), and, where applicable, the appropriate forms of depreciation and obsolescence and the remaining useful life of the intangible asset.

Market Approach

.36

Three frequently used valuation methods under the market approach for valuing a business, business ownership interest, or security are as follows:

- **Guideline public company method**
- **Guideline company transactions method**
- Guideline sales of interests in the subject entity, such as business ownership interests or securities

Three frequently used market approach valuation methods for intangible assets are as follows:

- Comparable uncontrolled transactions method (which is based on arm's-length sales or licenses of guideline intangible assets)
- Comparable profit margin method (which is based on comparison of the profit margin

earned by the subject entity that owns or operates the intangible asset to profit margins earned by guideline companies)

- **Relief from royalty method** (which is based on the royalty rate, often expressed as a percentage of revenue that the subject entity that owns or operates the intangible asset would be obligated to pay to a hypothetical third-party licensor for the use of that intangible asset)

For the methods involving guideline intangible assets (for example, the comparable profit margin method), the valuation analyst should consider the subject intangible asset's remaining useful life relative to the remaining useful life of the guideline intangible assets, if available.

.37

In applying the methods listed in paragraph .36 or other methods to determine valuation pricing multiples or metrics, the valuation analyst should consider the following:

- Qualitative and quantitative comparisons
- Arm's-length transactions and prices
- The dates and, consequently, the relevance of the market data

.38

The valuation analyst should set forth in the report the rationale and support for the valuation methods used (see paragraph .47).

.39

Rules of Thumb. Although technically not a valuation method, some valuation analysts use rules of thumb or industry benchmark indicators (hereinafter, collectively referred to as **rules of thumb**) in a valuation engagement. A rule of thumb is typically a reasonableness check against other methods used and should generally not be used as the only method to estimate the value of the subject interest.

Valuation Adjustments

.40

During the course of a valuation engagement, the valuation analyst should consider whether valuation adjustments (discounts or premiums) should be made to a **pre-adjustment** value. Examples of valuation adjustments for valuation of a business, business ownership interest, or security include a **discount for lack of marketability or liquidity** and a **discount for lack of control**. An example of a valuation adjustment for valuation of an intangible asset is obsolescence.

.41

When valuing a controlling ownership interest under the income approach, the value of any **non-operating assets**, non-operating liabilities, or **excess or deficient operating assets** should be excluded from the computation of the value based on the operating assets and should be added to or deleted from the value of the operating entity. When valuing a non-controlling ownership

interest under the income approach, the value of any non-operating assets, non-operating liabilities, or excess or deficient operating assets may or may not be used to adjust the value of the operating entity depending on the valuation analyst's assessment of the influence exercisable by the non-controlling interest. In the asset-based or cost approach, it may not be necessary to separately consider non-operating assets, non-operating liabilities, or excess or deficient operating assets.

Conclusion of Value

.42

In arriving at a conclusion of value, the valuation analyst should

- a. correlate and reconcile the results obtained under the different approaches and methods used.
- b. assess the reliability of the results under the different approaches and methods using the information gathered during the valuation engagement.
- c. determine, based on items a and b, whether the conclusion of value should reflect
 - i. the results of one valuation approach and method, or
 - ii. a combination of the results of more than one valuation approach and method.

Subsequent Events

.43

The valuation date is the specific date at which the valuation analyst estimates the value of the subject interest and concludes on his or her estimation of value. Generally, the valuation analyst should consider only circumstances existing at the valuation date and events occurring up to the valuation date. An event that could affect the value may occur subsequent to the valuation date; such an occurrence is referred to as a **subsequent event**. Subsequent events are indicative of conditions that were not known or knowable at the valuation date, including conditions that arose subsequent to the valuation date. The valuation would not be updated to reflect those events or conditions. Moreover, the valuation report would typically not include a discussion of those events or conditions because a valuation is performed as of a point in time—the valuation date—and the events described in this subparagraph, occurring subsequent to that date, are not relevant to the value determined as of that date. In situations in which a valuation is meaningful to the intended user beyond the valuation date, the events may be of such nature and significance as to warrant disclosure (at the option of the valuation analyst) in a separate section of the report in order to keep users informed (see paragraphs .52p, .71r, and .74). Such disclosure should clearly indicate that information regarding the events is provided for informational purposes only and does not affect the determination of value as of the specified valuation date.

Documentation

.44

Documentation is the principal record of information obtained and analyzed, procedures performed, valuation approaches and methods considered and used, and the conclusion of value. The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment. Documentation may include the following:

- Information gathered and analyzed to obtain an understanding of matters that may affect the value of the subject interest (paragraphs .25–.30)
- Assumptions and limiting conditions (paragraph .18)
- Any restriction or limitation on the scope of the valuation analyst's work or the data available for analysis (paragraph .19)
- Basis for using any **valuation assumption** during the valuation engagement
- Valuation approaches and methods considered
- Valuation approaches and methods used including the rationale and support for their use
- If applicable, information relating to subsequent events considered by the valuation analyst (paragraph .43)
- For any rule of thumb used in the valuation, source(s) of data used, and how the rule of thumb was applied (paragraph .39)
- Other documentation considered relevant to the engagement by the valuation analyst

.45

The valuation analyst should retain the documentation for a period of time sufficient to meet the needs of applicable legal, regulatory, or other professional requirements for records retention.

Calculation Engagement

.46

In performing a calculation engagement, the valuation analyst should consider, at a minimum, the following:

- a. Identity of the client
- b. Identity of the subject interest
- c. Whether or not a business interest has ownership control characteristics and its degree of marketability
- d. Purpose and intended use of the calculated value
- e. Intended users of the report and the limitations on its use
- f. Valuation date

- g. Applicable premise of value
- h. Applicable standard of value
- i. Sources of information used in the calculation engagement
- j. Valuation approaches or valuation methods agreed upon with the client
- k. Subsequent events, if applicable (see paragraph .43)

In addition, the valuation analyst should comply with the documentation requirements listed in paragraphs .44 and .45. The quantity, type, and content of documentation are matters of the valuation analyst's professional judgment.

The Valuation Report

.47

A valuation report is a written or oral communication to the client containing the conclusion of value or the calculated value of the subject interest. Reports issued for purposes of certain controversy proceedings are exempt from this reporting standard (see paragraph .50).

.48

The three types of written reports that a valuation analyst may use to communicate the results of an engagement to estimate value are as follows: either a detailed report or a summary report for a valuation engagement and a calculation report for a calculation engagement:

- a. *Valuation engagement—detailed report.* This report may be used only to communicate the results of a valuation engagement (conclusion of value); it should not be used to communicate the results of a calculation engagement (calculated value) (paragraph .51).
- b. *Valuation engagement—summary report.* This report may be used only to communicate the results of a valuation engagement (conclusion of value); it should not be used to communicate the results of a calculation engagement (calculated value) (paragraph .71). For a valuation engagement, the determination of whether to prepare a detailed report or a summary report is based on the level of reporting detail agreed to by the valuation analyst and the client.
- c. *Calculation engagement—calculation report.* This type of report should be used only to communicate the results of a calculation engagement (calculated value); it should not be used to communicate the results of a valuation engagement (conclusion of value) (see paragraph .73).

.49

The valuation analyst should indicate in the valuation report the restrictions on the use of the report (which may include restrictions on the users of the report, the uses of the report by such users, or both) (paragraph .65d).

Reporting Exemption for Certain Controversy Proceedings

.50

A valuation performed for a matter before a court, an arbitrator, a mediator or other facilitator, or a matter in a governmental or administrative proceeding, is exempt from the reporting provisions of this statement. The reporting exemption applies whether the matter proceeds to trial or settles. The exemption applies only to the reporting provisions of this statement (see paragraphs .47–.49 and .51–.78). The developmental provisions of the statement (see paragraphs .21–.46) still apply whenever the valuation analyst expresses a conclusion of value or a calculated value (Interpretation No. 1 [VS sec. 9100 par. .01–.89]).

Detailed Report

.51

The *detailed report* is structured to provide sufficient information to permit intended users to understand the data, reasoning, and analyses underlying the valuation analyst's conclusion of value. A detailed report should include, as applicable, the following sections titled using wording similar in content to that shown:

- Letter of transmittal
- Table of contents
- Introduction
- Sources of information
- Analysis of the subject entity and related nonfinancial information
- Financial statement or financial information analysis
- Valuation approaches and methods considered
- Valuation approaches and methods used
- Valuation adjustments
- Non-operating assets, non-operating liabilities, and excess or deficient operating assets (if any)
- Representation of the valuation analyst
- Reconciliation of estimates and conclusion of value
- Qualifications of the valuation analyst
- Appendixes and exhibits

The report sections previously listed and the detailed information within the sections described in

the following paragraphs .52–.77 may be positioned in the body of the report or elsewhere in the report at the discretion of the valuation analyst.

Introduction

.52

This section should provide an overall description of the valuation engagement. The information in the section should be sufficient to enable the intended user of the report to understand the nature and scope of the valuation engagement, as well as the work performed. The introduction section may include, among other things, the following information:

- a. Identity of the client
- b. Purpose and intended use of the valuation
- c. Intended users of the valuation
- d. Identity of the subject entity
- e. Description of the subject interest
- f. Whether the business interest has ownership control characteristics and its degree of marketability
- g. Valuation date
- h. Report date
- i. Type of report issued (namely, a detailed report) (paragraph .51)
- j. Applicable premise of value
- k. Applicable standard of value
- l. Assumptions and limiting conditions (alternatively, these often appear in an appendix) (paragraph .18)
- m. Any restrictions or limitations in the scope of work or data available for analysis (paragraph .19)
- n. Any hypothetical conditions used in the valuation engagement, including the basis for their use (paragraph .22)
- o. If the work of a specialist was used in the valuation engagement, a description of how the specialist's work was relied upon (paragraph .20)
- p. Disclosure of subsequent events in certain circumstances (paragraph .43)
- q. Any application of the jurisdictional exception (paragraph .10)
- r. Any additional information the valuation analyst deems useful to enable the user(s) of the report to understand the work performed

If the items previously listed are not included in the introduction, they should be included elsewhere

In the valuation report.

Sources of Information

.53

This section of the report should identify the relevant sources of information used in performing the valuation engagement. It may include, among other things, the following:

- a. For valuation of a business, business ownership interest, or security, whether and to what extent the subject entity's facilities were visited
- b. For valuation of an intangible asset, whether the legal registration, contractual documentation, or other tangible evidence of the asset was inspected
- c. Names, positions, and titles of persons interviewed and their relationships to the subject interest
- d. Financial information (paragraphs .54 and .56)
- e. Tax information (paragraph .55)
- f. Industry data
- g. Market data
- h. Economic data
- i. Other empirical information
- j. Relevant documents and other sources of information provided by or related to the entity

.54

If the financial information includes financial statements that were reported on (audit, review, compilation, or attest engagement performed under the Statements on Standards for Attestation Engagements [SSAEs] [AT sec. 20–701]) by the valuation analyst's firm, the valuation report should disclose this fact and the type of report issued. If the valuation analyst or the valuation analyst's firm did not audit, review, compile, or attest under the SSAEs (AT sec. 20–701) to the financial information, the valuation analyst should so state and should also state that the valuation analyst assumes no responsibility for the financial information.

.55

The financial information may be derived from or may include information derived from tax returns. With regard to such derived information and other tax information (see paragraph .53e), the valuation analyst should identify the tax returns used and any existing relationship between the valuation analyst and the tax preparer. If the valuation analyst or the valuation analyst's firm did not audit, review, compile, or attest under the SSAEs (AT sec. 20–701) to any financial information derived from tax returns that is used during the valuation engagement, the valuation analyst should so state and should also state that the valuation analyst assumes no responsibility for that derived information.

.56

If the financial information used was derived from financial statements prepared by management

that were not the subject of an audit, review, compilation, or attest engagement performed under the SSAEs, the valuation report should do the following:

- Identify the financial statements
- State that, as part of the valuation engagement, the valuation analyst did not audit, review, compile, or attest under the SSAEs (AT sec. 20–710) to the financial information and assumes no responsibility for that information

Analysis of the Subject Entity and Related Nonfinancial Information

.57

The valuation analyst should include a description of the relevant nonfinancial information listed and discussed in paragraph .27.

Financial Statement or Financial Information Analysis

.58

This section should include a description of the relevant information listed in paragraph .29. Such description may include the following:

- a. The rationale underlying any normalization or **control adjustments** to financial information
- b. Comparison of current performance with historical performance
- c. Comparison of performance with industry trends and norms, where available

Valuation Approaches and Methods Considered

.59

This section should state that the valuation analyst has considered the valuation approaches discussed in paragraph .31.

Valuation Approaches and Methods Used

.60

In this section, the valuation analyst should identify the valuation methods used under each valuation approach and the rationale for their use.

.61

This section should also identify the following for each of the three approaches (if used):

- a. Income approach:
 - Composition of the representative benefit stream
 - Method(s) used, and a summary of the most relevant risk factors considered in

selecting the appropriate discount rate, the capitalization rate, or both

- Other factors as discussed in paragraph .33

b. Asset-based approach or cost approach:

- *Asset-based approach.* Any adjustments made by the valuation analyst to the relevant balance sheet data
- *Cost approach.* The type of cost used, how this cost was estimated, and, if applicable, the forms of and costs associated with depreciation and obsolescence used under the approach and how those costs were estimated

c. Market approach:

- For the guideline public company method:
 - The selected guideline companies and the process used in their selection
 - The pricing multiples used, how they were used, and the rationale for their selection. If the pricing multiples were adjusted, the rationale for such adjustments
- For the guideline company transactions method, the sales transactions and pricing multiples used, how they were used, and the rationale for their selection; if the pricing multiples were adjusted, the rationale for such adjustments
- For the guideline sales of interests in the subject entity method, the sales transactions used, how they were used, and the rationale for determining that these sales are representative of arm's length transactions

.62

When a rule of thumb is used in combination with other methods, the valuation report should disclose the source(s) of data used and how the rule of thumb was applied (see paragraph .39).

Valuation Adjustments

.63

This section should (a) identify each valuation adjustment considered and determined to be applicable, for example, discount for lack of marketability, (b) describe the rationale for using the adjustment and the factors considered in selecting the amount or percentage used, and (c) describe the pre-adjustment value to which the adjustment was applied (see paragraph .40).

Non-Operating Assets and Excess Operating Assets

.64

When the subject interest is a business, business ownership interest, or security, the valuation report should identify any related non-operating assets, non-operating liabilities, or excess or deficient operating assets and their effect on the valuation (see paragraph .41).

Representation of the Valuation Analyst

.65

Each written report should contain the representation of the valuation analyst. The representation is the section of the report wherein the valuation analyst summarizes the factors that guided his or her work during the engagement. Examples of these factors include the following:

- a. The analyses and conclusion of value included in the valuation report are subject to the specified assumptions and limiting conditions (see paragraph .18), and they are the personal analyses and conclusion of value of the valuation analyst.
- b. The economic and industry data included in the valuation report have been obtained from various printed or electronic reference sources that the valuation analyst believes to be reliable (any exceptions should be noted). The valuation analyst has not performed any corroborating procedures to substantiate that data.
- c. The valuation engagement was performed in accordance with the American Institute of Certified Public Accountants Statement on Standards for Valuation Services.
- d. The parties for which the information and use of the valuation report is restricted are identified; the valuation report is not intended to be and should not be used by anyone other than such parties (see paragraph .49).
- e. The analyst's compensation is fee-based or is contingent on the outcome of the valuation.
- f. The valuation analyst used the work of one or more outside specialists to assist during the valuation engagement. (An outside specialist is a specialist other than those employed in the valuation analyst's firm.) If the work of such a specialist was used, the specialist should be identified. The valuation report should include a statement identifying the level of responsibility, if any, the valuation analyst is assuming for the specialist's work.
- g. The valuation analyst has no obligation to update the report or the conclusion of value for information that comes to his or her attention after the date of the report.
- h. The valuation analyst and, if applicable, the person(s) assuming responsibility for the valuation should sign the representation in their own name(s). The names of those providing significant professional assistance should be identified.

Representations Regarding Information Provided to the Valuation Analyst

.66

It may be appropriate for the valuation analyst to obtain written representations regarding information that the subject entity's management provides to the valuation analyst for purposes of his or her performing the valuation engagement. The decision whether to obtain a representation

letter is a matter of judgment for the valuation analyst.

Qualifications of the Valuation Analyst

.67

The report should contain information regarding the qualifications of the valuation analyst.

Conclusion of Value

.68

This section should present a reconciliation of the valuation analyst's estimate or various estimates of the value of the subject interest. In addition to a discussion of the rationale underlying the conclusion of value, this section should include the following or similar statements:

- a. A valuation engagement was performed, including the subject interest and the valuation date.
- b. The analysis was performed solely for the purpose described in this report, and the resulting estimate of value should not be used for any other purpose.
- c. The valuation engagement was conducted in accordance with the Statement(s) on Standards for Valuation Services of the American Institute of Certified Public Accountants.
- d. A statement that the estimate of value resulting from a valuation engagement is expressed as a conclusion of value.
- e. The scope of work or data available for analysis is explained, including any restrictions or limitations (see paragraph .19).
- f. A statement describing the conclusion of value, either a single amount or a range.
- g. The conclusion of value is subject to the assumptions and limiting conditions (see paragraph .18) and to the valuation analyst's representation (see paragraph .65).
- h. The report is signed in the name of the valuation analyst or the valuation analyst's firm.
- i. The date of the valuation report is included.
- j. The valuation analyst has no obligation to update the report or the conclusion of value for information that comes to his or her attention after the date of the report.

.69

The following is an example of report language that could be used, but is not required, when reporting the results of a valuation engagement:

We have performed a *valuation engagement*, as that term is defined in the Statement on Standards for Valuation Services (SSVS) of the American Institute of Certified Public Accountants, of [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [valuation date]. This valuation was performed solely to assist in the matter of [purpose of the valuation]; the resulting estimate of value should not be used for any other purpose or by

any other party for any purpose. This valuation engagement was conducted in accordance with the SSVS. The estimate of value that results from a valuation engagement is expressed as a conclusion of value.

[If applicable] We were restricted or limited in the scope of our work or data available for analysis as follows: [describe restrictions or limitations].

Based on our analysis, as described in this valuation report, the estimate of value of *[DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company]* as of *[valuation date]* was *[value, either a single amount or a range]*. This conclusion is subject to the Statement of Assumptions and Limiting Conditions found in *[reference to applicable section of valuation report]* and to the Valuation Analyst's Representation found in *[reference to applicable section of valuation report]*. ~~We have no obligation to update this report or our conclusion~~ of value for information that comes to our attention after the date of this report.

[Signature]

[Date]

Appendixes and Exhibits

.70

Appendixes or exhibits may be used for required information or information that supplements the detailed report. Often, the assumptions and limiting conditions and the valuation analyst's representation are provided in appendixes to the detailed report.

Summary Report

.71

A summary report is structured to provide an abridged version of the information that would be provided in a detailed report, and therefore, need not contain the same level of detail as a detailed report. However, a summary report should, at a minimum, include the following:

- a. Identity of the client
- b. Purpose and intended use of the valuation
- c. Intended users of the valuation
- d. Identity of the subject entity
- e. Description of the subject interest
- f. The business interest's ownership control characteristics, if any, and its degree of marketability
- g. Valuation date
- h. Valuation report date

- i.* Type of report issued (namely, a summary report) (paragraph .48)
- j.* Applicable premise of value
- k.* Applicable standard of value
- l.* Sources of information used in the valuation engagement
- m.* Assumptions and limiting conditions of the valuation engagement (paragraph .18)
- n.* The scope of work or data available for analysis including any restrictions or limitations (paragraph .19)
- o.* Any hypothetical conditions used in the valuation engagement, including the basis for their use (paragraph .22)
- p.* If the work of a specialist was used in the valuation (paragraph .20), a description of how the specialist's work was used, and the level of responsibility, if any, the valuation analyst is assuming for the specialist's work
- q.* The valuation approaches and methods used
- r.* Disclosure of subsequent events in certain circumstances (paragraph .43)
- s.* Any application of the jurisdictional exception (paragraph .10)
- t.* Representation of the valuation analyst (paragraph .65)
- u.* The report is signed in the name of the valuation analyst or the valuation analyst's firm
- v.* A section summarizing the reconciliation of the estimates and the conclusion of value as discussed in paragraphs .68 and .69
- w.* A statement that the valuation analyst has no obligation to update the report or the conclusion of value for information that comes to his or her attention after the date of the valuation report

.72

Appendixes or exhibits may be used for required information (see paragraph .70) or information that supplements the summary report. Often, the assumptions, limiting conditions, and the valuation analyst's representation are provided in appendixes to the summary report.

Calculation Report

.73

As indicated in paragraph .48, a calculation report is the only report that should be used to report the results of a calculation engagement. The report should state that it is a calculation report. The calculation report should include the representation of the valuation analyst similar to that in paragraph .65, but adapted for a calculation engagement.

.74

The calculation report should identify any hypothetical conditions used in the calculation engagement, including the basis for their use (paragraph .22), any application of the jurisdictional exception (paragraph .10), and any assumptions and limiting conditions applicable to the engagement (paragraph .18). If the valuation analyst used the work of a specialist (paragraph .20), the valuation analyst should describe in the calculation report how the specialist's work was used and the level of responsibility, if any, the valuation analyst is assuming for the specialist's work. The calculation report may also include a disclosure of subsequent events in certain circumstances (paragraph .43).

.75

Appendixes or exhibits may be used for required information (paragraph .72) or information that supplements the calculation report. Often, the assumptions and limiting conditions and the valuation analyst's representation are provided in appendixes to the calculation report.

.76

The calculation report should include a section summarizing the calculated value. This section should include the following (or similar) statements:

- a. Certain calculation procedures were performed; include the identity of the subject interest and the calculation date.
- b. Describe the calculation procedures and the scope of work performed or reference the section(s) of the calculation report in which the calculation procedures and scope of work are described.
- c. Describe the purpose of the calculation procedures, including that the calculation procedures were performed solely for that purpose and that the resulting calculated value should not be used for any other purpose or by any other party for any purpose.
- d. The calculation engagement was conducted in accordance with the Statement on Standards for Valuation Services of the American Institute of Certified Public Accountants.
- e. A description of the business interest's characteristics, including whether the subject interest exhibits control characteristics, and a statement about the marketability of the subject interest.
- f. The estimate of value resulting from a calculation engagement is expressed as a calculated value.
- g. A general description of a calculation engagement is given, including that
 - i. a calculation engagement does not include all of the procedures required for a valuation engagement, and
 - ii. had a valuation engagement been performed, the results may have been different.

- h. The calculated value, either a single amount or a range, is described.
- i. The report is signed in the name of the valuation analyst or the valuation analyst's firm.
- j. The date of the valuation report is given.
- k. The valuation analyst has no obligation to update the report or the calculation of value for information that comes to his or her attention after the date of the report.

.77

The following is an example of report language that could be used, but is not required, in reporting a calculation engagement:

We have performed a *calculation engagement*, as that term is defined in the Statement on Standards for Valuation Services (SSVS) of the American Institute of Certified Public Accountants. We performed certain calculation procedures on [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [calculation date]. The specific calculation procedures are detailed in paragraphs [reference to paragraph numbers] of our calculation report. The calculation procedures were performed solely to assist in the matter of [purpose of valuation procedures], and the resulting calculation of value should not be used for any other purpose or by any other party for any purpose. This calculation engagement was conducted in accordance with the SSVS. The estimate of value that results from a calculation engagement is expressed as a calculated value.

In a calculation engagement, the valuation analyst and the client agree on the specific valuation approaches and valuation methods the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform to estimate the value of the subject interest. A calculation engagement does not include all of the procedures required in a *valuation engagement*, as that term is defined in the SSVS. Had a valuation engagement been performed, the results might have been different.

Based on our calculations, as described in this report, which are based solely on the procedures agreed upon as previously referred to, the resulting calculated value of [DEF Company, GHI business ownership interest of DEF Company, GHI security of DEF Company, or GHI intangible asset of DEF Company] as of [valuation date] was [calculated value, either a single amount or a range]. This calculated value is subject to the Statement of Assumptions and Limiting Conditions found in [reference to applicable section of valuation report] and to the Valuation Analyst's Representation found in [reference to applicable section of valuation report]. We have no obligation to update this report or our calculation of value for information that comes to our attention after the date of this report.

[Signature]

[Date]

Oral Report

.78

An oral report may be used in a valuation engagement or a calculation engagement. An oral report should include all information the valuation analyst believes necessary to relate the scope, assumptions, limitations, and the results of the engagement so as to limit any misunderstandings between the analyst and the recipient of the oral report. The member should document in the working papers the substance of the oral report communicated to the client.

Effective Date

.79

This statement applies to engagements to estimate value accepted on or after January 1, 2008. Earlier application is encouraged.

Appendix A

Illustrative List of Assumptions and Limiting Conditions for a Business Valuation

.80

The valuation report or calculation report should include a list of assumptions and limiting conditions under which the engagement was performed. This appendix includes an illustrative list of assumptions and limiting conditions that may apply to a business valuation.

Illustrative List of Assumptions and Limiting Conditions

1. The conclusion of value (or the calculated value) arrived at herein is valid only for the stated purpose as of the date of the valuation.
2. Financial statements and other related information provided by [ABC Company] or its representatives, in the course of this engagement, have been accepted without any verification as fully and correctly reflecting the enterprise's business conditions and operating results for the respective periods, except as specifically noted herein. [Valuation Firm] has not audited, reviewed, or compiled the financial information provided to us and, accordingly, we express no audit opinion or any other form of assurance on this information.
3. Public information and industry and statistical information have been obtained from sources we believe to be reliable. However, we make no representation as to the accuracy or completeness of such information and have performed no procedures to corroborate the information.
4. We do not provide assurance on the achievability of the results forecasted by [ABC Company] because events and circumstances frequently do not occur as expected; differences between actual and expected results may be material; and achievement of the forecasted results is dependent on actions, plans, and assumptions of management.
5. The conclusion of value (or the calculated value) arrived at herein is based on the assumption that the current level of management expertise and effectiveness would continue to be

maintained, and that the character and integrity of the enterprise through any sale, reorganization, exchange, or diminution of the owners' participation would not be materially or significantly changed.

6. This report and the conclusion of value (or the calculated value) arrived at herein are for the exclusive use of our client for the sole and specific purposes as noted herein. They may not be used for any other purpose or by any other party for any purpose. Furthermore the report and conclusion of value (or the calculated value) are not intended by the author and should not be construed by the reader to be investment advice in any manner whatsoever. The stated valuation represents the considered conclusion of value (or the calculated value) of [Valuation Firm], based on information furnished to them by [ABC Company] and other sources.
7. Neither all nor any part of the contents of this report (especially the conclusion of value [or the calculated value], the identity of any valuation specialist(s), or the firm with which such valuation specialists are connected or any reference to any of their professional designations) should be disseminated to the public through advertising media, public relations, news media, sales media, mail, direct transmittal, or any other means of communication without the prior written consent and approval of [Valuation Firm].
8. Future services regarding the subject matter of this report, including, but not limited to testimony or attendance in court, shall not be required of [Valuation Firm] unless previous arrangements have been made in writing.
9. [Valuation Firm] is not an environmental consultant or auditor, and it takes no responsibility for any actual or potential environmental liabilities. Any person entitled to rely on this report, wishing to know whether such liabilities exist, or the scope and their effect on the value of the property, is encouraged to obtain a professional environmental assessment. [Valuation Firm] does not conduct or provide environmental assessments and has not performed one for the subject property.
10. [Valuation Firm] has not determined independently whether [ABC Company] is subject to any present or future liability relating to environmental matters (including, but not limited to CERCLA/Superfund liability) nor the scope of any such liabilities. [Valuation Firm]'s valuation takes no such liabilities into account, except as they have been reported to [Valuation Firm] by [ABC Company] or by an environmental consultant working for [ABC Company], and then only to the extent that the liability was reported to us in an actual or estimated dollar amount. Such matters, if any, are noted in the report. To the extent such information has been reported to us, [Valuation Firm] has relied on it without verification and offers no warranty or representation as to its accuracy or completeness.
11. [Valuation Firm] has not made a specific compliance survey or analysis of the subject property to determine whether it is subject to, or in compliance with, the American Disabilities Act of 1990, and this valuation does not consider the effect, if any, of noncompliance.
12. [Sample wording for use if the jurisdictional exception is invoked.] The conclusion of value (or the calculated value) in this report deviates from the Statement on Standards for Valuation Services as a result of published governmental, judicial, or accounting authority.
13. No change of any item in this report shall be made by anyone other than [Valuation Firm],

and we shall have no responsibility for any such unauthorized change.

14. Unless otherwise stated, no effort has been made to determine the possible effect, if any, on the subject business due to future Federal, state, or local legislation, including any environmental or ecological matters or interpretations thereof.
15. If prospective financial information approved by management has been used in our work, we have not examined or compiled the prospective financial information and therefore, do not express an audit opinion or any other form of assurance on the prospective financial information or the related assumptions. Events and circumstances frequently do not occur as expected and there will usually be differences between prospective financial information and actual results, and those differences may be material.
16. ~~We have conducted interviews with the current management of [ABC Company] concerning the past, present, and prospective operating results of the company.~~
17. Except as noted, we have relied on the representations of the owners, management, and other third parties concerning the value and useful condition of all equipment, real estate, investments used in the business, and any other assets or liabilities, except as specifically stated to the contrary in this report. ~~We have not attempted to confirm whether or not all assets of the business are free and clear of liens and encumbrances or that the entity has good title to all assets.~~

Appendix B

International Glossary of Business Valuation Terms ^{in *}

.31

To enhance and sustain the quality of business valuations for the benefit of the profession and its clientele, the subsequently identified societies and organizations have adopted the definitions for the terms included in this glossary.

The performance of business valuation services requires a high degree of skill and imposes upon the valuation professional a duty to communicate the valuation process and conclusion in a manner that is clear and not misleading. This duty is advanced through the use of terms whose meanings are clearly established and consistently applied throughout the profession.

If, in the opinion of the business valuation professional, one or more of these terms needs to be used in a manner which materially departs from the enclosed definitions, it is recommended that the term be defined as used within that valuation engagement.

This glossary has been developed to provide guidance to business valuation practitioners by further memorializing the body of knowledge that constitutes the competent and careful determination of value and, more particularly, the communication of how that value was determined.

Departure from this glossary is not intended to provide a basis for civil liability and should not be presumed to create evidence that any duty has been breached.

American Institute of Certified Public Accountants

**American Society of Appraisers
Canadian Institute of Chartered Business Valuators
National Association of Certified Valuation Analysts
The Institute of Business Appraisers**

Adjusted Book Value Method—a method within the asset approach whereby all assets and liabilities (including off-balance sheet, intangible, and contingent) are adjusted to their fair market values. {NOTE: In Canada on a going concern basis}

Adjusted Net Asset Method —see **Adjusted Book Value Method**.

Appraisal—see **Valuation**.

Appraisal Approach—see **Valuation Approach**.

Appraisal Date—see **Valuation Date**.

Appraisal Method—see **Valuation Method**.

Appraisal Procedure—see **Valuation Procedure**.

Arbitrage Pricing Theory—a multivariate model for estimating the cost of equity capital, which incorporates several systematic risk factors.

Asset (Asset-Based) Approach—a general way of determining a value indication of a business, business ownership interest, or security using one or more methods based on the value of the assets net of liabilities.

Beta—a measure of systematic risk of a stock; the tendency of a stock's price to correlate with changes in a specific index.

Blockage Discount—an amount or percentage deducted from the current market price of a publicly traded stock to reflect the decrease in the per share value of a block of stock that is of a size that could not be sold in a reasonable period of time given normal trading volume.

Book Value—see **Net Book Value**.

Business—see **Business Enterprise**.

Business Enterprise—a commercial, industrial, service, or investment entity (or a combination thereof) pursuing an economic activity.

Business Risk—the degree of uncertainty of realizing expected future returns of the business resulting from factors other than financial leverage. See **Financial Risk**.

Business Valuation—the act or process of determining the value of a business enterprise or ownership interest therein.

Capital Asset Pricing Model (CAPM)—a model in which the cost of capital for any stock or portfolio of stocks equals a risk-free rate plus a risk premium that is proportionate to the systematic risk of the stock or portfolio.

Capitalization—a conversion of a single period of economic benefits into value.

Capitalization Factor—any multiple or divisor used to convert anticipated economic benefits of a

single period into value.

Capitalization of Earnings Method—a method within the income approach whereby economic benefits for a representative single period are converted to value through division by a capitalization rate.

Capitalization Rate—any divisor (usually expressed as a percentage) used to convert anticipated economic benefits of a single period into value.

Capital Structure—the composition of the invested capital of a business enterprise; the mix of debt and equity financing.

Cash Flow—cash that is generated over a period of time by an asset, group of assets, or business enterprise. It may be used in a general sense to encompass various levels of specifically defined cash flows. When the term is used, it should be supplemented by a qualifier (for example, "discretionary" or "operating") and a specific definition in the given valuation context.

Common Size Statements—financial statements in which each line is expressed as a percentage of the total. On the balance sheet, each line item is shown as a percentage of total assets, and on the income statement, each item is expressed as a percentage of sales.

Control—the power to direct the management and policies of a business enterprise.

Control Premium—an amount or a percentage by which the pro rata value of a controlling interest exceeds the pro rata value of a non-controlling interest in a business enterprise to reflect the power of control.

Cost Approach—a general way of determining a value indication of an individual asset by quantifying the amount of money required to replace the future service capability of that asset.

Cost of Capital—the expected rate of return that the market requires in order to attract funds to a particular investment.

Debt-Free—*we discourage the use of this term.* See **Invested Capital**.

Discount for Lack of Control—an amount or percentage deducted from the pro rata share of value of 100% of an equity interest in a business to reflect the absence of some or all of the powers of control.

Discount for Lack of Marketability—an amount or percentage deducted from the value of an ownership interest to reflect the relative absence of marketability.

Discount for Lack of Voting Rights—an amount or percentage deducted from the per share value of a minority interest voting share to reflect the absence of voting rights.

Discount Rate—a rate of return used to convert a future monetary sum into present value.

Discounted Cash Flow Method—a method within the income approach whereby the present value of future expected net cash flows is calculated using a discount rate.

Discounted Future Earnings Method—a method within the income approach whereby the

present value of future expected economic benefits is calculated using a discount rate.

Economic Benefits—inflows such as revenues, net income, net cash flows, etc.

Economic Life—the period of time over which property may generate economic benefits.

Effective Date—see **Valuation Date**.

Enterprise—see **Business Enterprise**.

Equity—the owner's interest in property after deduction of all liabilities.

Equity Net Cash Flows—those cash flows available to pay out to equity holders (in the form of dividends) after funding operations of the business enterprise, making necessary capital investments, and increasing or decreasing debt financing.

Equity Risk Premium—a rate of return added to a risk-free rate to reflect the additional risk of equity instruments over risk free instruments (a component of the cost of equity capital or equity discount rate).

Excess Earnings—that amount of anticipated economic benefits that exceeds an appropriate rate of return on the value of a selected asset base (often net tangible assets) used to generate those anticipated economic benefits.

Excess Earnings Method—a specific way of determining a value indication of a business, business ownership interest, or security determined as the sum of a) the value of the assets derived by capitalizing excess earnings and b) the value of the selected asset base. Also frequently used to value intangible assets. See **Excess Earnings**.

Fair Market Value—the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts. (NOTE: In Canada, the term "price" should be replaced with the term "highest price.")

Fairness Opinion—an opinion as to whether or not the consideration in a transaction is fair from a financial point of view.

Financial Risk—the degree of uncertainty of realizing expected future returns of the business resulting from financial leverage. See **Business Risk**.

Forced Liquidation Value—liquidation value, at which the asset or assets are sold as quickly as possible, such as at an auction.

Free Cash Flow—*we discourage the use of this term*. See **Net Cash Flow**.

Going Concern—an ongoing operating business enterprise.

Going Concern Value—the value of a business enterprise that is expected to continue to operate into the future. The intangible elements of Going Concern Value result from factors such as having a trained work force, an operational plant, and the necessary licenses, systems, and procedures in place.

Goodwill—that intangible asset arising as a result of name, reputation, customer loyalty, location,

products, and similar factors not separately identified.

Goodwill Value—the value attributable to goodwill.

Guideline Public Company Method—a method within the market approach whereby market multiples are derived from market prices of stocks of companies that are engaged in the same or similar lines of business and that are actively traded on a free and open market.

Income (Income-Based) Approach—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more methods that convert anticipated economic benefits into a present single amount.

Intangible Assets—nonphysical assets such as franchises, trademarks, patents, copyrights, goodwill, equities, mineral rights, securities, and contracts (as distinguished from physical assets) that grant rights and privileges and have value for the owner.

Internal Rate of Return—a discount rate at which the present value of the future cash flows of the investment equals the cost of the investment.

Intrinsic Value—the value that an investor considers, on the basis of an evaluation or available facts, to be the "true" or "real" value that will become the market value when other investors reach the same conclusion. When the term applies to options, it is the difference between the exercise price and strike price of an option and the market value of the underlying security.

Invested Capital—the sum of equity and debt in a business enterprise. Debt is typically (a) all interest-bearing debt or (b) long-term, interest-bearing debt. When the term is used, it should be supplemented by a specific definition in the given valuation context.

Invested Capital Net Cash Flows—those cash flows available to pay out to equity holders (in the form of dividends) and debt investors (in the form of principal and interest) after funding operations of the business enterprise and making necessary capital investments.

Investment Risk—the degree of uncertainty as to the realization of expected returns.

Investment Value—the value to a particular investor based on individual investment requirements and expectations. (NOTE: in Canada, the term used is "Value to the Owner.")

Key Person Discount—an amount or percentage deducted from the value of an ownership interest to reflect the reduction in value resulting from the actual or potential loss of a key person in a business enterprise.

Levered Beta—the beta reflecting a capital structure that includes debt.

Limited Appraisal—the act or process of determining the value of a business, business ownership interest, security, or intangible asset with limitations in analyses, procedures, or scope.

Liquidity—the ability to quickly convert property to cash or pay a liability.

Liquidation Value—the net amount that would be realized if the business is terminated and the assets are sold piecemeal. Liquidation can be either "orderly" or "forced."

Majority Control—the degree of control provided by a majority position.

Majority Interest—an ownership interest greater than 50% of the voting interest in a business enterprise.

Market (Market-Based) Approach—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset by using one or more methods that compare the subject to similar businesses, business ownership interests, securities, or intangible assets that have been sold.

Market Capitalization of Equity—the share price of a publicly traded stock multiplied by the number of shares outstanding.

Market Capitalization of Invested Capital—the market capitalization of equity plus the market value of the debt component of invested capital.

Market Multiple—the market value of a company's stock or invested capital divided by a company measure (such as economic benefits, number of customers).

Marketability—the ability to quickly convert property to cash at minimal cost.

Marketability Discount—see **Discount for Lack of Marketability**.

Merger and Acquisition Method—a method within the market approach whereby pricing multiples are derived from transactions of significant interests in companies engaged in the same or similar lines of business.

Mid-Year Discounting—a convention used in the Discounted Future Earnings Method that reflects economic benefits being generated at midyear, approximating the effect of economic benefits being generated evenly throughout the year.

Minority Discount—a discount for lack of control applicable to a minority interest.

Minority Interest—an ownership interest less than 50% of the voting interest in a business enterprise.

Multiple—the inverse of the capitalization rate.

Net Book Value—with respect to a business enterprise, the difference between total assets (net of accumulated depreciation, depletion, and amortization) and total liabilities as they appear on the balance sheet (synonymous with Shareholder's Equity). With respect to a specific asset, the capitalized cost less accumulated amortization or depreciation as it appears on the books of account of the business enterprise.

Net Cash Flows—when the term is used, it should be supplemented by a qualifier. See **Equity Net Cash Flows** and **Invested Capital Net Cash Flows**.

Net Present Value—the value, as of a specified date, of future cash inflows less all cash outflows (including the cost of investment) calculated using an appropriate discount rate.

Net Tangible Asset Value—the value of the business enterprise's tangible assets (excluding excess assets and nonoperating assets) minus the value of its liabilities.

Nonoperating Assets—assets not necessary to ongoing operations of the business enterprise.
(NOTE: in Canada, the term used is "Redundant Assets.")

Normalized Earnings—economic benefits adjusted for nonrecurring, noneconomic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

Normalized Financial Statements—financial statements adjusted for nonoperating assets and liabilities and/or for nonrecurring, noneconomic, or other unusual items to eliminate anomalies and/or facilitate comparisons.

Orderly Liquidation Value—liquidation value at which the asset or assets are sold over a reasonable period of time to maximize proceeds received.

Premise of Value—an assumption regarding the most likely set of transactional circumstances that may be applicable to the subject valuation; for example, going concern, liquidation.

Present Value—the value, as of a specified date, of future economic benefits and/or proceeds from sale, calculated using an appropriate discount rate.

Portfolio Discount—an amount or percentage deducted from the value of a business enterprise to reflect the fact that it owns dissimilar operations or assets that do not fit well together.

Price/Earnings Multiple—the price of a share of stock divided by its earnings per share.

Rate of Return—an amount of income (loss) and/or change in value realized or anticipated on an investment, expressed as a percentage of that investment.

Redundant Assets—see **Nonoperating Assets**.

Report Date—the date conclusions are transmitted to the client.

Replacement Cost New—the current cost of a similar new property having the nearest equivalent utility to the property being valued.

Reproduction Cost New—the current cost of an identical new property.

Required Rate of Return—the minimum rate of return acceptable by investors before they will commit money to an investment at a given level of risk.

Residual Value—the value as of the end of the discrete projection period in a discounted future earnings model.

Return on Equity—the amount, expressed as a percentage, earned on a company's common equity for a given period.

Return on Investment—See **Return on Invested Capital** and **Return on Equity**.

Return on Invested Capital—the amount, expressed as a percentage, earned on a company's total capital for a given period.

Risk-Free Rate—the rate of return available in the market on an investment free of default risk.

Risk Premium—a rate of return added to a risk-free rate to reflect risk.

Rule of Thumb—a mathematical formula developed from the relationship between price and certain variables based on experience, observation, hearsay, or a combination of these; usually industry specific.

Special Interest Purchasers—acquirers who believe they can enjoy post-acquisition economies

of scale, synergies, or strategic advantages by combining the acquired business interest with their own.

Standard of Value—the identification of the type of value being utilized in a specific engagement; for example, fair market value, fair value, investment value.

Sustaining Capital Reinvestment—the periodic capital outlay required to maintain operations at existing levels, net of the tax shield available from such outlays.

Systematic Risk—the risk that is common to all risky securities and cannot be eliminated through diversification. The measure of systematic risk in stocks is the beta coefficient.

Tangible Assets—physical assets (such as cash, accounts receivable, inventory, property, plant and equipment, etc.).

Terminal Value—See **Residual Value**.

Transaction Method—See **Merger and Acquisition Method**.

Unlevered Beta—the beta reflecting a capital structure without debt.

Unsystematic Risk—the risk specific to an individual security that can be avoided through diversification.

Valuation—the act or process of determining the value of a business, business ownership interest, security, or intangible asset.

Valuation Approach—a general way of determining a value indication of a business, business ownership interest, security, or intangible asset using one or more valuation methods.

Valuation Date—the specific point in time as of which the valuator's opinion of value applies (also referred to as "Effective Date" or "Appraisal Date").

Valuation Method—within approaches, a specific way to determine value.

Valuation Procedure—the act, manner, and technique of performing the steps of an appraisal method.

Valuation Ratio—a fraction in which a value or price serves as the numerator and financial, operating, or physical data serve as the denominator.

Value to the Owner—see **Investment Value**.

Voting Control—*de jure* control of a business enterprise.

Weighted Average Cost of Capital (WACC)—the cost of capital (discount rate) determined by the weighted average, at market value, of the cost of all financing sources in the business enterprise's capital structure.

Appendix C

Glossary of Additional Terms

assumptions and limiting conditions. Parameters and boundaries under which a valuation is performed, as agreed upon by the valuation analyst and the client or as acknowledged or understood by the valuation analyst and the client as being due to existing circumstances. An example is the acceptance, without further verification, by the valuation analyst from the client of the client's financial statements and related information.

business ownership interest. A designated share in the ownership of a business (business enterprise).

calculated value. An estimate as to the value of a business, business ownership interest, security, or intangible asset, arrived at by applying valuation procedures agreed upon with the client and using professional judgment as to the value or range of values based on those procedures.

calculation engagement. An engagement to estimate value wherein the valuation analyst and the client agree on the specific valuation approaches and valuation methods that the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform to estimate the value of a subject interest. A calculation engagement generally does not include all of the valuation procedures required for a valuation engagement. If a valuation engagement had been performed, the results might have been different. The valuation analyst expresses the results of the calculation engagement as a calculated value, which may be either a single amount or a range.

capital or contributory asset charge. A fair return on an entity's *contributory assets*, which are tangible and intangible assets used in the production of income or cash flow associated with an intangible asset being valued. In this context, *income or cash flow* refers to an applicable measure of income or cash flow, such as net income, or operating cash flow before taxes and capital expenditures. A capital charge may be expressed as a percentage return on an economic rent associated with, or a profit split related to, the contributory assets.

capitalization of benefits method. A method within the income approach whereby expected future benefits (for example, earnings or cash flow) for a representative single period are converted to value through division by a capitalization rate.

comparable profits method. A method of determining the value of intangible assets by comparing the profits of the subject entity with those of similar uncontrolled companies that have the same or similar complement of intangible assets as the subject company.

comparable uncontrolled transaction method. A method of determining the value of intangible assets by comparing the subject transaction to similar transactions in the market place made between independent (uncontrolled) parties.

conclusion of value. An estimate of the value of a business, business ownership interest, security, or intangible asset, arrived at by applying the valuation procedures appropriate for a valuation engagement and using professional judgment as to the value or range of values based on those procedures.

control adjustment. A valuation adjustment to financial statements to reflect the effect of a controlling interest in a business. An example would be an adjustment to owners' compensation that is in excess of market compensation.

engagement to estimate value. An engagement, or any part of an engagement (for example, a tax, litigation, or acquisition-related engagement), that involves determining the value of a business, business ownership interest, security, or intangible asset. Also known as *valuation service*.

excess operating assets. Operating assets in excess of those needed for the normal operation of a business.

fair value. In valuation applications, there are two commonly used definitions for fair value:

- (1) For financial reporting purposes only, the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. *Source:* Financial Accounting Standards Board *Accounting Standards Codification* glossary.
- (2) For state legal matters only, some states have laws that use the term *fair value* in shareholder and partner matters. For state legal matters only, therefore, the term may be defined by statute or case law in the particular jurisdiction.

guideline company transactions method. A method within the market approach whereby market multiples are derived from the sales of entire companies engaged in the same or similar lines of business.

hypothetical condition. That which is or may be contrary to what exists, but is supposed for the purpose of analysis.

incremental income. Additional income or cash flow attributable to an entity's ownership or operation of an intangible asset being valued, as determined by a comparison of the entity's income or cash flow with the intangible asset to the entity's income or cash flow without the intangible asset. In this context, *income or cash flow* refers to an applicable measure of income or cash flow, such as license royalty income or operating cash flow before taxes and capital expenditures.

normalization. See *Normalized Earnings* in appendix B, "International Glossary of Business Valuation Terms." (see paragraph .81).

pre-adjustment value. The value arrived at prior to the application, if appropriate, of valuation discounts or premiums.

profit split income. With respect to the valuation of an intangible asset of an entity, a percentage allocation of the entity's income or cash flow whereby (1) a split (or percentage) is allocated to the subject intangible and (2) the remainder is allocated to all of the entity's tangible and other intangible assets. In this context, *income or cash flow* refers to an applicable measure of income or cash flow, such as net income or operating cash flow before taxes and capital expenditures.

relief from royalty method. A valuation method used to value certain intangible assets (for example, trademarks and trade names) based on the premise that the only value that a purchaser of the assets receives is the exemption from paying a royalty for its use. Application of this method usually involves estimating the fair market value of an intangible asset by quantifying the present value of the stream of market-derived royalty payments that

the owner of the intangible asset is exempted from or "relieved" from paying.

residual income. For an entity that owns or operates an intangible asset being valued, the portion of the entity's income or cash flow remaining after subtracting a capital charge on all of the entity's tangible and other intangible assets. *Income or cash flows* can refer to any appropriate measure of income or cash flow, such as net income or operating cash flow before taxes and capital expenditures.

security. A certificate evidencing ownership or the rights to ownership in a business enterprise that (1) is represented by an instrument or by a book record or contractual agreement, (2) is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment, and (3) either one of a class or series or, by its terms, is divisible into a class or series of shares, participations, interests, rights, or interest-bearing obligations.

subject interest. A business, business ownership interest, security, or intangible asset that is the subject of a valuation engagement.

subsequent event. An event that occurs subsequent to the valuation date.

valuation analyst. For purposes of this statement, an AICPA member who performs an engagement to estimate value that culminates in the expression of a conclusion of value or a calculated value.

valuation assumptions. Statements or inputs utilized in the performance of an engagement to estimate value that serve as a basis for the application of particular valuation methods.

valuation engagement. An engagement to estimate value in which a valuation analyst determines an estimate of the value of a subject interest by performing appropriate valuation procedures, as outlined in the AICPA Statement on Standards for Valuation Services, and is free to apply the valuation approaches and methods he or she deems appropriate in the circumstances. The valuation analyst expresses the results of the valuation engagement as a conclusion of value, which may be either a single amount or a range.

valuation service. See **engagement to estimate value**.

[Revised, June 2009, to reflect conforming changes necessary due to the issuance of FASB ASC; Revised, January 2015, to reflect the revised Code of Professional Conduct.]

Footnotes (VS Section 100 — Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset):

¹ This statement includes two glossaries. Appendix B, "International Glossary of Business Valuation Terms" (par. .81), is a verbatim reproduction of the glossary jointly developed by the AICPA, the American Society of Appraisers (ASA), the Canadian Institute of Chartered Business Valuators, the National Association of Certified Valuation Analysts, and the Institute of Business Appraisers. Appendix C, "Glossary of Additional Terms" (par. .82), provides definitions for terms included in this statement but not defined in the jointly developed glossary. The terms defined in appendix B are in boldface type the first time they appear in this statement; the terms defined in appendix C are in italicized boldface type the first time they appear in this statement.

^{In 2} Unless prohibited by statute or by rule, a member may use the client's estimates for compliance reporting to a third party if the member determines that the estimates are reasonable (based on the facts and circumstances known to the member). See Interpretation No. 1, "Scope of Applicable Services" (VS sec. 9100 par. .01–.89), and Statement for Standards on Tax Services No. 4, *Use of Estimates* (TS sec. 400).

^{In 3} Reproduced verbatim from the International Glossary of Business Valuation Terms (the Glossary), which appears at www.aicpa.org/InterestAreas/ForensicAndValuation/Membership/DownloadableDocuments/Intl%20Glossary%20of%20BV%20Terms.pdf. Note that the phrase, "we discourage the use of this term," that appears herein is also reproduced verbatim.

VS Section 9100

Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset: Valuation Services Interpretations of Section 100

1. Scope of Applicable Services

Background

.01

The Statement on Standards for Valuation Services (SSVS) No. 1, *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset* [VS section 100] establishes standards of performance and reporting for all AICPA members performing those valuation services that are within the scope of the Statement. When originally proposed on March 30, 2005, the Exposure Draft contained a list of questions and answers (Appendix A of the March 30, 2005 Exposure Draft) that were intended to assist members in determining if an engagement, particularly with regard to litigation or tax engagements, fell within the scope of the Statement. Through the Exposure Draft process, it was determined that the questions and answers were an integral part of the Statement and should be made authoritative. This Interpretation is part of the AICPA's continuing efforts at self-regulation of its members in valuation practice, and its desire to provide guidance to members when providing valuation services. The Interpretation does not change or elevate any level of conduct prescribed by any standard. Its goal is to clarify existing standards.

General Interpretation

.02

The SSVSs apply to an engagement to estimate value if, as all or as part of another engagement, a member determines the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraphs 1 and 2 [VS section 100.01–.02]). In the process of estimating value, professional judgment is used to apply valuation approaches and valuation methods as described in the SSVS No. 1, paragraph 4 [VS section 100.04].

.03

In determining whether a particular service falls within the scope of the Statement, a member should consider those services that are specifically excluded:

- Audit, review, and compilation engagements (SSVS No. 1, paragraph 5 [VS section 100.05])
- Use of values provided by the client or a third party (SSVS No. 1, paragraph 6 [VS section 100.06])
- Internal use assignments from employers to employee members not in the *practice of public accounting* (SSVS No. 1, paragraph 7 [VS section 100.07])
- Engagements that are exclusively for the purpose of determining economic damages (for example, lost profits) and that do not include an engagement to estimate value (SSVS No. 1, paragraph 8 [VS section 100.08])
- Mechanical computations that do not rise to the level of an engagement to estimate value (SSVS No. 1, paragraph 9(a) [VS section 100.09a])
- Engagements where it is not practical or reasonable to obtain or use relevant information and, therefore, the member is unable to apply valuation approaches and methods described in this Statement. (SSVS No. 1, paragraph 9(b) [VS section 100.09b])
- Engagements meeting the jurisdictional exception (SSVS No. 1, paragraph 10 [VS section 100.10])

.04

A member should be diligent in determining if an engagement falls within the scope of the Statement. Unless specifically excluded by the SSVS, if the engagement requires a member to apply valuation approaches and methods, and use professional judgment in applying those approaches and methods, the SSVS would apply. In determining the scope and requirements of the engagement, a member should consider the clients needs, or the requirements of a third party for which the valuation is intended, including governmental, judicial, and accounting authorities. In addition, a member should consider other professional standards that might apply.

Specific Illustrations

.05

The following illustrations address general fact patterns. Accordingly, the application of the guidance discussed in the "General Interpretation" section to variations in general facts, or to particular facts and circumstances, may lead to different conclusions. In each illustration, there is no authority other than that indicated.

Illustrations Relating to Litigation Engagements and Certain Controversy Proceedings

.06

Illustration 1. Do lost profits damage computations fall within the scope of the Statement?

.07

Conclusion. No, unless the computations are undertaken as part of an engagement to estimate value (SSVS No. 1, paragraphs 1, 2, and 8 [VS section 100.01, .02, and .08]).

.08

Illustration 2. Is an economic damages computation that incorporates a terminal value within the scope of the Statement?

.09

Conclusion. The use of a terminal value exclusively for the determination of lost profits is not within the scope of this statement unless that determination will be used as part of an engagement to estimate value (*Illustration 1*).

.10

Illustration 3. If a start-up business is destroyed, is the economic damages computation within the scope of the Statement?

.11

Conclusion. There are two common measures of damages: lost profits and loss of value. If a valuation analyst performs an engagement to estimate value to determine the loss of value of a business or intangible asset, the Statement applies. Otherwise, the Statement does not apply (*Illustration 1*). In order to determine whether the Statement applies, a member acting as an expert witness should evaluate whether the particular damages calculation constitutes an engagement to estimate value with respect to the business, business interest, security, or intangible asset or whether it constitutes a lost-profits computation.

.12

Illustration 4. Does the Statement include any exceptions relating to litigation or controversy proceedings?

.13

Conclusion. Yes, the Statement includes a reporting exemption for certain controversy proceedings (SSVS No. 1, paragraph 50 [VS section 100.50]); however, there is no litigation or controversy proceeding exemption from the developmental provisions of the Statement (SSVS No. 1, paragraphs 21–46 [VS section 100.21–.46]) in circumstances in which an engagement to estimate

value is performed (*Illustration 1*).

.14

Illustration 5. Is the Statements reporting exemption for litigation or controversy proceedings (see SSVS No. 1, paragraph 50 [VS section 100.50]) the same as the "litigation exemption" in the AICPA attestation standards?

.15

Conclusion. No, the so-called "litigation exemption" is provided for in the AICPA attestation standards and is further discussed in the attestation interpretations. The attestation standards do not apply to engagements in which a practitioner is engaged to testify as an expert witness in accounting, auditing, taxation, or other matters, given certain stipulated facts. This is clarified in the attestation interpretation, which states, in part, that the attestation standards do not apply to litigation services engagements when (among other requirements) the practitioner "has not been engaged to issue and does not issue an examination, a review, or an agreed-upon procedures report on the subject matter, or an assertion about the subject matter that is the responsibility of another party." (Interpretation No. 3, "Applicability of Attestation Standards to Litigation Services," of Chapter 1, "Attest Engagements," of Statement on Standards for Attestation Engagements No. 10, *Attestation Standards: Revision and Recodification*, as revised [AT section 9101.34-.42]. However, unlike the AICPA attestation standards, which do not apply in any capacity to litigation or controversy proceeding situations, as discussed above, the Statements exemption for litigation or certain controversy proceedings is an exemption from the reporting provisions of the Statement (SSVS No. 1, paragraphs 47-78 [VS section 100.47-.78]).

Illustrations Relating to Tax Engagements

.16

Illustration 6. When does the Statement apply to members who determine values related to tax reporting and planning engagements?

.17

Conclusion. The Statement applies when the member is engaged to estimate the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraph 1 [VS section 100.01]). The application of valuation approaches and methods and the use of professional judgment (SSVS No. 1, paragraph 4 [VS section 100.04]) are required, unless an exception applies (SSVS No. 1, paragraphs 5-10 [VS section 100.05-.10]).

.18

Illustration 7. If the sole purpose of an engagement is reporting a value in a tax return and the

Statement applies to this engagement, are any separate reports (specifically, valuation reports) required to be issued? To whom are those reports required to be provided? Is a report required to be attached to the tax return? Are any specific disclosures required?

.19

Conclusion. The Statement requires the preparation of a written or oral valuation report (SSVS No. 1, paragraphs 47–78 [VS section 100.47–.78]) that is communicated to the client (SSVS No. 1, paragraph 47 [VS section 100.47]) but does not require that any report be attached to the tax return or mandate any other tax-specific disclosures. In limited circumstances, a taxing authority may require its own report, which would obviate the need for a separate valuation report (SSVS No. 1, paragraph 10 [VS section 100.10] and *Illustration 18*). There is also a reporting exemption for certain controversy proceedings (SSVS No. 1, paragraph 50 [VS section 100.50] and *Illustration 4*).

.20

Illustration 8. Are mechanical computations of value, for example, computations using actuarial tables, excluded from the Statement?

.21

Conclusion. Mechanical computations of value are excluded from the Statement if they do not rise to the level of an engagement to estimate value, that is, if the member does not apply valuation approaches and methods, and does not use professional judgment, as described in the Statement (SSVS No. 1, paragraph 9(a) [VS section 100.09a]).

.22

Examples of services that do not rise to the level of an engagement to estimate value include: (a) computations of a remainder interest under a grantor retained annuity trust (GRAT) using actuarial tables; (b) determining the value of relatively small blocks (relative to the total amount of corporate stock outstanding) of publicly traded stock whose per share price is readily ascertainable; (c) preparing a tax return using the valuation of a business that was provided by a third-party appraiser, or by the client (SSVS No. 1, paragraph , [VS section 100.06]); and (d) calculating cash "hold back" requirements for tax contingencies (SSVS No. 1, paragraphs 4 and 9(a) [VS section 100.01, .04, and .09a]).

.23

Examples of services that rise to the level of an engagement to estimate value include: (a) valuing a block of publicly traded stock, if the analysis includes consideration of a discount for blockage, lock-up, or other contractual or market restrictions such that valuation approaches and methods are applied, and professional judgment is used to determine the fair value, fair market value, or other applicable standard of value; (b) valuing stock that is not publicly traded; and (c) computing the fair

market value of assets in a charitable remainder trust (CRT), if the engagement requires the application of valuation approaches and methods, and the use of professional judgment to estimate the fair market value.

.24

Illustration 9. Does the "jurisdictional exception" (SSVS No. 1, paragraph 10 [VS section 100.10]) provide that an engagement to estimate value is not subject to the Statement if a member determines and reports values using procedures mandated or allowed by the Internal Revenue Code (IRC), Internal Revenue Service (IRS) regulations, court cases, or other published guidance and other sources of federal, state, and local law solely for purposes of tax return preparation and other tax services using these methods?

.25

Conclusion. No, the "jurisdictional exception" would not exempt the engagement from this Statement, even if the engagements sole purpose was to value a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]) for tax reporting purposes. Only the portion of the Statement that differs from the published governmental or judicial authority is superseded for purposes of the engagement. The remainder of the Statement applies to the engagement.

.26

Illustration 10. Is an interest in a publicly traded partnership whose shares are frequently traded considered a "security" under the Statement? Is an interest in a family limited partnership (FLP), or in another nontraded partnership, considered a "security" under the Statement?

.27

Conclusion. Whether interest constitutes a "security" is a legal determination. However, where the value of a security is readily ascertainable, a valuation analyst does not need to apply valuation approaches and methods and use professional judgment. Accordingly, the valuation of such an interest would not be subject to the Statement (SSVS No. 1, paragraphs 1 and 9(a) [VS section 100.01 and .09a]). An interest in a nonpublicly traded partnership, such as an FLP, whether considered a security or not, is a business ownership interest. The valuation of such nonpublicly traded interest requires the application of valuation approaches and methods and the use of professional judgment, and, accordingly, would be subject to the Statement (SSVS No. 1, paragraphs 1, 4, [VS section 100.01 and .04], and *Illustration 6*), unless the exception under SSVS No. 1, paragraph 9(b) [VS section 100.09b] applies (*Illustration 13a*). If the engagement requires the valuation analyst to consider and apply adjustments, for example, valuation discounts or premiums, then the engagement would be subject to the Statement.

.28

Illustration 11. A client engages a member to provide advice for planning purposes (such as estate planning, personal financial planning, or merger and acquisitions planning). The client holds an ownership interest in a family business being operated as a limited liability company, an interest in a private real estate limited partnership, publicly traded stock, a personal residence, and a retirement account (not an IRA). Is this a valuation engagement subject to the Statement?

.29

Conclusion. It depends. Providing technical advice, without reference to values for the various assets, is not subject to the Statement. However, if a member calculates a value to illustrate various planning options, he or she may fall under the Statement with regard to various assets. If one or more of the assets for which value is to be determined for purposes of the plan illustrations is a business, business ownership interest, security, or intangible asset, and the client or a third party does not provide the values for these assets, or the member does not use assumed or hypothetical values as part of the overall engagement, the member performing the valuation(s) is subject to the Statement with regard to these assets (SSVS No. 1, paragraph 1, [VS section 100.01] and *Illustration 6*). In this example, if the member applies valuation approaches and methods and uses professional judgment to determine the value of the ownership interest in the family business or the interest in the private real estate limited partnership in order to provide planning advice, the Statement would apply. In contrast, if the client or a third party provides the values for these assets, or the member uses assumed or hypothetical values, the Statement would not apply because the member would not be applying valuation approaches and methods and using professional judgment. In addition, the exception under SSVS No. 1, paragraph 9(b), [VS section 100.09b], where it is not practical or reasonable to obtain or use relevant information, could apply (see *Illustration 13e*). The computation of the "estimated estate tax" or other taxes once the values have been determined, assumed, or provided is not subject to the Statement, as the computation is a tax computation but would be subject to the Statements on Standards for Tax Services [TS sections 100–900] (*Illustration 10* at paragraph .27 of this Interpretation).

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Illustration 12. There are many instances where a tax engagement involves the need for a member to estimate value. The estimation of value may not be the primary purpose of the engagement, but rather a necessary task to perform or item to consider, when making a tax determination concerning the reporting of a transaction on a tax return. Consider the following practice situations:

.31

Illustration 12a. A member has been engaged to determine the deductibility of interest on a nonrecourse loan. Under applicable regulations, interest on a nonrecourse loan cannot be deducted if it is clear that the company will be unable to service the debt. For purposes of tax reporting, a conclusion must be reached concerning the ability of the company to service the debt. Is this considered a valuation engagement subject to the Statement?

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Conclusion. This is not a valuation engagement covered by the Statement because it is not the valuation of a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]). This example is a debt-service analysis.

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Illustration 12b. There are compliance filings that require an estimate of the value of a company. For example, the "market value" of "intangible personal property," as defined by a states taxing authority may need to be reported annually on an intangible personal property tax return. A client has a subject interest that is considered intangible personal property for purposes of the return. The member has been engaged to prepare the tax return. Is this a valuation engagement subject to the Statement?

.34

Conclusion. It depends. If the state requires an estimation of the value of a subject interest, and the estimation of value requires the application of valuation approaches and methods and the use of professional judgment (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]), the Statement applies. If, however, the client or a third-party appraiser provides the value of the subject interest to the member, the Statement does not apply (SSVS No. 1, paragraphs 1 and 6 [VS section 100.01 and .06]). In addition, the exception under SSVS No. 1, paragraph 9(b) [VS section 100.09b], where it is not practical or reasonable to obtain or use relevant information, could apply (*Illustration 13e*). Alternatively, if the state follows more informal rules where the application of valuation approaches or valuation methods are not necessary, the Statement does not apply (SSVS No. 1, paragraph 4 [VS section 100.04]).

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Illustration 12c. There are times when a member must allocate value among various assets. For example, IRC sections 1060 and 338 require the allocation to assets, based on relative values, of consideration paid. In partnership taxation, there may be allocations under IRC sections 754, 743, and 734 and special tax basis adjustments for partnerships (sales or exchanges and transfers at or upon death) may require an allocation of value among various partnership assets. Are these types of allocations engagements to estimate value subject to the Statement?

.36

Conclusion. It depends. If one or more of the assets to which value is to be allocated is a subject interest (that is, a business, business ownership interest, security, or intangible asset), and the client or a third party did not provide the member with a value for those assets, then the member performing the allocation would be subject to the Statement, and the member is required to apply valuation approaches and methods, and use professional judgment to value those assets (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*), unless an exception

applies (SSVS No. 1, paragraphs 5–10 [VS section 100.05–.10]). For example, in an IRC section 1060 allocation, after the allocation of purchase price to cash, receivables, inventory, and depreciable tangible assets, there is a residual amount of value allocable to goodwill or going concern. The mechanical assignment of the residual amount to goodwill or going concern is not subject to the Statement. However, if the member allocates this residual amount to specific intangible assets (such as to various customer-based and supplier-based intangibles), such allocation is based on the assets relative values. Because the member applies valuation approaches and methods and uses professional judgment to value those specific intangible assets, the Statement applies.

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Illustration 12d. If the member does not apply any discount and simply computes the fair market value of an interest in a family limited partnership (FLP) for tax purposes, is this a valuation engagement subject to the Statement?

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Conclusion. Yes, the Statement applies if the member determines the value of the FLP or an interest in an FLP. The application of valuation approaches and methods, and the use of professional judgment are required, unless an exception applies (SSVS No. 1, paragraphs 5–10 [VS section 100.05–.10]). The fact that the member does not apply a discount does not exempt the engagement from the Statement (SSVS No. 1, paragraphs 1–4 and 9(a) [VS section 100.01–.04 and .09a]).

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Illustration 12a. Would the Statement apply to the computation of the fair market value of assets in, or the computation of the required distribution of, a charitable remainder trust (CRT)?

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Conclusion. It depends on the underlying assets held by the CRT. The Statement would apply only if the member determines the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraph 1 [VS section 100.01]). To the extent that the CRT holds assets that, to be valued, require the application of valuation approaches and methods, and the use of professional judgment, such as an interest in a limited liability corporation (LLC), the Statement would apply. However, if the CRT only holds publicly traded stock with a readily ascertainable value, the Statement would not apply because valuation approaches and methods and professional judgment would not be needed in the computation (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*).

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Illustration 12f. In circumstances in which the value of assets contributed by partners to a partnership differ from their cost basis, each difference must be tracked for tax purposes under IRC section 704(c) so that amounts of gain or loss can be properly assigned to the contributing partners. Are these types of asset value assignments valuation engagements subject to the Statement?

.42

Conclusion. It depends. If one or more of the assets for which value is relevant under IRC section 704(c) is a subject interest that is, a business, business ownership interest, security, or intangible asset, and the client or a third party does not provide the valuation, and the member applies valuation approaches and methods and uses professional judgment to value these assets for IRC section 704(c) tax purposes, then the Statement applies (SSVS No. 1, paragraphs 1 and 6 [VS section 100.01 and .06], and *Illustration 6*).

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Illustration 12g. A member has been engaged to perform a cost segregation study. The study involves an analysis of the costs of building a structure and the allocation of such costs to the real and personal property components of the structure so that depreciation of those components may be properly computed. Is this a valuation engagement subject to the Statement?

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Conclusion. No, none of the assets constitutes a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]).

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Illustration 12h. A member has been engaged to provide advice to a company regarding the tax planning for income from discharge of indebtedness under IRC section 108. The company has advised the member that the company will be able to negotiate a settlement in complete satisfaction of an obligation at 30 cents on the dollar. Is this a valuation engagement subject to the Statement?

.46

Conclusion. It depends. Under IRC section 108(a), gross income of the company excludes income from discharge of indebtedness only under certain circumstances. One of those circumstances is the insolvency of the company. Under IRC section 108(d) (3), insolvency results from an excess of liabilities over the fair market value of assets. If (a) the company must rely on the insolvency provisions of IRC section 108; (b) one or more of the assets for which value is relevant under IRC section 108 is a subject interest (that is, a business, business ownership interest, security, or intangible asset); (c) the company or a third party does not provide the valuation; and (d) the member applies valuation approaches and methods, and uses professional judgment to value the subject interest(s) for purposes of the IRC section 108(d)(3) insolvency determination, the

Statement applies.

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Illustration 13. An executor has engaged a member to prepare an estate tax return, which requires determining values for the following estate assets: (a) shares in a publicly traded company, "TI Corporation," whose shares are infrequently traded; (b) a large block of stock in "LB Corporation," a publicly traded company; (c) a brokerage account consisting of shares in various publicly traded companies; (d) "CHB Corporation," a closely held business owned by the decedent and the decedent's family; and (e) a 5 percent interest in "RP," a privately held rental real estate partnership. Does the Statement apply to any of the following assets owned by the estate? (See *Illustration 10* at paragraph .27 of this Interpretation regarding the valuation of a security.)

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Illustration 13a. Does the Statement apply to shares in a publicly traded company, "TI Corporation," whose shares are traded infrequently?

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Conclusion. It depends; although the price of a share of publicly traded stock is ascertainable from published sources, there are no definitive criteria that would indicate when the Statement applies to shares that are infrequently traded. A key consideration is the average daily trading volume of TI Corporation stock on or around the valuation date. The concept of fair market value incorporates the notions that (1) cash could have been received for the stock at the valuation date, and (2) the share price of an infrequently traded stock could decrease if a relatively large block of the stock were to be put on the market on that date. If the subject shares held by the estate do not represent a significant percentage of the daily trading volume of TI stock on or around the valuation date, and the price of a share of the stock is readily ascertainable on the valuation date, then the resulting value (the quoted share price times the number of shares owned) represents a cash price that could have been received at the valuation date for the block, and the Statement does not apply because the calculation of value is mechanical (SSVS No. 1, paragraph 9(a) [VS section 100.09a]). If, however, the subject shares held by the estate represent a large percentage of the average daily trading volume of the stock, the quoted market price for a share may not be adequate for purposes of determining the fair market value of the block of shares on the valuation date. In that case, the Statement applies because valuation approaches and methods need to be applied, and professional judgment needs to be used in determining the value of the block (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]) (See *Illustration 10* at paragraph .27 of this Interpretation regarding the valuation of a security.)

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Illustration 13b. Does the Statement apply to a large block of stock in "LB Corporation," a publicly traded company?

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Conclusion. The answer depends on the amount of shares to be valued in relation to the average daily trading volume in LB Corporation on or around the valuation date. There are no definitive criteria that would indicate when the Statement applies to the valuation of a large block of publicly traded stock. The concept of fair market value incorporates the notion that cash could have been received from a sale of the block on the valuation date. A large block could decrease the share price if sold on the valuation date. The Statement would typically not apply to the valuation of a large block (for example, 200,000 shares) of a large and actively-traded public company. Even though the value of the estate's stock may be large in absolute terms, the daily trading volume in such stock on the valuation date may be sufficiently high that a sale of the block on the valuation date would not affect the market price of a company's shares. In such a case, the quoted market price of a share ~~times the number of shares held by the estate may be considered to reflect the fair market value of~~ the subject block of stock, and because it would not be the case that valuation approaches and methods would need to be applied and professional judgment used, the Statement would not apply. If, however, the large block of publicly traded shares represents a significant percentage of the daily trading volume, the Statement would apply because valuation approaches and methods would need to be applied and professional judgment used to determine the value (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]).

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Illustration 13c. Does the Statement apply to a brokerage account consisting of shares in various publicly traded companies?

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Conclusion. The Statement would not apply to the determination of the value of a brokerage account consisting of publicly traded securities, except as discussed in paragraphs .49 and .51 of this Interpretation. Absent certain scenarios involving infrequently traded securities or large blocks of stock, the application of valuation approaches and methods and the use of professional judgment are not necessary in that determination (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]).

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Illustration 13d. Does the Statement apply to "CHB Corporation," a closely held business owned by the decedent and the decedent's family?

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Conclusion. The Statement would apply to the determination of value of CHB Corporation because valuation approaches and methods need to be applied, and professional judgment needs to be used to determine the fair market value of the ownership interest in CHB (SSVS No. 1, paragraphs 1 and

4 [VS section 100.01 and .04]).

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Illustration 13e. Does the Statement apply to a 5 percent interest in a privately held rental real estate partnership (RP)?

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Conclusion. The Statement would apply to the determination of value of the 5 percent interest in rental real estate partnership (RP) because valuation approaches and methods need to be applied and professional judgment needs to be used to determine the fair market value of the ownership of a fractional interest in a privately held partnership (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]). However, where it is not practical or not reasonable to obtain or use relevant information and, therefore, the member is unable to apply valuation approaches and methods, the Statement would not apply. For example, the member has requested from RP's general partner financial information the member needs in order to apply valuation approaches and methods. The general partner is not responsive to the member's requests, and the due date for filing the estate tax return is near. Given the small ownership interest, and given that RP is likely a relatively small percent of the total estate, unless prohibited by statute or by rule, the member may then use the taxpayer's estimates if the member determines that the estimates are reasonable (based on the facts and circumstances known to the member) (SSVS No. 1, paragraph 9(b) [VS section 100.09b]).

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Illustration 14. Would the answers to *Illustration 13* change if the values were provided by the client or a client-engaged third party?

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Conclusion. The Statement would not apply if the values were provided by the client or by a client-engaged third party because the member is not applying valuation approaches and methods and using professional judgment to determine value (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]). However, the member would be subject to Statement on Standards for Tax Services No. 3, *Certain Procedural Aspects of Preparing Returns* [TS section 300], in providing appropriate due diligence with respect to the values provided to the member. It is also recommended that the understanding between member and client in these circumstances include documentation of the fact that the member is not determining but rather is being provided with the value of the subject interest.

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Illustration 15. Would the answers to *Illustration 13* change if the values were provided by an outside third-party specialist hired by the member?

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Conclusion. If the member engages an outside third-party specialist to assist with the member's work, and it is the member expressing a conclusion or calculated value, the member will be applying valuation approaches and methods and using professional judgment; thus, the Statement would apply (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]; SSVS No. 1, paragraph 20, "Using the Work of Specialists in the Valuation Engagement," [VS section 100.20]). If, however, the third-party specialist is determining the value in his or her own name and providing that value to the client, and the member will not be applying valuation approaches and methods or using professional judgment (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*), the Statement would not apply, but the member would be subject to Statement on Standards for Tax Services No. 3, *Certain Procedural Aspects of Preparing Returns* [TS section 300] in providing appropriate due diligence with respect to the values provided.

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Illustration 16. The client and the member agree that the member will value a partnership interest and then apply an "average" discount that the member is to determine (based on the results of various studies and case law). Does the Statement apply? If so, is this a valuation engagement or a calculation engagement?

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Conclusion. Yes, the Statement applies because the member determined the value of the partnership interest by applying valuation approaches and valuation methods and using professional judgment. This would be considered a calculation engagement because the member and the client have agreed on the specific valuation approaches or valuation methods the valuation analyst will use and the extent of valuation procedures the valuation analyst will perform (SSVS No. 1, paragraph 21(b) [VS section 100.21b] and *Illustration 6*).

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Illustration 17. Would the Statement apply if a member has an informal conversation or communicates in writing with a client regarding the alternative tax consequences of gifting versus selling a business using a presumption of a specific value of the business?

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Conclusion. No, the Statement would not apply. The member is providing tax advice using an assumed or hypothetical value of a business and is not determining value, applying valuation approaches and methods, and using professional judgment to value a business (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04], and *Illustration 6*).

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Illustration 18. Would the Statement apply to a transfer pricing study (IRC section 482) that involves the use of specific methodologies, data, terminology, and documentation requirements that are provided in the IRS regulations and procedures, and whose methodologies and documentation requirements differ from those contained in the Statement?

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Conclusion. No. To the extent that the transfer pricing study applies, for example, to the valuation of inventory or services, the Statement would not apply (see SSVS No. 1, paragraph 1 [VS section 100.01] and *Illustration 6*). To the extent that the transfer pricing study applies to the valuation of intangible assets, the Statement would normally apply. However, because the IRS regulations require that the taxpayer reasonably calculate an arm's-length price according to the best method that is determined using third-party comparable data under explicit IRS rules and documentation procedures, and to the extent these IRS rules and procedures differ from the Statement, the jurisdictional exception (SSVS No. 1, paragraph 10 [VS section 100.10]) would exempt the valuation of the intangible assets from the developmental provisions of the Statement (SSVS No. 1, paragraphs 25–48 [VS section 100.25–.48]). In addition, to the extent that the IRS regulations (such as IRS regulation section 1.6662-6(d) (2) (iii)) and procedures provide specific documentation requirements for avoiding potential penalties, and if a transfer pricing report is provided to a client according to such IRS documentation requirements, the jurisdictional exception would apply to the reporting provisions of the Statement (SSVS No. 1, paragraphs 50–78 [VS section 100.50–.78]) and thus a valuation report would not be necessary.

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Illustration 19. In a situation where the Statement applies to members who determine value as part of tax engagements, would the member also be required to be in compliance with the Statements on Standards for Tax Services (SSTSs) [TS sections 100–900]?

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Conclusion. Yes, the Statement would apply only to the valuation determination and reporting aspects of the engagement but the SSTSs would apply to all aspects of the engagement. For example, even though the Statement would govern the determination of value of an applicable asset reported on a tax return, the member would also have to be in compliance with SSTS No. 1, *Tax Return Positions*, [TS section 100], for that valuation.

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Illustration 21. Do settlements or negotiations of value in offers-in-compromise or tax disputes fall under the Statement?

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Conclusion. No, settlements or negotiations of value in offers-in-compromise or tax disputes are part of a tax process. However, if a member prepares a valuation in preparation for a settlement or negotiation of value, and the valuation involves the application of valuation approaches and methods and the use of professional judgment, the valuation would fall under the developmental aspects of the Statement. The settlement or negotiation process itself is not a valuation and would not fall under the Statement. In addition, the Statement's reporting exemption for certain controversy proceedings would apply as the valuation was performed specifically for the administrative matter (SSVS No. 1, paragraph 50 [VS section 100.50]).

Illustrations Relating to Other Engagements

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Illustration 20. Does determining the value of accounts receivable fall under the Statement?

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Conclusion. No, accounts receivable constitute **tangible assets** under the Statement (SSVS No. 1, Appendix B [VS section 100.81], and do not constitute a subject interest (SSVS No. 1, paragraph 1 [VS section 100.01]).

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Illustration 22. In the course of performing a valuation under the Statement, if a valuation analyst prepares prospective financial information (for example, as part of a discounted cash flow or discounted earnings analysis within the income approach), does this require the valuation analyst to examine or compile such information in accordance with the Statements on Standards for Attestation Engagements (SSAEs) [AT sections 20–701]?

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Conclusion. No, Chapter 1, "Attest Engagements," of SSAE No. 10, *Attestation Standards: Revision and Recodification*, as amended [AT section 101.01] states that the attestation standards apply when a practitioner is "engaged to issue or does issue an examination, a review, or an agreed-upon procedures report on subject matter, or an assertion about the subject matter.... that is the responsibility of another party." If the valuation analyst has not been engaged to examine, compile, assemble, review, or apply agreed-upon procedures to prospective financial information, and does not issue an examination, compilation, assembly, or agreed-upon report on prospective financial information, the SSAEs [AT sections 20–701] do not apply (SSARS 14 [AR section 120]).

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Illustration 23. Under a valuation engagement, a valuation analyst is free to select any and all valuation approaches and methods the valuation analyst deems appropriate in the circumstances.

Under a calculation engagement, the valuation analyst and the client agree to the specific approaches or methods the valuation analyst will use or the extent of calculation procedures the valuation analyst will perform. (SSVS No. 1, paragraph 21 [VS section 100.21]) Under SSVS No. 1, paragraph 18 [VS section 100.18], a restriction or limitation on the scope of the valuation analyst's work, or the data available for analysis may be present and known to the valuation analyst at the outset of the engagement, or may arise during the course of an engagement (and such restriction or limitation should be disclosed in the report). Is it possible to have a restriction or limitation that is of such a degree that a valuation analyst engaged to perform a valuation engagement should propose altering the engagement to be a calculation engagement?

.77

Conclusion. Although the two engagements represent two different types of service performed by valuation analysts, the possibility exists. If, in the course of a valuation engagement, restrictions, or limitations on the scope of the valuation analyst's work or the data available for analysis are so significant that the valuation analyst believes that he or she cannot, even with disclosure in the valuation report of the restrictions or limitations, adequately perform a valuation engagement leading to a conclusion of value, the valuation analyst should determine whether he or she has the ability to adequately complete the engagement as a calculation engagement or should consider resigning from the engagement.

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Illustration 24. If a member employed in industry, government, or education "moonlights" doing engagements to estimate value, do the Standards apply?

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Conclusion. Yes, the Standard applies. By moonlighting, the member is holding him or herself out as a certified public accountant and as being in public practice. The Standard would apply just as it would to any other member in public practice unless one of the exceptions applies.

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Illustration 25. Does the Statement apply to an assignment from an employer to an employee member not in public practice to prepare a valuation for internal financial reporting purposes?

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Conclusion. No, SSVS No. 1, paragraph 7 [VS section 100.07] exempts internal use assignments from an employer to an employee member not in the practice of public accounting. However, if the valuation is to be used for financial reporting purposes, the employer and the employee may wish to consider whether the work will be accepted by the employer's outside auditors if the statement is not followed.

Illustrations for PFP-Specific Engagements

These illustrations assume the member has not been engaged to perform a business valuation.

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Illustration 26. When does the Statement apply to members who determine values related to personal financial planning engagements?

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Conclusion. The Statement applies to personal financial planning engagements when the member determines the value of a business, business ownership interest, security, or intangible asset (SSVS No. 1, paragraph 1 [VS section 100.01]) and in the process of determining the value applies valuation approaches and methods and uses professional judgment (SSVS No. 1, paragraph 4 [VS section 100.04]) unless an exception applies (SSVS No. 1, paragraphs 5–10 [VS section 100.05–.10]).

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Illustration 27. If a member is engaged to provide personal financial planning services to a client and, in the course of the engagement, estimates the proceeds from a hypothetical future sale of the client's business interest, does the Statement apply?

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Conclusion. No. The Statement does not apply because estimate of future sales proceeds does not in itself constitute a valuation engagement (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]).

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Illustration 28. A member is engaged to provide personal financial planning services to a client and, in the course of the engagement, estimates the proceeds from a hypothetical future sale of the client's business interest. As part of that engagement, the member shares general industry knowledge to assist the client in estimating the current value of the business interest. Does the Statement apply?

.87

Conclusion:

(a) If, in the process of determining the current value from which the member estimates future sales proceeds, the member applies valuation approaches and methods and uses professional judgment, the Statement applies to the determination of the current value (SSVS No. 1, paragraph 4

[VS section 100.04]). However, the Statement does not apply when the member shares general industry knowledge with the client instead of applying professional judgment.

(b) If the client or another party provides the current value, and the member does not apply valuation approaches and methods, the Statement does not apply (SSVS No. 1, paragraphs 4 and 6 [VS section 100.04 and .06]).

(c) If the member uses a hypothetical or assumed value as the starting point for the calculation of future sales proceeds and does not apply valuation approaches and methods, the Statement does not apply (SSVS No. 1, paragraphs 1 and 4 [VS section 100.01 and .04]). The Statement does not apply to a general discussion with the client of valuation concepts or industry price multiples based on the member's industry knowledge, which assists the client in determining a hypothetical or assumed value (SSVS No. 1, paragraphs 4 and 6 [VS section 100.04 and .06]).

.38

Illustration 29. The client has asked the member to prepare a personal financial plan that includes an estimate of future proceeds from a sale of the business interest at retirement. The member estimates the future proceeds based on an estimate of the business' current value by applying a rule of thumb for the business' industry, but the member does not consider the risk factors of the subject interest or exercise other professional judgment in applying the multiple. Does the Statement apply?

.89

Conclusion. No, the Statement does not apply because the member did not use professional judgment (SSVS No. 1, paragraph 4 [VS section 100.04]). If the member considers specific risk factors of the business interest in applying the price multiple, the Statement applies.

This Statement titled Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset was unanimously adopted by the assenting votes of the AICPA Consulting Services Executive Committee.

JOINT EXHIBIT 28

Paulette Crawford

From: Paulette Crawford
Sent: Tuesday, May 08, 2012 3:36 AM
To: 'Brown, Victor - Victor C'
Cc: Cynthia M. Krull; Kimberly Hyatt
Subject: RE: Use Tax

Victor,

Any sales to contractors are retail sales to them. We do not issue them retail licenses unless they have a store where people can come in and buy things off the shelf.

We do give them a purchaser's certificate sometimes. This is to let them pay us the tax on items they buy and have shipped from out of state to use in SC and haven't paid the tax on it at time of purchase. They should pay you the full retail shelf price. So if they buy \$8,000 worth of materials. You would charge them the same tax as you would me if I came in and bought \$8,000 worth of materials off the shelf. Since their tax liability has been met, they usually bill the customer one price for materials and labor.

Since you are a retailer selling and billing directly to the customer you are required to charge them the shelf price for the appliances and other materials. This is what we call a sales contract or sales & installation. Any materials sold are taxed at the retail shelf price. The installation labor is non-taxable if it is listed as a separate item on their invoice.

I hope this clears up any questions. If not, let me know.

Paulette C. Crawford

Auditor

South Carolina Department of Revenue

Rock Hill Taxpayer Service Center

454 S. Anderson Rd. PO Box 12099

Rock Hill, SC 29731

(803)909-8766 Fax: (803)324-8289

DOR RESP LOWE'S 0745 808

crawfop@sctax.org

From: Brown, Victor - Victor C [mailto:Victor.C.Brown@Lowe.com]
Sent: Monday, May 07, 2012 6:24 PM
To: Paulette Crawford
Subject: RE: Use Tax

I just wanted to make sure I understand how the tax on installed sales should work. Another way I look at this is the sales in our stores. Say a contractor is installing kitchen cabinets in someone's house and they go to the Lowe's store and buy the cabinets off the shelf. The contractor drives away from the store with the cabinets on his trailer and plans on installing the cabinets in the customer's house. Let's say the cabinets the contractor buys from Lowe's cost the contractor \$8,000.

1- Would the contractor give Lowe's a resale certificate and buy the cabinets exempt from sales tax?

2- When they install the cabinets in their customer's house, would the contractor invoice the customer South Carolina sales tax on the materials only?

3- If the contractor gives an invoice with a subtotal of \$15,000 with \$5,000 for labor and \$10,000 for material, would the contractor have to invoice sales tax on the \$10,000?

From: Paulette Crawford [mailto:CRAWFOP@sctax.org]
Sent: Monday, May 07, 2012 2:02 PM
To: Brown, Victor - Victor C
Subject: RE: Use Tax

Believe me I understand.

Paulette C. Crawford

Auditor

South Carolina Department of Revenue

Rock Hill Taxpayer Service Center

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Rock Hill, SC 29731

(803)909-8766 Fax: (803)324-8239

crawfop@sctax.org

From: Brown, Victor - Victor C (mailto:Victor.C.Brown@Lowes.com)

Sent: Monday, May 07, 2012 2:01 PM

To: Paulette Crawford

Subject: RE: Use Tax

Sorry. I barely remember last week. I think all these audits have melted my brain.

From: Paulette Crawford (mailto:CRAWFOP@sctax.org)

Sent: Monday, May 07, 2012 2:00 PM

To: Brown, Victor - Victor C

Subject: RE: Use Tax

Yes, remember we had this issue last audit and treated it the same way.

Paulette C. Crawford

Auditor

South Carolina Department of Revenue

Rock Hill Taxpayer Service Center

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Rock Hill, SC 29731

(803)909-8766 Fax: (803)324-8239

crawfop@sctax.org

From: Brown, Victor - Victor C (mailto:Victor.C.Brown@Lowes.com)

Sent: Monday, May 07, 2012 1:59 PM

To: Paulette Crawford

DOR RESP LOWE'S 0747 810

Subject: RE: Use Tax

I just wanted to clarify the tax that you say is due on the installed sales. Are you saying that sales tax is due on the retail selling price of all installed material? Are you saying it is sales tax and not use tax? Is that for all installed sales (everything from dishwashers to cabinets to carpet)?

From: Paulette Crawford (mailto:CRAWFOP@sctax.org)
Sent: Monday, May 07, 2012 8:48 AM
To: Brown, Victor - Victor C
Subject: RE: Use Tax

No, you didn't mention this before. I don't know if this will affect the expense sample or not, but I will discuss this with Carol and get back with you. At this time I would assume that you would be allowed credit for this tax accrued.

Now, changing channels to sales: I have attached a total schedule of the installed sales for April 2011 for the 24 stores from the sales sample.

Since you are still accruing tax on the cost of the appliances & installation materials and not the retail price, I will need the details of the installed sales and accruals for the audit period to mark the accrual up to the tax due on the retail price. There are no 90000 numbers included in these totals since you said this was for labor only and no product was sold.

We can just do a projection if you prefer. If so, you can just give us the accruals for the amounts on this schedule for April 2011. If you have any questions please let me know.

Thanks for your help.

Paulette C. Crawford

Auditor

South Carolina Department of Revenue

Rock Hill Taxpayer Service Center

154 S. Anderson Rd. PO Box 12099

Rock Hill, SC 29731

DOR RESP LOWE'S 0748 811

(303)909-8766 Fax: (303)324-3239

rawfop@sctax.org

From: Brown, Victor - Victor C [mailto:Victor.C.Brown@Lowe.com]
Sent: Sunday, May 06, 2012 3:59 PM
To: Paulette Crawford
Subject: Use Tax

I can't remember if I brought this to your attention so I just wanted to make sure. Lowe's accrues an estimated use tax each month to offset against the use tax assessment in the audit. The description is Expense Accrual. Instead of looking at every \$10 and \$20 invoice, we accrue around \$50 for each store. I would like to use this as an offset of the use tax assessment.

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JOINT EXHIBIT 29

South Carolina Department of Revenue

Audit Services
454 S. Anderson Road, Suite 202
P.O. Box 12099
Rock Hill, South Carolina 29731

September 24, 2012

Lowe's Home Centers, Inc.
Attn: Victor Brown-NB3TA.
P O Box 1000
Mooresville, NC 28115

Type Tax: Sales Tax
Period: 08/01/2008 to 07/31/2011
File #: 40038688-1
Audit #: 06/21/2192
Response Date: 12/27/2012

Dear Mr. Brown:

The Department's audit of the above referenced tax return(s) has been completed. Enclosed is the audit report which explains our **Proposed Assessment**.

If you agree with the changes detailed in the enclosed report, the balance on Form AS-54 should be remitted to this office within 90 days from the date of this letter. Otherwise, additional interest, and penalties, if applicable, will accrue. Please include a copy of the AS-54 Distribution, or, Processing Report with your check to insure proper processing.

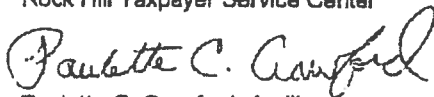
If you agree with the Department's adjustments, but are unable to make full payment at this time, please complete the enclosed Waiver of Restriction on Assessment (SC 870) and return it to this office as soon as possible. Upon receipt of this document, a final assessment will be issued.

If you disagree with any of the adjustments of tax, interest, or penalties that have been proposed by the Department, a written protest must be submitted to this office by the response date. Enclosed is an information guide (CID-6) which explains the information that must be included in your protest. The protest may be submitted on the enclosed form or by letter.

If you do not respond to this letter by the response date, you will have waived your right to appeal the proposed assessment and the Department will issue the final assessment and begin collection action.

Should you have any questions, please do not hesitate to contact this office.

Sincerely,
Rock Hill Taxpayer Service Center



Paulette C. Crawford, Auditor
Email crawfop@sctax.org, (803)909-8766, FAX (803)324-8289
P. O. Box 12099
Rock Hill, SC 29731



SOUTH CAROLINA DEPARTMENT OF REVENUE
Audit Services

Lowe's Home Centers, Inc. P O Box 1000, Mooresville, NC 28115 Lowe's Home Centers, Inc. PO Box 1000, Mooresville, NC 28115	SID: 1384067 000 FEN/SSN: xx-xxx8358 File#: 40038688-1 ACN: 06/21/2192	Period: 08/01/2008 thru 07/31/2011 (36 Mths) Auditor: Paulette C. Crawford 6428 Auditor: Kimberly Hyatt Interest & Penalty Date: 12/27/2012 County/Municipality Code:
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Combined Billing Summary & Distribution Report

This Combined Distribution Report was run to apply the negligence penalty to only one schedule of the audit. This schedule is the SC Installed Sales - Mark Up To Retail. This schedule represents a 40% markup. Last audit this issue was discussed and adjustments made applying a 42% markup to the installed sales.

Schedules Included	Tax	Interest	Penalty	Amount	
1					1
2 1. SEE BILLING SUMMARY & DISTRIBUTION #1	2,206,054.28	222,469.43	221,537.70	2,650,061.41	2
3 SC Installed Sales - Mark Up to Retail					3
4 (Negligence Penalty applied to this sch only)					4
5					5
6					6
7					7
8					8
9 2. SEE BILLING SUMMARY & DISTRIBUTION #2	201,520.12	21,186.88	0.00	222,707.00	9
10 Other Taxable Sales					10
11 Sales Tax Paid Incorrect Amount					11
12 Stat Sample for Expenses					12
13 Use Tax Accrual Credits					13
14					14
Total (14)	2,407,574.40	243,656.31	221,537.70	2,872,768.41	

South Carolina Department of Revenue

Audit Services

Victor Brown, Tax Manager
Lowe's Home Centers, Inc.
P O Box 1000
Mooresville, NC 28115

File Number: 40038688-1
Tax Type: Sales Tax
Audit Control #: 06/21/2192

Audit periods: From 08/01/2008 To 07/31/2011

Explanation of Audit Adjustments and Assessments

FOR AN ADJUSTMENT TO SALES TAX

A computer assisted audit method was used in verification of your sales records. During the review of the data for April 2011 which you provided, it was determined that tax was not being paid on some taxable sales transactions and incorrect tax was being paid on others. These sales were made to customers that did not have an exemption certificate on file. Examples are empty propane tanks, trees and annuals that are not fruit (food) producing, candles, miscellaneous hardware and plumbing supplies, building supplies, etc. Other items could not be identified since a product description was not available in the sales data. Tax was also assessed on these unidentified items.

Please refer to the following Sales Schedules and Worksheets for details of these taxable sales transactions.

(1) **Other Taxable Sales**— This schedule breaks down the assessment by each of the 48 stores for the 36 month period or portion of the audit period in which they were open.

(A) **Other Taxable Sales Worksheet**—This worksheet contains detailed entries for the untaxed sales transactions.

(2) **Sales Tax Paid - Incorrect Amount**—This schedule breaks down the assessment by each of the 48 stores for the 36 month period or portion of the audit period in which they were open.

(A) **Sales Tax Paid - Incorrect Amount Worksheet**—This worksheet contains detailed entries for the sales transactions where additional tax is due.

A sales tax, equal to five percent of the gross proceeds of sales, is imposed upon every person engaged or continuing within this State in the business of selling tangible personal property at retail.

SC Code Section 12-36-910

Beginning June 1, 2007, an additional sales, use, and casual excise tax equal to one percent is imposed on amounts taxable pursuant to this chapter, except that this additional one percent tax does not apply to amounts taxed pursuant to:

- Section 12-36-920(A) - accommodations for transients
- Section 12-36-2110 - items subject to a maximum sales and use tax
- Section 12-36-910(d)(1) - unprepared food which may be lawfully purchased with United States Department of Agriculture food coupons.

SC Code Section 12-36-1110

It is presumed that all gross proceeds are subject to the tax, until the contrary is established. The burden of proof that the sale of tangible personal property is not a sale at retail is on the seller. SC Code Section 12-36-950

FOR ADJUSTMENTS TO WITHDRAWALS

installed sales

Our audit also disclosed that you were withdrawing appliances, building materials and miscellaneous installation supplies at store cost for installation sales. Audit adjustments were made for the difference in the retail price vs. the cost that was reported on the ST-3 returns.

See the following **Schedule** and **Worksheet** for details of installed transactions and the calculation of a 40% markup from cost to retail pricing.

(1) **SC Installed Sales - Mark Up to Retail** - This schedule contains the use tax amount paid on installed sales which you provided and applies a 40% markup.

(A) **Markup Worksheet** - This worksheet provides pricing at cost and retail of a sample of installed appliances and materials used to determine the markup percentage.

(Note: In the last audit assessed in 2007 the markup percentage was calculated at 42%.)

SC Code Section 12-36-90 states:

"Gross proceeds of sales" or any similar term, means the value proceeding or accruing from the sale, lease, or rental of tangible personal property. The term includes the fair market value of tangible personal property previously purchased at wholesale which is withdrawn from the business or stock and used or consumed by any person withdrawing it.

FOR AN ADJUSTMENT TO USE TAX

A Stat Sample audit method was used to determine the amount of use tax due on untaxed purchases. The auditors chose account numbers from the chart of accounts for the types of expenses to examine. After the data was reviewed and the taxable items were scheduled and approved by you, the Stat sample calculations were performed by the Computer Assisted Audit staff in our Columbia Office.

Please refer to the following schedules for the breakdown of the sample calculations :

(1) **The Assessment Result Report**

(A) **The Expenses Sample Worksheet** for details of the taxable items.

Credit for Use Tax Accrued and Paid:

You accrued approximately \$50 use tax for each store location for each month of the audit period. Since a stat sample audit method was used and expense items were included for all periods and locations a credit was allowed for this use tax paid against the expense sample results.

See the **Use Tax Accrued Schedule** for these credits amounts.

SC Code Section 12-36-1310 states:

A use tax is imposed on the storage, use, or other consumption in the State of tangible personal property purchased at retail for storage, use, or other consumption in this State, at the rate of five percent of the sales price of the property, regardless of whether the retailer is or is not engaged in business in this State.

Beginning June 1, 2007, an additional sales, use, and casual excise tax equal to one percent is imposed on amounts taxable pursuant to this chapter, except that this additional one percent tax does not apply to amounts taxed pursuant to:

- Section 12-36-920(A) - accommodations for transients
 - Section 12-36-2110 - Items subject to a maximum sales and use tax
 - Section 12-36-910(d)(1) - unprepared food which may be lawfully purchased with United States Department of Agriculture food coupons.
- SC Code Section 12-36-1110

Every person storing, using, or otherwise consuming in this State tangible personal property purchased at retail, is liable for the use tax, until the tax is paid to the state.

SC Code Section 12-36-1330

Local Sales and Use Taxes

Local Sales and Use Taxes were applicable to the majority of your SC store locations. They were assessed on any tax adjustment as required. They were also applied to the use tax credits allowed for your monthly accruals.

Counties may levy sales and use tax upon referendum approval. Such taxes are to be administered and collected by the SC Department of Revenue in the manner that sales and use taxes are administered and collected pursuant to Chapter 36 of Title 12. For more detailed information refer to SC Information Letter 05-1 of January 6, 2005 and Chapter 10 of Title 4.

Since a sale is not completed until delivery is made, items shipped from a local option County into a non-local option County for first receipt by the customer are not subject to the local option tax and deliveries made into a local option County are subject to the local option tax of that county.

Purchases of building material for use under a construction contract are exempt from the local option tax if:

- <1> the written bid is submitted and
- <2> the construction contract is executed before the imposition date and
- <3> a verified copy of the contract is submitted within six months to the Department.

A special exemption certificate, ST-10-C, will be used to document this exemption.

In accordance with the Catawba Indian Claims Settlement Act, the sales and use tax imposed on sales in and deliveries into the Catawba Indian Reservation will be as follows: (effective 1-Jan-2004)

- Sales within the Reservation - 6% Tribal sales tax
- Deliveries into the Reservation -
- Invoices larger than \$100 - 6% Tribal sales tax
- Invoices of \$100 and less - 5% State sales tax and no local option tax.

The General Ledger (G/L) Code assigned to the 'regular' local option tax is 34-2721. The Counties, Catawba Tribal Sales and Use, and Tourism Development Sales and Use with special local option tax and the appropriate G/L Code are indicated with an @1, @2, @3, @4, @5, and @6. Chapter 10 of SC Code Title 4.

@1 Capital Projects Local Option, G/L 34-2726

@2 School District Local Option, G/L 34-2730, Food which may be purchased with food stamps are exempt. The exemption applies to everyone who purchases these types of

qualified items. Effective July 1, 2005, this exemption does not apply to the Clarendon School District Local Option tax.

@3 Transportation Local Option, G/L 34-2728

@4 Property Offset, G/L code will be assigned when the tax is imposed by a county.

@5 Catawba Tribal Sales Tax, G/L 34-3768

@6 TOURISM DEVELOPMENT TAX, G/L 34-2740

The effective dates for the local option taxes are listed below: (Counties in **BOLD** impose multiple local option taxes.)

1-Jul-91: **Charleston**, Colleton, **Jasper**, **Hampton**, **McCormick** and **Marion**.

1-May-92: **Abbeville**, **Allendale**, **Bamberg**, **Edgefield**, **Lancaster**, **Marlboro** and **Saluda**.

1-May-94: **Chester** and **Florence**.

1-May-95: **Pickens**.

1-May-96: **Dillon**, **Lee** and **Sumter**.

1-Jul-96: **Cherokee @2**

1-May-97: **Berkeley**, **Chesterfield**, **Clarendon**, **Darlington**, **Kershaw** and **Williamsburg**.

1-May-98: **York @1**.

1-May-99: **Barnwell**, **Chester @1** (repealed 05/01/2000), **Jasper @1** (Capital Projects replaced with School District on 12/01/2002), **Laurens**, **Newberry @1**, **Orangeburg @1**.

1-Jun-99: **Beaufort @3** (repealed 12/01/2000)

30-Apr-2000: **Chester @1** - Last day for 1% Capital Projects Local Option. Note, the 1% local option is still in effect.

1-Sep-2000: **Chesterfield @2**

30-Nov-2000: **Beaufort @3** - Last day for 1% Transportation Local Option.

1-May-2001: **Alken @1**, **Allendale @1**

30-Nov-2002: **Jasper @1** - Last day for 1% Capital Projects Local Option. Audit adjustments for audits completed after 30-Nov-2002 for this tax for Jasper County will be reflected in the Jasper School District tax.

1-Dec-2002: **Jasper @2** - First day for 1% School District Local Option

1-May-2003: **Dillon @2 <1>** - First day for 1% Capital Project, **Hampton @1**

1-Jan-2004: **Catawba Tribal Sales Tax @5** 6% tax rate

1-Feb-2004 **Darlington County School District @2**

1-Jun-2004 **Clarendon County School District @2**

1-Mar-2005 **Lexington County School District @2**

1-May-2005 **Calhoun**, **Charleston @3** 0.5% rate, **Dorchester @3**, and **Richland**

1-May-2006 **Fairfield**

1-Oct-2006 **Lee @2**

31-Dec-2006 **Allendale @1** - Last day for 1% Capital Projects Local Option.

1-May-2007 **Beaufort @3**, **Florence @1**, **Greenwood @1**, **Horry @1**

1-June-2007: **Catawba Tribal Sales Tax @5** 7% tax rate

30-Sept-2008: **Dillon @1** - Last day for 1% Capital Projects Local Option. Audit adjustments for audits completed after 30-Sept-2008 for this tax for Dillon County will be reflected in the Dillon County School District tax.

1-Oct-2008: **Dillon @2** - First day for 1% School District Local Option

1-Mar-2009 **Horry @2**

1-May-2009 **Allendale @1**, **Berkeley @3**, **Cherokee**, **Chester @1**, **Lancaster @1**, **Sumter @1**

1-May-2009: **Catawba Tribal Sales Tax @5** 8% tax rate

1-August-2009 **Myrtle Beach @6**

31-Dec-09 **Hampton @1** - Last day for 1% Capital Projects Local Option.

Notes

<1> Dillon CP tax ended 09/30/2008. Dillon SD tax started 10/01/2008

TAX on Unprepared Food Items

Sales adjustments were also made for some transactions that were not considered unprepared food items as described below. These are included on the schedules **Sales Tax Paid - Incorrect Amount and Other Taxable Sales**.

Beginning on January 1, 2001, the State sales and use tax rate on food items eligible for purchase with United States Department of Agriculture food coupons was 4% instead of 5%. On July 1, 2001 such food items were given same tax treatment as afforded all other items and taxed at a rate of 5%. Beginning October 1, 2006, such food items are taxed at 0.03%. Beginning November 1, 2007 such food items are exempt from the state sales and use tax but are taxed by the local options taxes that do not specifically exclude unprepared food. SC Code Section 12-36-910(d)(1) Imposing the tax on unprepared food items was superseded when SC Code Section 12-36-2120(75) providing the state exemption for unprepared food items was implemented on November 1, 2007.

INTEREST

Interest on taxes owed and refunds due is computed using the Internal Revenue Service interest rates <*> for underpayment compounded daily. Generally, interest is not paid during the first seventy-five days after filing a request for refund. SC Code Section 12-54-25

*** Note reduction of interest rate on refunds, Section 72, Proviso 72.17 and Section 89, Proviso 89.142 of 2010 House Bill 4657, Part 1B direct the Department to reduce the rate of interest paid on eligible refunds by a total of three percentage points from the above listed rates for refunds paid from July 1, 2010 through June 30, 2011.**

NEGLIGENCE (ALL PERIODS)

The negligence penalty has been applied to all periods for the installed sales transactions which were taxed at cost and not at retail price as stated in SC Code Section 12-36-90. This issue was addressed in the last SC Sales Tax Audit for the periods 3/1/2002 through 2/28/2005 which was completed and assessed in January 2007.

If any part of an underpayment of tax or part of a claim for refund of tax is due to negligence or disregard of regulations, there must be added to the tax an amount equal to the sum of five percent of the underpayment and an amount equal to fifty percent of the interest payable under Section 12-54-25. SC Code Section 12-54-43(F)(1)

JOINT EXHIBIT 30

JONES DAY

1420 PEACHTREE STREET, N.E. • SUITE 800 • ATLANTA, GEORGIA 30309 3033

TELEPHONE: +1 404.581.3939 • FACSIMILE: +1 404 581 8330

December 21, 2012

Certified Article Number

7160 3901 9848 3702 9162

SENDER'S RECORD

VIA CERTIFIED MAIL, RETURN RECEIPT REQUESTED

CONFIDENTIAL TAXPAYER INFORMATION

South Carolina Department of Revenue
Audit Services
454 S. Anderson Road, Suite 202
P.O. Box 12099
Rock Hill, South Carolina 29731

Re: Protest Of Proposed Assessment - Lowe's Home Centers, Inc. (FEIN: 56-0748358)

To the South Carolina Department of Revenue:

This correspondence serves as a protest (the "Protest") of the proposed assessment dated September 24, 2012 (the "Proposed Assessment")¹ issued by the South Carolina Department of Revenue (the "Department") to Lowe's Home Centers, Inc. ("LHC" or the "Taxpayer"). The Proposed Assessment asserts that LHC is liable for additional state and local sales tax, interest and penalties applicable to the tax period beginning August 1, 2008 and ending July 31, 2011 (the "Audit Period"). As discussed below, the majority of the Proposed Assessment is contrary to South Carolina law and should be abated in full. In addition, the imposition of penalties is unwarranted and all penalties should be abated in full. Finally, LHC respectfully requests a hearing before the Department to discuss the Protest and the Proposed Assessment.

BACKGROUND

Real Property Improvement Services

LHC owns and operates stores in South Carolina where it sells at retail home improvement products and building materials. In addition to its retailing activities in the state, LHC is a contractor and enters into agreements with customers for real property improvement services (the "Installation Contracts"). Pursuant to its Installation Contracts and in its capacity as a contractor, LHC affixes items of tangible personal property ("TPP") to real property owned by its customers. The items of TPP that LHC uses to perform its real property improvement services are withdrawn from its supply of materials purchased at wholesale. At the time of withdrawal, LHC accrues and remits tax based on the price it paid to acquire the materials. Upon execution of its Installation Contracts, LHC charges its customers one lump-sum price for the labor and materials it estimates will be necessary to fulfill its contractual obligations.

¹ A copy of the Proposed Assessment is attached hereto as Exhibit I.

ATI-2540674v3

ALKHOBAR • ATLANTA • BEIJING • BOSTON • BRUSSELS • CHICAGO • CLEVELAND • COLUMBUS • DALLAS • DUBAI
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SAN FRANCISCO • SAO PAULO • SHANGHAI • SILICON VALLEY • SINGAPORE • SYDNEY • TAIPEI • TOKYO • WASHINGTON

14-ALJ-17-0552-CC_0000008

South Carolina Department of Revenue
December 21, 2012
Page 2

Procedural History

During the Audit Period, the Department examined LHC's Installation Contracts and other items unrelated to the treatment of real property improvement services under South Carolina law. The Proposed Assessment is based on the imposition of taxes related to two issues summarized in the table below:

<u>ISSUE</u>	<u>TAX</u>	<u>INTEREST</u>	<u>PENALTY</u>	<u>TOTAL</u>
Installed Sales	\$2,206,054.28	\$222,469.43	\$221,537.70	\$2,650,061.41
Other Taxable Sales; Incorrect Amount of Sales Tax Paid	\$201,520.12	\$21,186.88	\$0	\$222,707.00
Total	\$2,407,574.40	\$243,656.31	\$221,537.70	\$2,872,768.41

LHC is protesting only that portion of the Proposed Assessment related to installed sales and is submitting \$222,707 in payment of the remainder of the Proposed Assessment. A "Waiver of Restriction on Assessment and Collection of Additional Tax or Acceptance of Overassessment" along with Check No. 2260762 is attached hereto as Exhibit 2.

With respect to installed sales, the Department's examination of the Installation Contracts that LHC executed with customers during the Audit Period concluded that LHC did not pay the correct amount of tax on the materials used to provide its real property improvement services. The Department based its conclusion on the assertion that LHC was required to impose tax on the price that it would have received had it sold the materials at retail. LHC did not, however, sell the materials at retail or in its capacity as a retailer. Because LHC withdrew the materials from its supply for the purpose of performing real property improvement services, it accrued and remitted tax based on the fair market value (*i.e.*, the purchase price) of the items to a general contractor.

SOUTH CAROLINA LAW

Imposition Of Sales Tax

Under South Carolina law, "sales tax, equal to five percent of the gross proceeds of sales, is imposed upon every person engaged or continuing within this State, in the business of selling tangible personal property at retail."² A *sale at retail* includes:

- "[S]ales of building materials to construction contractors, builders, or land owners for resale or use in the form of real estate";
- "[S]ales to contractors for use in the performance of construction contracts"; and

² S.C. CODE ANN. § 12-36-910 (emphasis added).

South Carolina Department of Revenue
December 21, 2012
Page 3

- The "withdrawal, use, or consumption of tangible personal property by anyone who purchases it at wholesale."

The term *gross proceeds of sales* includes the "fair market value of tangible personal property previously purchased at wholesale which is withdrawn from the business or stock and used or consumed in connection with the business."³

Tax Treatment Of Contractors

The Department has provided by regulation that "[s]ales of building materials to contractors, builders, or landowners *for resale* or use in the form of real estate are retail sales in whatever quantity sold."⁴ A *contractor* includes "any person, firm, association or corporation making repairs, or additions to real property" (hereafter, a "**Contractor**").⁵ Even in situations in which the real property improvement is owned by a Contractor and will be resold through a lease or rental following construction, the sales tax applies to the Contractor's purchase of the necessary construction materials:

Sales of building materials for use in adding to, repairing or altering real property, are subject to the sales or use tax at the time of purchase *even though the property erected therefrom may be subsequently leased or rented to the person who owns or controls the land on which the property is situate[d]*. Examples include, but are not limited to, building materials used in constructing grain storage tanks, silos, pre-engineered buildings and other structures.⁶

Tax Treatment Of Retailers Making Withdrawals

Retailers that sell TPP at retail and withdraw such property for their own use must purchase the TPP at wholesale.⁷

Operators of businesses who are both making retail sales and withdrawing for use from the same stock of goods are to purchase at wholesale all of the goods so sold or used and report both retail sales and withdrawals for use under the sales tax law. This ruling applies only to those who actually carry on a retail business having a substantial number of retail sales and *does not apply to*

³ *Id.* § 12-36-90(1)(c) (emphasis added).

⁴ S.C. CODE REGS. § 117-314.

⁵ *Id.* § 117-314.2.

⁶ *Id.* § 117-314.1 (emphasis added).

⁷ S.C. CODE ANN. § 12-36-110(a); *see also* S.C. CODE REGS. § 117-324.1 ("Sales of building materials for use in adding to, repairing or altering real property, are subject to the sales or use tax at the time of purchase.").

South Carolina Department of Revenue
December 21, 2012
Page 4

*contractors, plumbers, repairmen, and others who make isolated or accommodation sales and who have not set themselves up as being engaged in selling.*⁸

If the TPP purchased by a retailer is sold at retail, sales tax is collected at the time of sale.⁹ If such property is instead withdrawn from inventory for consumption by the retailer, S.C. CODE ANN. § 12-36-90 (the "Gross Proceeds Statute") imposes sales tax on the fair market value (the "FMV") of the property at the time of its withdrawal:

Gross proceeds of sales, or any similar term, means the value proceeding or accruing from the sale, lease, or rental of tangible personal property. The term includes . . . *the fair market value of tangible personal property previously purchased at wholesale which is withdrawn from the business or stock and used or consumed in connection with the business or used or consumed by any person withdrawing it.* (emphasis added).

Thus, TPP withdrawn from the inventory of a retailer will be subject to sales tax based on its FMV in the hands of the retailer for such purposes.

Negligence Penalties

If an underpayment of tax is the result of negligence or disregard of the law, penalties are imposed as follows:

If any part of an underpayment of tax or part of a claim for refund of tax is due to negligence or disregard of regulations, there must be added to the tax an amount equal to the sum of five percent of the underpayment and an amount equal to fifty percent of the interest payable under Section 12-54-25.¹⁰

If underpayment of tax is not the result of negligence or disregard of the law, the Department does not have the authority to impose such penalties.

ANALYSIS

The "Fair Market Value" Of The Withdrawn Property Is LHC's Cost Price

The Department's position is that LHC was required to remit sales tax based on a 40% mark-up of LHC's cost price, which the Department believes LHC would receive if the property were sold at retail to an individual consumer. The Department does not, however, dispute that LHC is a contractor. In fact, the South Carolina Department of Labor, Licensing and Regulation

⁸ S.C. CODE REGS. § 117-324 (emphasis added).

⁹ S.C. CODE ANN. § 12-36-910.

¹⁰ *Id.* § 12-54-43(F)(1).

South Carolina Department of Revenue
December 21, 2012
Page 5

has licensed LHC as a general contractor and assigned it license number 116664.¹¹ Further, the auditor has not assessed LHC for improper taxation of its customers (at point-of-sale) on installed TPP. Rather, the auditor agrees that LHC is acting as a real property improvement contractor and, therefore, agrees that tax is due on the withdrawal of the goods. The auditor's opinion, however, is that LHC does not owe tax based on the FMV of the withdrawn materials in the hands of a contractor, but instead owes tax based upon the price at which such goods would be offered for sale to consumers on a stand-alone basis.

LHC respectfully contends that the Department's position is contrary to South Carolina law, and LHC is not aware of any situation in which the Gross Proceeds Statute has been applied to a contractor or contractor transactions – particularly in a manner that deems the FMV of contractor purchases to be taxable at a 40% mark-up. The Gross Proceeds Statute requires that sales tax be remitted based on the FMV of the TPP withdrawn from inventory. The FMV of the property withdrawn by LHC for use in fulfilling its Installation Contracts is the price LHC paid for the property. The Department's approach is unlawful because it (1) fails to consider (a) any factors that might affect FMV or (b) the fact that a business can be both a contractor and retailer, and (2) is applying a requirement to a contractor that is intended to address the withdrawal of inventory for use in a retailer's (not contractor's) business operations. Rather, the Department with a stroke of the proverbial pen merely adds a 40% mark-up to the price paid by LHC for the purpose of determining FMV. This is not what the Gross Proceeds Statute or South Carolina law requires.

South Carolina law requires that the FMV of property be determined – for whatever purpose – by the totality of the facts and circumstances. The Administrative Law Court has held that when "estimating the value of property, all of the factors which affect market value or would influence the mind of a purchaser should be considered."¹² Among the factors that the Department should have considered are:

- Whether the withdrawn property is being used in a contracting line of business;
- The price actually paid by LHC for the property;
- The price a similarly situated Contractor (*e.g.*, Pulte Homes, Inc.) would pay for the property; and
- The price at which a Contractor would be competitively disadvantaged in paying.

The most recent (and only) purchase price paid by a taxpayer must be a factor in determining FMV. In the instant case, LHC paid its vendor a fair price for the withdrawn TPP and remitted tax based on that price. In addition, the price a willing Contractor would pay for the

¹¹ A screenshot of LHC's licensing information is attached hereto as Exhibit 3.

¹² *Northbridge Associates, LLC v. Charleston Cnty. Assessor*, S. C. Admin. Law Ct., 2008 WL 5416996, at *9 (November 25, 2008). The determination of FMV should take into consideration all relevant factors regardless of whether the tax to be applied to such value is a sales tax or property tax.

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property is a factor that is relevant in the calculation of FMV. LHC operates a contracting line of business, and the price a Contractor of LHC's size would pay for TPP (considering the costs incurred by such a large Contractor and its negotiating power) is an essential consideration. LHC asserts that its cost is the price a large Contractor would pay for the withdrawn TPP because LHC could have purchased identical property at the same cost price and tax would have been calculated on that basis. Similarly, the price at which a Contractor becomes competitively disadvantaged should have been considered. Deeming a 40% mark-up of the cost price to be the FMV places LHC at a competitive disadvantage. In fact, neither LHC nor any other Contractor could purchase construction materials at a 40% mark-up and remain in business in South Carolina. This arbitrary approach compels LHC to price its services at a rate that is not competitive with other Contractors whose tax costs are calculated on a lower sales price. A 40% mark-up simply does not reflect the FMV of the property to LHC.

Finally, the Department provides no evidence that a 40% mark-up to the cost price equates to the FMV of the property in the hands of a Contractor. Rather, the Department takes the overly simplistic position that the retail price paid by an individual consumer making a "one off" purchase at an LHC store location is the FMV of the withdrawn TPP. The lack of evidence to support this value is sufficient reason to abate the Proposed Assessment.

The Department's Position Creates Disparate Treatment Of Contractors

The South Carolina legislature did not anticipate an application of the Gross Proceeds Statue that would result in radically disparate treatment of Contractors. The Department's position that LHC should add a 40% mark-up to its up purchase price results in a higher tax on Contractors who engage in more than one line of business. An increase in tax of this magnitude negatively affects LHC's ability to compete as a Contractor.

The Gross Proceeds Statute does not contemplate the treatment of Contractors and should not be interpreted in a manner that creates an unequal "playing field" within the contracting industry. The Gross Proceeds Statute assumes that withdrawals will be made from a retailer's inventory, which a non-retailing Contractor will never possess. Even the Department's regulations do not anticipate that Contractors who are purchasing at wholesale and holding inventory as "sales of building materials to contractors . . . for resale" are subject to sales tax at the time of the Contractor's purchase. Rather, the Gross Proceeds Statute naturally addresses circumstances in which a retailer withdraws TPP for use in its retail operations. A retailer might, for example, withdraw cleaning supplies for custodial purposes, or make facility repairs using bricks and lumber from its existing wholesale supplies. In these circumstances, the retailer is not put at a competitive disadvantage by paying tax on the retail price to individual consumers. Applying the Gross Proceeds Statute to impose a 40% mark-up on products that are withdrawn by LHC for use in a contracting line of business that is subject to its own competitive pressures, including pricing pressures, is not what was contemplated by the legislature. If the FMV of the TPP were calculated by considering all of the relevant facts and circumstances, the FMV of the withdrawn TPP would not be LHC's cost plus a 40% mark-up.

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The Negligence Penalty Should Be Abated

The Proposed Assessment provides the following explanation of the negligence penalty imposed pursuant to S.C. CODE ANN. § 12-54-43(F)(1) (the "Penalty Statute"):

The negligence penalty has been applied to all periods for the installed sales transactions which were taxed at cost and not at retail price as stated in SC Code Section 12-36-90. This issue was addressed in the last SC Sales Tax Audit for the periods 3/1/2002 through 2/28/2005 which was completed and assessed in January 2007.

The Penalty Statute provides that the Department must demonstrate that the "underpayment of tax . . . is due to negligence or disregard of regulations."¹³ Here, the Department can show neither.

The Department points to the fact that the "issue was addressed in the last SC Sales Tax Audit" to show that LHC was aware of the Department's position and was thus negligent in the tax treatment of its Installation Contracts during the Assessment Period. While LHC settled the same issue during the prior audit for purposes of expediency, it did not (and does not) agree with the Department's position. In addition, LHC did not ignore relevant regulations. Instead, and as discussed above, LHC determined that the Gross Proceeds Statute supports its position with respect to the FMV of the TPP consumed by LHC in the performance of its real property improvement services. Because LHC neither acted negligently nor disregarded relevant Department regulations, the penalties reflected in the Proposed Assessment should be abated in full.

CONCLUSION

For the reasons discussed above, the Department should abate the portion of the Proposed Assessment related to installed sales in its entirety. LHC correctly determined and remitted sales tax based upon the FMV of the TPP that it used to fulfill the terms of its Installation Contracts.

If you have any questions, please do not hesitate to contact me at (404) 581-8012.¹⁴

¹³ S.C. CODE ANN. § 12-54-43(F)(1).

¹⁴ An executed Power of Attorney form is attached hereto as Exhibit 4.

JONES DAY

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Sincerely,



John Allan

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JOINT EXHIBIT 31

JONES DAY

1420 PEACHTREE STREET, N.E. • SUITE 800 • ATLANTA, GEORGIA 30309 3053
TELEPHONE: +1 404 581 3939 • FACSIMILE: +1 404 581 8330

August 2, 2013

VIA CERTIFIED MAIL & EMAIL: CRAWFOP@SCTAX.ORG

CONFIDENTIAL TAXPAYER INFORMATION

South Carolina Department of Revenue
Audit Services
454 S. Anderson Road, Suite 202
P.O. Box 12099
Rock Hill, South Carolina 29731
Attn: Paulette Crawford

Re: Protest Of Proposed Assessment - Lowe's Home Centers, Inc. [REDACTED]

Dear Ms. Crawford:

This correspondence serves as a supplement to the December 21, 2012 protest (the "Protest")¹ of the proposed assessment dated September 24, 2012 (the "Proposed Assessment")² issued by the South Carolina Department of Revenue (the "Department") to Lowe's Home Centers, Inc. ("LHC" or the "Taxpayer"). The Proposed Assessment asserts that LHC is liable for additional state and local sales tax, interest and penalties applicable to the tax period beginning August 1, 2008 and ending July 31, 2011 (the "Audit Period").

During the Audit Period, the Department examined LHC's treatment of real property improvement service agreements ("Home Improvement Contracts") under South Carolina law. The Department's position is that LHC was required to remit sales tax based on the withdrawal of goods on a 40% mark-up of LHC's cost price, which the Department believes LHC would receive if the property were sold at retail to an individual consumer. The Department does not, however, dispute that LHC is a contractor.³ The Department determined that tax is due on the withdrawal of the goods from LHC's inventory.⁴ As LHC is a home improvement contractor that purchases a high volume of materials in order to perform real property improvement services, a 40% markup to cost price does not reasonably reflect the market value of the construction materials used by LHC in its Home Improvement Contracts. LHC is the purchaser of items used in its Home Improvement Contracts⁵ and to tax items purchased for those contracts

¹ A copy of the Protest is attached hereto as Exhibit 1.

² A copy of the Proposed Assessment is attached hereto as Exhibit 2.

³ The South Carolina Department of Labor, Licensing and Regulation has licensed LHC as a general contractor and assigned it license number 116664. A screenshot of LHC's licensing information is attached hereto as Exhibit 3.

⁴ The Department did not assess sales tax on the customer's purchase, evidencing that the Taxpayer correctly treated itself as a real property improvement contractor and properly exempted these transactions from sales tax.

⁵ A "retail sale" includes "[S]ales to contractors for use in the performance of construction contracts." S.C. CODE ANN. § 12-36-110(1)(e).

ATI-2571373v3

ALKHOBAR • AMSTERDAM • ATLANTA • BEIJING • BOSTON • BRUSSELS • CHICAGO • CLEVELAND • COLUMBUS • DALLAS
DUBAI • DUSSELDORF • FRANKFURT • HONG KONG • HOUSTON • IRVINE • JEDDAH • LONDON • LOS ANGELES
MADRID • MEXICO CITY • MILAN • MOSCOW • MUNICH • NEW YORK • PARIS • PITTSBURGH • RIYADH • SAN DIEGO
SAN FRANCISCO • SAO PAULO • SHANGHAI • SILICON VALLEY • SINGAPORE • SYDNEY • TAIPEI • TOKYO • WASHINGTON

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at an artificially higher base would place LHC at a competitive disadvantage to similarly situated real property improvement contractors. The South Carolina legislature has not created a separate class of taxpayers such that contractors who also sell at retail constitute a separate class from those who exclusively engage in contracting. To impose a new and artificially higher rate of tax on contractors who also sell at retail, for administrative convenience, is an action that is not sanctioned by the South Carolina legislature and would violate the equal protection clause of the South Carolina Constitution.⁶

The most recent (and only) purchase price paid by LHC should be determinative of the taxable Fair Market Value ("FMV") of the withdrawn goods. LHC asserts that the price upon which it should accrue use tax is the price it paid for the withdrawn property because LHC could have purchased identical property at the same cost price and remitted sales tax at the time of purchase.⁷ Under those circumstances, the Department would not dispute that an appropriate amount of tax had been paid by LHC. Thus, the fact that LHC accrued use tax on the cost price of the property at the time of withdrawal (plus an additional amount of approximately 7%, as discussed below) does not justify an additional mark-up or have any bearing on the FMV of the property.

As to the Department's position that an additional markup should be applied by LHC to the cost price of its withdrawn inventory, we initially point out that the FMV of the property LHC purchased is the price for which LHC purchased the property. Nonetheless, LHC has already internally marked up its inventory items by an additional 7% and accrued South Carolina tax on the increased tax base. The calculation below illustrates the inventory adjustment:

Inventory (before mark-up)	Mark-up Amount	Inventory Value (after mark-up)	Mark-up (as a percentage of inventory value before mark-up)
\$8,908,985,635	\$631,553,782	\$9,540,539,417	7.09%

Any further mark-up is unwarranted under South Carolina law.⁸

We appreciate your consideration of the information provided herein. Once you have had a chance to review, I would appreciate the opportunity to discuss this matter with you. If you have any questions, please do not hesitate to contact me at (404) 581-8012.⁹

⁶ S.C. CONST. art. I, § 3.

⁷ Given its position as one of the nation's largest home improvement contractors, LHC is able to secure the most favorable pricing based on the volume of its purchases.

⁸ S.C. CONST. art. I, § 3.

⁹ An executed Power of Attorney form is attached hereto as Exhibit 4.

JONES DAY

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Sincerely,

John Allan *with express permission*
EA

John Allan

ATI-2571373v3

14-ALJ-17-0552-CC_0000018

JOINT EXHIBIT 32

**South Carolina Administrative Law Court (SC ALC)
Request for Contested Case Hearing FORM**
Mail to: 1205 Pendleton St., Suite 224, Columbia, SC 29201

Last Name: Lowe's Home Centers, LLC		First:	Middle:	☐ Mr. ☐ Mrs.	☐ Miss ☐ Ms.	Docket No. (To Be Completed by ALC)
Mailing Address: P.O. Box 1000		City: Mooreville		State and Zip: NC, 28115		
Home Number:	Work Number: 704-758-3737	Cell Number:		*E-Mail Address: erogerswalsh@jonesday.com		

*By providing your e-mail address, you consent to receive court orders and notices via electronic transmission

REPRESENTATION

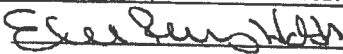
Are you representing yourself? ☐ Yes ☒ No	
Are you represented by an Attorney? ☒ Yes ☐ No	Name of Attorney: Elaine Rogers Walsh, Jones Day
Attorney Mailing Address: 1420 Peachtree Street, N.E. Suite 800	City, State and Zip: Atlanta, GA 30309
Attorney Work Number and Cell Number: Work: 404.581.8371 Cell: 404.217.7811	Attorney E-Mail Address: erogerswalsh@jonesday.com

CASE INFORMATION

Name of Agency that Issued the Decision: (Example - Dept. of Revenue, Dept. of Insurance, DHEC) Department of Revenue (File Number 40038688-1)	
In order to have your case processed, you must attach the agency decision. Is it attached? ☒ Yes ☐ No	If no, please explain:
Date the decision was issued: October 24, 2014	Date the decision was received: October 27, 2014

Please provide a brief statement regarding why the hearing is being requested and the relief sought: Please see attached.
The taxpayer believes that the Department of Revenue has improperly assessed sales tax on the materials that the taxpayer uses to perform real property improvement services in South Carolina. The taxpayer requests that the assessed taxes be abated in full. Please see the attached document for a more detailed discussion of these issues.

Payment via ☒ Check ☐ Money Order ☐ Cash for \$ 500 (applicable filing fee pursuant to ALC Rule 71) is being submitted today to the Administrative Law Court via ☐ U.S. Postal Service ☐ Hand-delivery

 X Your Signature or Signature of Attorney	November 21, 2014 Date
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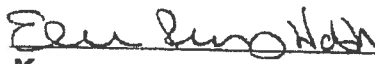
PROOF OF SERVICE (MUST BE COMPLETED)

Your Name: Elaine Rogers Walsh	Date: 11/21/2014	City: Atlanta	State: Georgia
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I hereby certify that on the date and place listed above, I served a copy of the foregoing Request for Contested Case Hearing on all other parties to this matter by depositing the same in the United States Mail, postage paid, and addressed as follows (use the reverse side for any additional names):

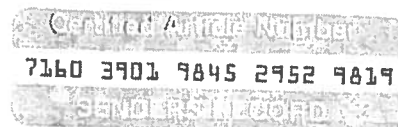
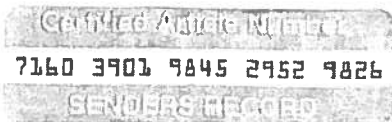
Nicole M. Wooten	P.O. Box 12265	Columbia, SC 29211
Name and/or Agency Name	Address	City, State and Zip

Name and/or Agency Name	Address	City, State and Zip
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 X Your Signature or Signature of Attorney	November 21, 2014 Date
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Attention: All cases filed in the Administrative Law Court are subject to the Rules of Procedure found at the Court's website www.scalc.net or from the Clerk of Court. Failure to follow these rules may result in dismissal of your case.

14-ALJ-17-0552-CC_0000019



**ATTACHMENT TO REQUEST FOR CONTESTED CASE HEARING
STATEMENT OF BASIS FOR HEARING REQUEST & RELIEF SOUGHT**

For the reasons set forth below, the October 24, 2014 Determination (the "Determination")¹ issued to Lowe's Home Centers, LLC ("LHC")² by the South Carolina Department of Revenue (the "Department") erroneously concluded that LHC is liable for additional sales tax, penalty and interest related to the tax period beginning August 1, 2008 and ending July 31, 2011 (the "Audit Period"). LHC requests a hearing before the Administrative Law Court to present evidence supporting its position that the Determination was issued in error and should be abated in full.

PROCEDURAL HISTORY

On December 21, 2012, LHC filed a protest (the "Protest") of the proposed assessment dated September 24, 2012 (the "Proposed Assessment") issued by the Department.³ The Proposed Assessment asserts that LHC is liable for additional state and local sales tax, interest and penalties applicable to the Audit Period. On August 2, 2013, LHC provided the Department with correspondence to supplement the Protest.⁴ On October 24, 2014, the Department issued the Determination, which upheld that portion of the Proposed Assessment relating to LHC's real property improvement contracts (hereafter, "Installation Contracts") and stated that LHC is liable for tax, penalty and interest in the following amounts:

¹ A copy of the Determination is attached hereto as Exhibit 1.

² The Protest in this matter was filed by Lowe's Home Centers, Inc., which converted to Lowe's Home Centers, LLC effective November 1, 2013. Lowe's Home Centers, Inc. was the taxpayer during the tax period at issue in this appeal. Lowe's Home Centers, LLC is the successor in interest to Lowe's Home Centers, Inc. for all purposes.

³ A copy of the Protest is attached hereto as Exhibit 2.

⁴ A copy of the August 2, 2013 correspondence is attached hereto as Exhibit 3.

<u>ISSUE</u>	<u>TAX</u>	<u>INTEREST</u>	<u>PENALTY</u>	<u>TOTAL</u>
Installation Contracts	\$2,206,054.28	\$360,580.69	\$290,593.35	\$2,857,228.32

With respect to LHC's Installation Contracts, the Department concluded that LHC did not pay the correct amount of tax on the materials it used in fulfilling its Installation Contracts. Because LHC used materials to perform its real property improvement services in its capacity as a construction contractor (a "Contractor") under the Installation Contracts, it remitted tax based on the purchase price of the items. The Department determined, however, that LHC was required to compute tax based on a 40% mark-up of LHC's purchase price, which is the price the Department determined the company would have received had it sold each of the materials at retail to an individual consumer. The difference in the tax base has given rise to the instant dispute.

BACKGROUND

Contractor Line of Business

LHC owns and operates stores nationwide where it sells home improvement products and building materials at retail. In addition to – and separate from – its retailing activities in the state, LHC operates a nearly \$5 billion Contractor line of business and enters into Installation Contracts for real property improvements. Upon execution of its Installation Contracts, LHC charges its customers one lump-sum price for the labor and materials it estimates will be necessary to fulfill its contractual obligations. The Installation Contracts provide that LHC will be the Contractor for purposes of making the improvements. The customer pays the lump-sum

[2]

amount before LHC begins performance of the Installation Contract services, and the amount charged to the customer does not vary based upon the actual amount of labor and materials used by LHC to fulfill its obligations under the contract.

Pursuant to its Installation Contracts and in its capacity as a Contractor, LHC affixes items of tangible personal property ("TPP") to real property owned by its customers. Title to the materials affixed to real property pursuant to the Installation Contracts does not pass from LHC to the customer until the real property improvement is completed. The items of TPP that LHC uses to perform its real property improvement services are often specially ordered for the individual property improvement project. Furthermore, the materials are almost always purchased from out-of-state vendors or shipped from distribution centers in Georgia and North Carolina to LHC store locations in South Carolina as needed. LHC does not have a distribution center in South Carolina. At the time they are used, LHC accrues and remits tax on the building materials based on the purchase price.

Special Order Items Not Held in Stock of Goods

A substantial portion of the items LHC uses or consumes in performing its Installation Contracts, including many that are part of the Department's tax assessment, are not even maintained in stock and must be specially ordered for each project (hereafter, "Special Order Items"). Special Order Items used in real property improvement contracts, such as cabinets, are not purchased for resale.

SOUTH CAROLINA LAW

Sales Tax Imposition

Under South Carolina law, "sales tax, equal to five percent of the gross proceeds of sales, is imposed upon every person engaged or continuing within this State, in the business of selling tangible personal property at retail." S.C. CODE ANN. § 12-36-910. A *sale at retail* includes:

- "[S]ales of building materials to construction contractors, builders, or land owners for resale or use in the form of real estate";
- "[S]ales to contractors for use in the performance of construction contracts"; and
- The "withdrawal, use, or consumption of tangible personal property by anyone who purchases it at wholesale."

Id. § 12-36-110. The term *gross proceeds of sales* includes the "fair market value of tangible personal property previously purchased at wholesale which is withdrawn from the business or stock and used or consumed in connection with the business." *Id.* § 12-36-90(1)(c).

Tax Treatment Of Contractors

The Department has provided by regulation that "[s]ales of building materials to contractors, builders, or landowners for resale or use in the form of real estate *are retail sales* in whatever quantity sold." S.C. CODE REGS. § 117-314 (emphasis added). Contractors are subject to sales tax on their purchases. *Id.* A *Contractor* includes "any person, firm, association or corporation making repairs, or additions to real property." *Id.* § 117-314.2. Even in situations in which the real property improvement is owned by a Contractor and will be resold through a lease or rental following construction, the sales tax applies to the Contractor's purchase of the necessary construction materials:

Sales of building materials for use in adding to, repairing or altering real property, *are subject to the sales or use tax at the time of purchase* even though the property erected therefrom may be subsequently leased or rented to the person who owns or controls the land on which the property is situate[d]. Examples include, but are not limited to, building materials used in constructing grain storage tanks, silos, pre-engineered buildings and other structures.

Id. § 117-314.1 (emphasis added). Further, the South Carolina Court of Appeals has held that Contractors do not collect sales tax from customers for whom such Contractors perform real property improvement services. *See South Carolina Dep't of Revenue v. Springs Indus., Inc.*, No. 2003-UP-029 (S.C. Ct. App. 2003). Charges to customers for building materials used to make a real property improvement are not subject to sales tax. *See Private Letter Ruling 07-4* (S.C. Dep't of Revenue (Jul. 13, 2007)). Because sales to – and purchases by – Contractors are subject to sales tax at the time of the sale, the timing and tax amount are set at the time of the purchase.

In *South Carolina Department of Revenue v. Springs Indus., Inc.*, the South Carolina Court of Appeals left undisturbed an administrative decision finding that when determining whether a contract is a construction contract, it is appropriate to look to the nature and characteristics of the agreement. *Springs Indus., Inc.*, No. 2003-UP-029 (“[T]he ALJ made detailed findings regarding the nature and characteristics of the agreements and noted substantial similarities between their features and those of construction contracts.”). In particular, the fact that a lump sum price is charged and the agreement makes references to a “contractor” supports

[5]

that the agreements are construction contracts. *Id.* ("In particular, the ALJ found that . . . a lump sum price was charged . . . Accordingly, we find that the agreements' features, particularly . . . numerous references in the agreements to 'contracts' and 'contractors,' provide substantial support for the ALJ's findings that the agreements in this case were construction contracts.").

Tax Treatment Of Retailers Making Withdrawals From Inventory

The Department has provided by regulation that Retailers which sell TPP at retail and also withdraw property from inventory for their own use must purchase the TPP at wholesale:

Operators of businesses who are both making retail sales and withdrawing for use *from the same stock of goods are to purchase at wholesale* all of the goods so sold or used and report both retail sales and withdrawals for use under the sales tax law. This ruling applies only to those who actually carry on a retail business having a substantial number of retail sales and does not apply to contractors, plumbers, repairmen, and others who make isolated or accommodation sales and who have not set themselves up as being engaged in selling.

S.C. CODE REGS. § 117-324 (emphasis added); *see also id.* § 117-314.1 ("Sales of building materials for use in adding to, repairing or altering real property, are subject to the sales or use tax at the time of purchase."). The requirements of Regulation 117-324 are not statutorily imposed, and the Regulation appears to have been promulgated as a convenience to the Department. The approach of Regulation 117-324 is consistent with the policy stipulated in *Colonial Stores, Inc. v. South Carolina Tax Commission*, 168 S.E.2d 774 (S.C. 1969), in which Department of Revenue (i) authorized a taxpayer to purchase promotional merchandise free of

[6]

sales tax because segregation of sales and use tax between the items acquired as promotional merchandise and those held for resale would be impractical; and (ii) allowed the taxpayer to account directly to the Department of Revenue for the tax when the promotional merchandise was exchanged for stamps based on the *purchase price* of the merchandise to the company because the merchandise was acquired for company promotional use and would otherwise have been subject to tax at the time of purchase.

If TPP purchased by a vendor is sold at retail, sales tax is collected at the time of sale. S.C. CODE ANN. § 12-36-910. However, if the same property is withdrawn from inventory for consumption by the vendor, S.C. CODE ANN. § 12-36-90 (the "Gross Proceeds Statute") imposes sales tax on the fair market value (the "FMV") of the property at the time of its withdrawal:

Gross proceeds of sales, or any similar term, means the value proceeding or accruing from the sale, lease, or rental of tangible personal property. The term includes . . . *the fair market value of tangible personal property previously purchased at wholesale which is withdrawn from the business or stock* and used or consumed in connection with the business or used or consumed by any person withdrawing it. (emphasis added)

Thus, TPP withdrawn from stock will be subject to sales tax based on its FMV in the hands of the Contractor for purposes of its construction business.

In 2002 – nearly a dozen years after the Gross Proceeds Statute was enacted – the Department promulgated Regulation 117-309.17 (the "Fair Value Regulation") relating to the determination of FMV for purposes of TPP purchased at wholesale for resale and later withdrawn from inventory:

[7]

To be included in gross proceeds of sales is the money value of property purchased at wholesale for resale purposes and subsequently withdrawn from stock for use or consumption by the purchaser. *The value to be placed upon such goods is the price at which these goods are offered for sale by the person withdrawing them.* All cash or other customary discounts which he would allow to his customers may be deducted; however, in no event can the amount used as gross proceeds of sales be less than the amount paid for the goods by the person making the withdrawal.

S.C. CODE REGS. § 117-309.17 (emphasis added).

Negligence Penalties

If an underpayment of tax is the result of negligence or disregard of the law, penalties are imposed as follows under S.C. CODE ANN. § 12-54-43 (the "Penalty Statute") as follows:

If any part of an underpayment of tax or part of a claim for refund of tax is due to negligence or disregard of regulations, there must be added to the tax an amount equal to the sum of five percent of the underpayment and an amount equal to fifty percent of the interest payable under Section 12-54-25.

S.C. CODE ANN. § 12-54-43(F)(1). If underpayment of tax is not the result of negligence or disregard of the law, the Department does not have the authority to impose a penalty.

TAXPAYER POSITIONS

LHC Properly Remitted Tax on Its Contractor Purchases Under the South Carolina Sales Tax Statutes

The South Carolina Code imposes sales tax on every person engaging in the business of selling TPP at retail in South Carolina. *Id.* § 12-36-910(A). A *sale at retail* is specifically

defined to include "sales of building materials to *construction contractors*, builders, or landowners for resale or use in the form of real estate." *Id.* § 12-36-110(1)(a) (emphasis added). The term *building materials* is broadly defined to include "any material used in making repairs, alterations, or additions to real property." *Id.*

The South Carolina sales tax statutes impose sales tax at the time a retail sale is made to a Contractor and based on the purchase price paid by the Contractor. Because Department Regulation 117-324 requires that contractor-retailers make *all* of their purchases at wholesale, however, LHC did not pay sales tax on its purchases at the time the building materials were purchased. The Department cannot now claim that LHC, which merely complied with the Department's administrative guidance, should be penalized by having to pay sales tax on a higher tax basis than the original purchase price. See *Colonial Stores, Inc. v. South Carolina Tax Comm'n*, 168 S.E.2d 774 (S.C. 1969) (in which the Department of Revenue (i) authorized a taxpayer to purchase promotional merchandise free of sales tax because segregation of sales and use tax between the items acquired as promotional merchandise and those held for resale would be impractical; and (ii) allowed the taxpayer to account directly to the Department of Revenue for the tax when the promotional merchandise was exchanged for stamps based on the *purchase price* of the merchandise to the company because the merchandise was acquired for company promotional use and would otherwise have been subject to tax at the time of purchase).

The Fair Market Value Of The Property Used to Make Real Property Improvements Is the Purchase Price Paid by LHC

The Department asserts that LHC is required to remit sales tax on the items it used to make real property improvements based on a 40% mark-up of LHC's cost price, which the

[9]

Department believes to be the retail selling price to LHC's individual customers. The Department's position is inconsistent with the Gross Proceeds Statute for three reasons:

- *First*, the Department failed to understand that materials purchased for LHC's Contractor operations were *not* offered for sale at retail.
- *Second*, the Department failed to determine the FMV of the property using comparable sales of similar property (*i.e.*, bulk sales of building materials to other Fortune 50 businesses) and has instead based FMV on the retail value of a single item sold to a walk-in consumer making a purchase at an LHC store location.
- *Third*, the Department's position is not consistent with South Carolina statutory law, and results in LHC – as a Contractor – being treated differently from (and less favorably than) other South Carolina contractors. The Department's position also results in the non-uniform treatment of Contractors and the creation of different classes of Contractors, which the legislature has not authorized.

Special Order Items Are Not Subject to the Rules Governing Inventory Withdrawals

A substantial portion of the items LHC uses or consumes in performing its Installation Contracts, including many that are part of the Department's tax assessment, are not maintained in stock. These Special Order Items (*e.g.*, kitchen cabinets and doors) are not offered for sale because they are expressly purchased for use in making a real property improvement by LHC's Contractor business.

The Department asserts that LHC is uniformly – and without any distinction between any of its products or the intended use of those products – subject to the tax based on the “fair market value of tangible personal property purchased at wholesale which is withdrawn from the business or stock.” The FMV provision of the Gross Proceeds Statute *does not apply* to materials used or consumed by a taxpayer that are *not maintained in stock*. Similarly, the Fair Valuation

[10]

Regulation, upon which the Department relies, only applies to a "person withdrawing" products from inventory.

Comparable Sales Should Be Used to Determine FMV

Even if the building materials LHC uses to make real property improvements were maintained in stock (which most are not), the Department's determination of FMV would be flawed. The Gross Proceeds Statute requires that FMV be used to calculate the tax for each item of TPP that is used to make a real property improvement. Although the Department was careful in its Determination to point out those authorities cited by LHC that were property tax cases, it nonetheless quoted and relied upon a South Carolina Court of Appeals property tax decision for the definition of *fair market value*:

Fair market value is that price which a willing buyer will pay a willing seller, neither being under compulsion to buy or sell and both being fully informed of all uses to which the property is adopted and for which it is capable of being used.

Quoting *Hous. Auth. of City of Charleston v. Olasov*, 320 S.E.2d 478, 481 (S.C. Ct. App. 1984).

The flaw in the Department's interpretation of its Regulations as they relate to determining FMV is that it deems FMV to essentially be the suggested retail price paid by walk-in customers to LHC stores, and so has failed to use comparable sales to determine FMV. As a result, the Department's valuation is wholly unreliable and erroneous.

The South Carolina Administrative Law Division (the "Law Division") has enumerated the requirements for comparable sales that are used to determine FMV:

[11]

To determine a fair market price for the Taxpayers' property, comparisons of the sale price of other properties of the same character may be utilized. While it is impossible to predict with certainty what a particular property will sell for, utilizing *comparable sales* is a good indicator of what a potential purchaser will likely pay and it provides probative evidence of the market value of the subject property, *if the comparables are similar in character, location, and physical characteristics.*

Hendrix vs. Lexington County Assessor, Docket No.03-ALJ-17-0475-CC (S.C. Admin. Law Div. Jul. 20, 2005) (citations omitted) (emphasis added). The Law Division's pronouncement is clear: the comparable sales used to determine FMV must be similar to the purchase transactions in which the taxpayer engaged. A succinct definition of a *comparable sale* is:

one to (1) *comparable purchasers* (2) at comparable locations (3) under comparable conditions of sale and (4) involve similar quality products (5) *in similar quantities.*

Texaco Refining & Marketing, Inc. v. Department of Revenue, 127 P.3d 771 (Wash. Ct. App. 2006) (quoting WASH. ADMIN. CODE 458-20-112) (emphasis added).

The use of an "off the shelf" sale of a single item to a walk-in customer at an LHC store location is not "comparable" to a bulk sale made to a Fortune 50 business that makes nearly a billion dollars in annual building material purchases. Thus, the Department's approach to valuation is fundamentally flawed. A more appropriate sales comparison for purposes of valuing the consumed building materials is a bulk sale of the same type of property to other large Contractors. In a competitive industry, the Company's cost price valuation is the same or very close to the true FMV of the building materials. Because LHC has comparable purchase data for

[12]

recent time periods, it can determine the FMV of the building materials. The time between when a product is purchased and used by LHC to make an improvement is very small. Thus, there is little difference between the purchase price paid by LHC for building materials and the FMV of the product when it is used by LHC.

The Department's Fair Valuation Regulation should have little or no bearing on the valuation of LHC's building materials. The Fair Valuation Regulation (promulgated in 2002) comes approximately a dozen years after the Gross Proceeds Statute was enacted (1990). It has long been the law in South Carolina that regulations that are not promulgated contemporaneously with the statute which they purport to interpret are entitled to little deference. *See S.C. Att'y Gen. Op. (Oct. 1, 1986)*, 1986 S.C. AG LEXIS 69, *9-*10 (relying on "the rule of statutory construction that the longstanding *contemporaneous construction* of a statute by the agency charged with administration and enforcement of the statute is most significant"); *South Carolina Ambulatory Surgery Ctr. Ass'n v. South Carolina Workers' Compensation Comm'n*, 699 S.E.2d 146 (S.C. 2010) (applying rules of statutory construction to regulations).

The Department's Regulations Cannot Result in Disparate Treatment of Contractors

In its Protest, LHC detailed the disparate treatment that the Department's position creates among taxpayers in the construction industry by arbitrarily treating Contractors who also engage in a retail line of business differently from Contractors that do not. In its Determination, the Department maintains that it has not created separate classes of taxpayers within the Construction industry, relying primarily on the mistaken belief that LHC is not a Contractor.

[13]

LHC is a Contractor for purposes of the Installation Contract services provided to South Carolina customers and is not required to collect sales tax from such customers pursuant to the Contracts. The Department has defined a Contractor to include “any person, firm, association or corporation *making repairs, or additions to real property.*” S.C. CODE REGS. § 117-314.2 (emphasis added). LHC clearly falls into this definition when making a real property improvement in South Carolina and is thus liable for tax based upon the purchase price of the property used to perform the Installation Contract. *See Technical Advice Memorandum 89-10* (S.C. Tax Comm’n (Mar. 15, 1989)); *South Carolina Dep’t of Revenue v. Springs Indus., Inc.*, No. 2003-UP-029 (S.C. Ct. App. 2003). The Department has not explained how LHC fails to meet this definition.

Although holding a Contractor’s license is not required by South Carolina law to fall within the definition of a *Contractor*, LHC nonetheless holds License No. 116664 and has provided a copy of this license to the Department.⁵ The Determination asserts that LHC “is not a contractor based on the facts and circumstances in this matter.” In support of its position that LHC is not a Contractor, the Department notes that License No. 116664 was not issued until June 23, 2011, which is at the end of the Audit Period. LHC, however, has been licensed as Contractor in South Carolina since 2001, and was so licensed during the entirety of the Audit Period.⁶ LHC provided License No. 116664 along with its Protest because this was the license in effect at the end of the Audit Period and at the time the Protest was filed.

⁵ A screenshot of LHC’s licensing information is attached hereto as Exhibit 4.

⁶ LHC’s previous South Carolina Contractor’s license documentation is attached hereto as Exhibit 5.

The Determination seeks to further support the Department's position that LHC is not a Contractor by emphasizing that LHC also engages in retailing activities. The Determination states, for example, that LHC "advertises itself as a retailer" and that the "vast majority of the taxpayer's sales are sales at retail that do not include installation services." The fact that LHC engages in retailing activities, in addition to and separately from, its construction services does not make LHC any less a Contractor. The Department has acknowledged that taxpayers are not retailers with respect to their real property improvement contracts (but rather Contractors), *see Private Letter Ruling 07-4* (S.C. Dep't of Revenue (Jul. 13, 2007)), and has provided nothing to support its position that a taxpayer cannot be both a Contractor and a retailer. Furthermore, the Department's position is blatantly contrary to its own Regulation, which provides that "*any person, firm, association or corporation making repairs, or additions to real property*" is a Contractor. S.C. ADMIN. CODE § 117-314.2 (emphasis added). For that matter, if the Department truly believed that LHC operated solely as a retailer, it would have had little need to assess sales tax under the theory that LHC was withdrawing materials from inventory for its own use.

LHC's purchase of building materials as if they were at wholesale is in compliance with Regulation 117-324, which establishes the timing of the taxable event (the Contractor's purchase) and the tax basis of the transaction (the purchase price).⁷ Charges to LHC's customers

⁷ LHC purchases some building materials with the knowledge that a portion of them will be used in making a real property improvement, and the remainder will be sold at retail. As stipulated in *Colonial Stores, Inc. v. South Carolina Tax Commission*, 168 S.E.2d 774 (S.C. 1969), the Department of Revenue has historically authorized

related to TPP which becomes part of real property were not (and are not) subject to sales tax.

See Private Letter Ruling 07-4 (S.C. Dep't of Revenue (Jul. 13, 2007)).

The nature and characteristics of LHC's Installation Contracts also indicate that they are construction contracts. In particular, the Contracts charge a single lump sum price and clearly indicate that LHC is a Contractor. *See South Carolina Dep't of Revenue v. Springs Indus., Inc.* No. 2003-UP-029, (S.C. Ct. App. (2003)). ("In particular, the ALJ found that . . . a lump sum price was charged . . . Accordingly, we find that the agreements' features, particularly . . . numerous references in the agreements to 'contracts' and 'contractors,' provide substantial support for the ALJ's findings that the agreements in this case were construction contracts.").

As explained above, LHC clearly acts as a Contractor when making real property improvements. The Department should not be permitted to add a 40% mark-up to the purchase price of materials used in LHC's Installation Contract transactions, while failing to add a similar mark-up to other Contractors.

(continued...)

taxpayers to remit tax based on the purchase price for that portion of the materials that is used or consumed (and was intended to be used or consumed) by the taxpayer.

[16]

The Negligence Penalty Should Be Abated

The Department has improperly imposed penalties on LHC. The Penalty Statute provides that the Department must demonstrate that the “underpayment of tax . . . is due to negligence or disregard of regulations.” S.C. CODE ANN. § 12-54-43(F)(1). Here, the Department can show neither.

First, as discussed above, LHC has not underpaid its South Carolina tax. Instead, it correctly accrued and remitted tax based on the purchase price of building materials used to make real property improvements.

Second, even if the Administrative Law Court finds that LHC is liable for any additional tax, it is clear from the preceding analysis that LHC has not been negligent and has not disregarded the applicable provisions of South Carolina law. LHC performed a careful and detailed review and analysis of the statutes and regulations and, based on this analysis, developed a well reasoned determination of how the sales tax provisions apply to its facts.

Because LHC neither acted negligently nor disregarded relevant Department regulations, it respectfully requests that the Administrative Law Court abate the penalties reflected in the Determination.

RELIEF SOUGHT

For the reasons discussed above, LHC requests that the Administrative Law Court find that: (1) LHC acted as a Contractor in making real property improvements; (2) LHC correctly determined the tax basis of the materials used to make improvements based on the purchase price

paid to acquire the materials; and (3) the tax, penalties and interest reflected in the Determination should be abated.

[18]

JONES DAY		1420 PEACHTREE, N.E. ATLANTA, GA 30309-3053	CHECK NO.: 1005420
INVOICE #	DATE	AMOUNT	
LOWE'S	11-20-2014	500.00.	

JONES DAY
 1420 PEACHTREE STREET, N. E.
 SUITE 800
 ATLANTA, GA 30309-3053
 PHONE (404) 521-3838

CHECK DATE
 11/20/2014

PNC BANK, N. A. 070
 ASHLAND OH

CHECK NO. 1005420

58-388
 412

OPERATING ACCOUNT
 CHECK AMOUNT

\$500.00*****

FIVE HUNDRED AND 00/100 DOLLARS

PAY
 TO THE
 ORDER OF

SOUTH CAROLINA ADMINISTRATIVE COURT
 1205 PENDLETON ST., SUITE 224
 COLUMBIA, SC 29201

Lianne Thomas
V. J. Brown
 VOID AFTER 180 DAYS

⑈ 1005420⑈ ⑆044203895⑆ 4260592995⑈

EXHIBIT 1

14-ALJ-17-0552-CC_0000039

State of South Carolina
Department of Revenue
Office of General Counsel for Litigation
300A Outlet Pointe Blvd., (29210) P.O. Box 12265, Columbia, South Carolina 29211
Telephone (803) 898-5130 FAX (803) 896-0171

October 24, 2014

John M. Allan
1420 Peachtree Street, N.E.
Suite 800
Atlanta, GA 30309-3053

**Re: Department Determination
Lowes Home Center, Inc.
File number: 40038688-1**

Dear Mr. Allan:

Enclosed is the South Carolina Department of Revenue's Determination in the above-referenced matter. If you disagree with the Determination, you may request a contested case hearing before an Administrative Law Judge. If you choose to pursue such remedy, you must do so within thirty days of the date of this letter. If you fail to respond within this time limitation, you will lose your right to appeal the Department Determination and your protest will be ended. Should you desire a contested case hearing, you must complete the enclosed request form and mail it, along with a \$500.00 filing fee, to the Administrative Law Court at the address stated on the form's instruction sheet.

The Administrative Law Court rules require that you also send me a copy of your request. My address is as follows: P.O. Box 12265, Columbia, SC 29211.

If you would like to pay your liability, please mail your payment to my attention at the Office of General Counsel for Litigation, P.O. Box 12265, Columbia, SC 29211.

Sincerely,

OFFICE OF GENERAL COUNSEL FOR LITIGATION


Nicole M. Wooten
Counsel for Litigation

Enclosures: tm

14-ALJ-17-0552-CC_0000040

DEPARTMENT DETERMINATION

Taxpayer:

Lowe's Home Centers, Inc.
P.O. Box 1000
Mooresville, NC 28115

Periods Involved:

Sales Tax August 1, 2008 to July 31, 2011

Matter in Dispute:

1. Did Lowe's Home Centers, Inc. (taxpayer) improperly tax withdrawals from inventory at acquisition cost, thereby underpaying sales tax for the periods in question?
2. Did the South Carolina Department of Revenue (Department) properly impose negligence penalties against the taxpayer?

Amount in Dispute:

Tax	\$2,206,054.28
Interest*	360,580.69
Penalties	290,593.35
Total	\$2,857,228.32

*Interest and Penalties are calculated through October 31, 2014, and will continue to accrue until matter is resolved.

Determination:

1. The taxpayer improperly taxed withdrawals from inventory at acquisition cost, and thereby underpaid sales tax for the periods in question.
2. The Department properly imposed negligence penalties against the taxpayer.

Relevant Facts:

1. Lowe's Home Centers, Inc. is a corporation operating as a retailer of building materials, appliances and other home products to the general public and the building trades. Retail outlets are located throughout South Carolina and in other states around the country.

2. The taxpayer purchases tangible personal property at wholesale for resale to its customers. The tangible personal property is stored in inventory at warehouses and at each retail facility.
3. The taxpayer also withdraws items from its inventory to perform "contract" sales and installations (installed sales).
4. The taxpayer paid sales tax for the installed sales based on the acquisition cost of the goods.
5. The taxpayer's markup of goods sold at retail is 40% above the acquisition cost.
6. On September 24, 2012, the Department issued a Proposed Assessment in the amount of \$2,872,768.41. The proposed assessment resulted from adjustments made to tax on other taxable sales and incorrect amount of sales tax paid (\$201,520.12 plus interest) which is uncontested by the taxpayer and on installed sales (2,206,054.28 plus penalty and interest) which is contested by the taxpayer.¹ The taxpayer has remitted payment for the uncontested portion and related interest.
7. On December 21, 2012, the taxpayer timely protested the proposed assessment.
8. On February 21, 2013, the Department held a conference with the taxpayer to discuss the proposed assessment.
9. On August 2, 2013, the taxpayer provided a supplemental protest to the Department.
10. The matter was forwarded to the Office of General Counsel, Tax, and Regulatory Services.

Analysis:

I. The Taxpayer's Withdrawals From Inventory For The Installed Sales Should Be Taxed Based On Retail Price Less Any Customary Discounts Rather Than Acquisition Cost To The Taxpayer

Under South Carolina law, a sales tax of six percent of "the gross proceeds of sales, is imposed upon every person² engaged or continuing within this State in the business of

¹This Determination only addresses the contested portion.

²For sales and use tax purposes, the term person "includes any individual, firm, partnership, limited liability company, association, corporation, receiver, trustee, any group or combination acting as a unit, the State, any state agency, any instrumentality, authority, political subdivision, or municipality." S.C. Code Ann. § 12-36-30.

selling tangible personal property at retail." S.C. Code Ann. §§ 12-36-910(A) and 12-36-1110 (2014). "Retailers" are defined as every person "selling or auctioning tangible personal property whether owned by the person or others[.]" S.C. Code Ann. § 12-36-70(1)(a) (2014). The taxpayer operates retail stores in South Carolina and is in the business of selling tangible personal property within this State. Accordingly, the taxpayer is subject to a sales tax of six percent of the gross proceeds of its sales. Moreover, "[i]t is presumed that all gross proceeds are subject to the tax until the contrary is established" and the burden of proof for this establishment lies with the seller. S.C. Code Ann. § 12-36-950 (2014).

S.C. Code § 12-36-90(1)(c) states the "[g]ross proceeds of sales . . . includes . . . the fair market value of tangible personal property previously purchased at wholesale which is withdrawn from the business or stock and used or consumed by any person withdrawing it." S.C. Code Ann. § 12-36-110(1)(c) (2014) defines "sale at retail" and "retail sale" as including the "withdrawal, use, or consumption of tangible personal property by anyone who purchases it at wholesale." When a taxpayer removes items from its inventory and those items are not sold but are otherwise consumed, the taxpayer's removal of such items is the "last transaction" and the taxpayer is considered the "final consumer" of such transaction. See Greystone Catering v. S.C. Dep't of Revenue and Taxation, 326 S.C. 551, 486 S.E.2d 7 (Ct. App. 1997).

The taxpayer's installed sales included items that were withdrawn from the taxpayer's inventory. Subsequently, such items were used or consumed by the taxpayer when the items were provided as part of the taxpayer's installation agreements. Thus, pursuant to sections 12-36-90(1)(c) and 12-35-110(1)(c), the withdrawal for use of these items by the taxpayer should be characterized as retail sales and included in the taxpayer's gross proceeds of sales subject to the tax.

Further, 27 S.C. Code Ann. Regs. 117-309.17 (2012), labeled "Withdrawals From Stock, Merchants," states the following:

To be included in gross proceeds of sales is the money value of property purchased at wholesale for resale purposes and subsequently withdrawn from stock for use or consumption by the purchaser.

The value to be placed upon such goods is the price at which these goods are offered for sale by the person withdrawing them. All cash or other customary discounts which he would allow to his customers may be deducted; however, in no event can the amount used as gross proceeds of sales be less than the amount paid for the goods by the person making the withdrawal.

Regulation 117-309.17 informs taxpayers of the appropriate taxable amount on items purchased at wholesale and subsequently withdrawn from the taxpayer's inventory. Pursuant to the first sentence of the Regulation 117-309.17, such items are to be included in the "gross proceeds of sales." The second sentence indicates that the "value to be placed upon such goods is the price at which these goods are offered for sale by the person withdrawing them." The South Carolina Supreme Court has stated the valuation for tax purposes of "goods . . . purchased for resale but later withdrawn from stock and used by the taxpayer . . . is the 'reasonable and fair market value' of the tangible property withdrawn." Colonial Stores, Inc. v. S.C. Tax Comm'n, 253 S.C. 14, 17-18 168 S.E.2d 774, 776 (1969).³

As noted above, section 12-36-90(1)(c) states the "[g]ross proceeds of sales . . . includes the fair market value of tangible personal property previously purchased at wholesale which is withdrawn from the business or stock and used or consumed by any person withdrawing it" Therefore, the value to be placed on tangible personal property purchased at wholesale and subsequently withdrawn from the taxpayer's inventory for its own use is the fair market value of such tangible personal property. The third and last sentence of the Regulation 117-309.17 provides that when determining the valuation, the taxpayer may deduct "customary discounts which he would allow his customers," but indicates that the value of the tangible personal property may not be less than the amount paid for the said property by the person making the withdrawal. Therefore, goods which are purchased at wholesale and subsequently withdrawn from inventory should be included in the taxpayer's gross proceeds of sales at the fair market value. When determining the fair market value, the taxpayer may incorporate "customary discounts"; however, such fair market value may not be less than the amount paid for the goods by the person making the withdrawal.

II. Taxpayer's Arguments

A. Contractor vs. Retailer Making Installed Sales

The taxpayer asserts that it is in the business of retail transactions and contractor services. The taxpayer states its installed sales are part of its contracting business and should be taxed on the price at which it purchased the materials used in its installed sales contracts. However, the taxpayer's argument lacks merit because the taxpayer is a retailer making sales and installations, and not a contractor. The Department has set forth its long-standing policy on this issue as follows:

³ In Colonial Stores, Inc., the South Carolina Supreme Court relied upon S.C. Code Ann. § 65-1353. This code section has since been recodified and subsequently identified as section 12-36-90. Substantially, the language the Supreme Court relied upon remains in the recodified version of the statute.

⁴ Section 12-36-90(1)(c) also provides a list of exceptions to this rule, none of which apply to the taxpayer.

[T]he determination as to whether a person is a retailer making sales and installations or a contractor depends on the facts and circumstances. Factors used in making this determination include, but are not limited to: how a person advertises his business (as a retailer or contractor); are retail sales made in which installation is not performed by the seller or on behalf of the seller; does the person have a showroom to display his products and how would this showroom be perceived by the general public; is the person licensed as a contractor under state law; does the person perform labor for a general contractor as a subcontractor etc.

South Carolina Sales and Use Tax Manual, Chapter 16 at p. 4 (2013 Spring ed.).

If a retailer truly serves as a contractor or subcontractor in the traditional sense for some transactions (e.g., bids on a project against others, enters into a contract upon winning the bid process, etc.), then the building materials purchased for those contracts may be purchased as a contractor with sales tax being paid at the time of the purchase of the raw building materials. Generally, in order to purchase building material tax paid as a contractor, the retailer would need to demonstrate, based on its books and records and other operational documentation, that these purchases were purchases at retail for a construction contract. If the retailer is unable to demonstrate that the purchases were for a construction contract, the retailer's transactions with its customers will be treated either as retail sales and installations subject to the tax at the time of the sale or "withdrawals for use" subject to the tax at the time the tangible personal property is withdrawn from inventory.

The taxpayer is not a contractor based on the facts and circumstances in this matter. The taxpayer advertises itself as a retailer – the taxpayer's website states that the taxpayer is a "[r]etailer of a complete line of home improvement products and equipment." Lowe's Home Page, <http://www.lowes.com> (last visited October 22, 2014). The vast majority of the taxpayer's sales are sales at retail that do not include installation services. The taxpayer displays its products used in its installed sales at its retail stores. The taxpayer does not perform labor for general contractors as a subcontractor. In fact, based on the factors set forth above, the only factor that may show that the taxpayer is a contractor is that the taxpayer has a contractor's license in South Carolina. Interestingly, this license was not issued until June 23, 2011, which is at the end of the audit period. The fact that the taxpayer did not have this license for most of the installed sales at issue illustrates that the license does not affect the taxpayer's classification with regards to the installed sales. Because the taxpayer is not truly a contractor, the installed sales transaction must either be treated as retail sales or withdrawals for use subject to tax at the time the tangible personal property is withdrawn from inventory.

B. Fair Market Value

The taxpayer also argues that the fair market value of inventory withdrawn is not the price at which the items are sold at retail. The definition of "fair market value" is well settled law. "Fair market value is that price which a willing buyer will pay a willing seller, neither being under compulsion to buy or sell and both being fully informed of all uses to which the property is adopted and for which it is capable of being used." Hous. Auth. of City of Charleston v. Olasov, 282 S.C. 603, 608, 320 S.E.2d 478, 481 (Ct. App. 1984). Based on this standard, well-settled definition, the Department correctly determined that the fair market value of the inventory withdrawn is the price that the taxpayer's retail customers pay for inventory in retail transactions – it is the price that a willing buyer is already paying a willing seller for the same goods.

The taxpayer argues that the Department should look at other factors to determine the fair market value, such as: whether the withdrawn property is being used in a contracting line of business, the price actually paid by the taxpayer for the property, the price a similarly situated Contractor would pay for the property, and the price at which a contractor would be competitively disadvantaged in paying. The taxpayer does not provide any support for these factors other than an Administrative Law Court opinion that states " [in] estimating the value of property, all of the factors which affect market value or would influence the mind of a purchaser should be considered, such as location, quality, condition, and use." Northbridge Associates, LLC v. Charleston County Assessor, 06-ALJ-17-0863-CC. Notably, this opinion involves valuation for property tax purposes. The opinion states "[t]here is no valid distinction between market value for sales purposes and market value for taxation purposes." *Id.* The opinion also states that "market sales of comparable properties present probative evidence of fair market value of similar property." *Id.* Furthermore, this opinion states "[a]n Assessor's valuation is presumed correct and the property owner bears the burden of proving the Assessor's determination is not correct." *Id.*

As provided even in the case posited by the taxpayer, the Department determined the fair market value of the withdrawn inventory by comparing market sale of identical items sold in the taxpayer's retail operations. There is no distinction between the retail sales and the installed sales based on location, quality, condition or use that would affect the fair market value of the withdrawn inventory. The taxpayer has not provided evidence that the Department's determination of fair market value is incorrect.

C. Competitive Disadvantage

The taxpayer argues that it is at a competitive disadvantage with other contractors and that the Legislature did not intend a result of disparate treatment of contractors and thus, the taxpayer's gross proceeds of sales on the installed sales should only be the price at which the taxpayer purchased the items at wholesale. The taxpayer's argument lacks merit because (a) the taxpayer is not a contractor and (b) the taxpayer is not at a competitive disadvantage.

As previously discussed, the taxpayer is not a contractor, so arguing competitive disadvantage with other contractors is a flawed argument. The taxpayer advertises as a retailer, maintains a showroom, is perceived by the public as a retailer, does not act as a subcontractor for general contractors, and just recently obtained a contractor's license after a majority of its installed sales actually took place. Because the taxpayer is not actually a contractor, the taxpayer is not receiving disparate treatment.

The taxpayer is also not competitively disadvantaged. Because the taxpayer is a large retailer, the taxpayer has the ability to purchase large quantities of goods at reduced wholesale prices. The taxpayer then sells these items at a 40% markup at retail. If the taxpayer sells the item under an installed sales contract, the taxpayer charges the customer at least the same price that it would at retail. A true contractor purchases its materials from a retailer like the taxpayer, and these materials are already subject to the retail markup. The true contractor, on top of the purchase price, must also charge for labor in order to make a profit, which results in a higher price charged to the true contractor's customers. Point of fact, the taxpayer generally holds a significant competitive advantage over a true contractor.

III. The Taxpayer Is Subject To Negligence Penalties

Section 12-54-43(F)(1) states "[i]f part of an underpayment of tax or part of a claim for refund of tax paid is due to negligence or disregard of regulations, there must be added to the tax an amount equal to the sum of five percent of the underpayment or claimed refund and an amount equal to fifty percent of the interest payable under Section 12-54-25." The Department applied this negligence penalty to the taxpayer's assessment of tax because regulation 117-309.17 clearly provides the taxpayer the appropriate tax treatment of the installed sales transactions and the issue was addressed in the taxpayer's prior audit for the periods March 1, 2002 through February 28, 2005. During the prior audit, the taxpayer taxed the installed sales at store cost price. The Department adjusted the installed sales to be taxed at the retail shelf price. The audit was completed in January of 2007. The taxpayer was aware of the appropriate tax procedure prior to the audit period at issue. The taxpayer did not dispute the installed sales method in the prior audit; however, the taxpayer chose to continue the inappropriate practice of taxing the installed sales at cost price. The taxpayer clearly disregarded regulation 117-309.17 as well as instruction from the Department in a prior audit as to the appropriate tax procedure, thus imposition of the negligence penalty is proper.

Conclusion:

The taxpayer's installed sales are taxable as withdrawals of inventory for use by the taxpayer. These transactions are taxed at the fair market value of tangible personal property previously purchased at wholesale. The fair market value is the price a willing buyer is willing to pay a willing seller which is evidenced by the taxpayer's retail transactions on the same inventory. The taxpayer is also subject to negligence penalties

because the taxpayer disregarded the regulations and instructions from the Department in a prior audit regarding the appropriate tax treatment of these installed sales transactions.

October 24, 2014

South Carolina Administrative Law Court (SC ALC)
Request for Contested Case Hearing FORM
Mail to: 1205 Pendleton St., Suite 224, Columbia, SC 29201

Last Name:	First:	Middle:	☐ Mr. ☐ Miss ☐ Mrs. ☐ Ms.	Docket No. (To Be Completed by ALC)
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Mailing Address:	City:	State and Zip:
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Home Number:	Work Number:	Cell Number:	*E-Mail Address:
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*By providing your e-mail address, you consent to receive court orders and notices via electronic transmission

REPRESENTATION

Are you representing yourself? ☐ Yes ☐ No

Are you represented by an Attorney? ☐ Yes ☐ No Name of Attorney:

Attorney Mailing Address: City, State and Zip:

Attorney Work Number and Cell Number: Attorney E-Mail Address:

CASE INFORMATION

Name of Agency that Issued the Decision:

(Example - Dept. of Revenue, Dept. of Insurance, DHEC)

In order to have your case processed, you must attach the agency decision. Is it attached? ☐ Yes ☐ No If no, please explain:

Date the decision was issued: Date the decision was received:

Please provide a brief statement regarding why the hearing is being requested and the relief sought:

Payment via ☐ Check ☐ Money Order ☐ Cash for \$ submitted today to the Administrative Law Court via (applicable filing fee pursuant to ALC Rule 71) is being
☐ U.S. Postal Service ☐ Hand-delivery

X Your Signature or Signature of Attorney Date

PROOF OF SERVICE (MUST BE COMPLETED)

Your Name: Date: City: State:

I hereby certify that on the date and place listed above, I served a copy of the foregoing Request for Contested Case Hearing on all other parties to this matter by depositing the same in the United States Mail, postage paid, and addressed as follows (use the reverse side for any additional names):

Name and/or Agency Name	Address	City, State and Zip
-------------------------	---------	---------------------

Name and/or Agency Name	Address	City, State and Zip
-------------------------	---------	---------------------

X Your Signature or Signature of Attorney Date

Attention: All cases filed in the Administrative Law Court are subject to the Rules of Procedure found at the Court's website www.scalc.net or from the Clerk of Court. Failure to follow these rules may result in dismissal of your case.

14-ALJ-17-0552-CC_0000049

Filing and Assignment of a Contested Case with the Administrative Law Court

Complete the Request for Contested Case Hearing and Certificate of Service form in its entirety. File the original by mailing it or hand-delivering it to the Administrative Law Court, along with a copy of the decision from the agency and the appropriate filing fee. Be sure to serve a copy of the Request on the agency which you are appealing as well as any other known parties or protestants. Your case will be deemed filed with the Administrative Law Court upon receipt of your request and filing fee, and will normally be assigned to an administrative law judge within a week of filing. You should receive a Notice of Assignment within a few days of your case being assigned. The Notice of Assignment will have the case caption, docket number, date of filing and the name of the administrative law judge assigned to your case. Once your case has been assigned, all filings and questions regarding your case should be directed to the assigned judge.

Clerk's Office
South Carolina Administrative Law Court
1205 Pendleton St., Ste. 224
Columbia, SC 29201

South Carolina Department of Revenue
Office of General Counsel for Litigation
PO Box 12265
Columbia, SC 29211

EXHIBIT 2

14-ALJ-17-0552-CC_0000051

JONES DAY

1420 PEACHTREE STREET, N.E. • SUITE 900 • ATLANTA, GEORGIA 30309-2053

TELEPHONE: +1.404.581.3539 • FACSIMILE: +1.404.581.8330

December 21, 2012

Certified Article Number

7160 3901 9848 3702 7162

SENDER'S RECORD

VIA CERTIFIED MAIL, RETURN RECEIPT REQUESTED

CONFIDENTIAL TAXPAYER INFORMATION

South Carolina Department of Revenue
Audit Services
454 S. Anderson Road, Suite 202
P.O. Box 12099
Rock Hill, South Carolina 29731

Re: Protest Of Proposed Assessment - Lowe's Home Centers, Inc. (FEIN: 56-0748358)

To the South Carolina Department of Revenue:

This correspondence serves as a protest (the "Protest") of the proposed assessment dated September 24, 2012 (the "Proposed Assessment")¹ issued by the South Carolina Department of Revenue (the "Department") to Lowe's Home Centers, Inc. ("LHC" or the "Taxpayer"). The Proposed Assessment asserts that LHC is liable for additional state and local sales tax, interest and penalties applicable to the tax period beginning August 1, 2008 and ending July 31, 2011 (the "Audit Period"). As discussed below, the majority of the Proposed Assessment is contrary to South Carolina law and should be abated in full. In addition, the imposition of penalties is unwarranted and all penalties should be abated in full. Finally, LHC respectfully requests a hearing before the Department to discuss the Protest and the Proposed Assessment.

BACKGROUND

Real Property Improvement Services

LHC owns and operates stores in South Carolina where it sells at retail home improvement products and building materials. In addition to its retailing activities in the state, LHC is a contractor and enters into agreements with customers for real property improvement services (the "Installation Contracts"). Pursuant to its Installation Contracts and in its capacity as a contractor, LHC affixes items of tangible personal property ("TPP") to real property owned by its customers. The items of TPP that LHC uses to perform its real property improvement services are withdrawn from its supply of materials purchased at wholesale. At the time of withdrawal, LHC accrues and remits tax based on the price it paid to acquire the materials. Upon execution of its Installation Contracts, LHC charges its customers one lump-sum price for the labor and materials it estimates will be necessary to fulfill its contractual obligations.

¹ A copy of the Proposed Assessment is attached hereto as Exhibit 1.

ATI-2540674v3

ALKHOBAR • ATLANTA • BEIJING • BOSTON • BRUSSELS • CHICAGO • CLEVELAND • COLUMBUS • DALLAS • DUBAI
DOSSELDORF • FRANKFURT • HONG KONG • HOUSTON • IRVINE • JEDDAH • LONDON • LOS ANGELES • MADRID
MEXICO CITY • MILAN • MOSCOW • MUNICH • NEW DELHI • NEW YORK • PARIS • PITTSBURGH • RIYADH • SAN DIEGO
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South Carolina Department of Revenue
December 21, 2012
Page 2

Procedural History

During the Audit Period, the Department examined LHC's Installation Contracts and other items unrelated to the treatment of real property improvement services under South Carolina law. The Proposed Assessment is based on the imposition of taxes related to two issues summarized in the table below:

<u>ISSUE:</u>	<u>TAX:</u>	<u>INTEREST:</u>	<u>PENALTY:</u>	<u>TOTAL:</u>
Installed Sales	\$2,206,054.28	\$222,469.43	\$221,537.70	\$2,650,061.41
Other Taxable Sales; Incorrect Amount of Sales Tax Paid	\$201,520.12	\$21,186.88	\$0	\$222,707.00
Total	\$2,407,574.40	\$243,656.31	\$221,537.70	\$2,872,768.41

LHC is protesting only that portion of the Proposed Assessment related to installed sales and is submitting \$222,707 in payment of the remainder of the Proposed Assessment. A "Waiver of Restriction on Assessment and Collection of Additional Tax or Acceptance of Overassessment" along with Check No. 2260762 is attached hereto as Exhibit 2.

With respect to installed sales, the Department's examination of the Installation Contracts that LHC executed with customers during the Audit Period concluded that LHC did not pay the correct amount of tax on the materials used to provide its real property improvement services. The Department based its conclusion on the assertion that LHC was required to impose tax on the price that it would have received had it sold the materials at retail. LHC did not, however, sell the materials at retail or in its capacity as a retailer. Because LHC withdrew the materials from its supply for the purpose of performing real property improvement services, it accrued and remitted tax based on the fair market value (*i.e.*, the purchase price) of the items to a general contractor.

SOUTH CAROLINA LAW

Imposition Of Sales Tax

Under South Carolina law, "sales tax, equal to five percent of the gross proceeds of sales, is imposed upon every person engaged or continuing within this State, in the business of selling tangible personal property at retail."² A *sale at retail* includes:

- "[S]ales of building materials to construction contractors, builders, or land owners for resale or use in the form of real estate";
- "[S]ales to contractors for use in the performance of construction contracts"; and

² S.C. CODE ANN. § 12-36-910 (emphasis added).

South Carolina Department of Revenue
December 21, 2012
Page 3

- The "withdrawal, use, or consumption of tangible personal property by anyone who purchases it at wholesale."

The term *gross proceeds of sales* includes the "fair market value of tangible personal property previously purchased at wholesale which is withdrawn from the business or stock and used or consumed in connection with the business."³

Tax Treatment Of Contractors

The Department has provided by regulation that "[s]ales of building materials to contractors, builders, or landowners *for resale* or use in the form of real estate are retail sales in whatever quantity sold."⁴ A *contractor* includes "any person, firm, association or corporation making repairs, or additions to real property" (hereafter, a "Contractor").⁵ Even in situations in which the real property improvement is owned by a Contractor and will be resold through a lease or rental following construction, the sales tax applies to the Contractor's purchase of the necessary construction materials:

Sales of building materials for use in adding to, repairing or altering real property, are subject to the sales or use tax at the time of purchase *even though the property erected therefrom may be subsequently leased or rented to the person who owns or controls the land on which the property is situate[d]*. Examples include, but are not limited to, building materials used in constructing grain storage tanks, silos, pre-engineered buildings and other structures.⁶

Tax Treatment Of Retailers Making Withdrawals

Retailers that sell TPP at retail and withdraw such property for their own use must purchase the TPP at wholesale.⁷

Operators of businesses who are both making retail sales and withdrawing for use from the same stock of goods are to purchase at wholesale all of the goods so sold or used and report both retail sales and withdrawals for use under the sales tax law. This ruling applies only to those who actually carry on a retail business having a substantial number of retail sales and *does not apply to*

³ *Id.* § 12-36-90(1)(c) (emphasis added).

⁴ S.C. CODE REGS. § 117-314.

⁵ *Id.* § 117-314.2.

⁶ *Id.* § 117-314.1 (emphasis added).

⁷ S.C. CODE ANN. § 12-36-110(a); *see also* S.C. CODE REGS. § 117-324.1 ("Sales of building materials for use in adding to, repairing or altering real property, are subject to the sales or use tax at the time of purchase.").

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December 21, 2012
Page 4

contractors, plumbers, repairmen, and others who make isolated or accommodation sales and who have not set themselves up as being engaged in selling.⁸

If the TPP purchased by a retailer is sold at retail, sales tax is collected at the time of sale.⁹ If such property is instead withdrawn from inventory for consumption by the retailer, S.C. CODE ANN. § 12-36-90 (the "Gross Proceeds Statute") imposes sales tax on the fair market value (the "FMV") of the property at the time of its withdrawal:

Gross proceeds of sales, or any similar term, means the value proceeding or accruing from the sale, lease, or rental of tangible personal property. The term includes . . . *the fair market value of tangible personal property previously purchased at wholesale which is withdrawn from the business or stock and used or consumed in connection with the business or used or consumed by any person withdrawing it.* (emphasis added).

Thus, TPP withdrawn from the inventory of a retailer will be subject to sales tax based on its FMV in the hands of the retailer for such purposes.

Negligence Penalties

If an underpayment of tax is the result of negligence or disregard of the law, penalties are imposed as follows:

If any part of an underpayment of tax or part of a claim for refund of tax is due to negligence or disregard of regulations, there must be added to the tax an amount equal to the sum of five percent of the underpayment and an amount equal to fifty percent of the interest payable under Section 12-54-25.¹⁰

If underpayment of tax is not the result of negligence or disregard of the law, the Department does not have the authority to impose such penalties.

ANALYSIS

The "Fair Market Value" Of The Withdrawn Property Is LHC's Cost Price

The Department's position is that LHC was required to remit sales tax based on a 40% mark-up of LHC's cost price, which the Department believes LHC would receive if the property were sold at retail to an individual consumer. The Department does not, however, dispute that LHC is a contractor. In fact, the South Carolina Department of Labor, Licensing and Regulation

⁸ S.C. CODE REGS. § 117-324 (emphasis added).

⁹ S.C. CODE ANN. § 12-36-910.

¹⁰ *Id.* § 12-54-43(F)(1).

South Carolina Department of Revenue
December 21, 2012
Page 5

has licensed LHC as a general contractor and assigned it license number 116664.¹¹ Further, the auditor has not assessed LHC for improper taxation of its customers (at point-of-sale) on installed TPP. Rather, the auditor agrees that LHC is acting as a real property improvement contractor and, therefore, agrees that tax is due on the withdrawal of the goods. The auditor's opinion, however, is that LHC does not owe tax based on the FMV of the withdrawn materials in the hands of a contractor, but instead owes tax based upon the price at which such goods would be offered for sale to consumers on a stand-alone basis.

LHC respectfully contends that the Department's position is contrary to South Carolina law, and LHC is not aware of any situation in which the Gross Proceeds Statute has been applied to a contractor or contractor transactions – particularly in a manner that deems the FMV of contractor purchases to be taxable at a 40% mark-up. The Gross Proceeds Statute requires that sales tax be remitted based on the FMV of the TPP withdrawn from inventory. The FMV of the property withdrawn by LHC for use in fulfilling its Installation Contracts is the price LHC paid for the property. The Department's approach is unlawful because it (1) fails to consider (a) any factors that might affect FMV or (b) the fact that a business can be both a contractor and retailer, and (2) is applying a requirement to a contractor that is intended to address the withdrawal of inventory for use in a retailer's (not contractor's) business operations. Rather, the Department with a stroke of the proverbial pen merely adds a 40% mark-up to the price paid by LHC for the purpose of determining FMV. This is not what the Gross Proceeds Statute or South Carolina law requires.

South Carolina law requires that the FMV of property be determined – for whatever purpose – by the totality of the facts and circumstances. The Administrative Law Court has held that when “estimating the value of property, all of the factors which affect market value or would influence the mind of a purchaser should be considered.”¹² Among the factors that the Department should have considered are:

- Whether the withdrawn property is being used in a contracting line of business;
- The price actually paid by LHC for the property;
- The price a similarly situated Contractor (e.g., Pulte Homes, Inc.) would pay for the property; and
- The price at which a Contractor would be competitively disadvantaged in paying.

The most recent (and only) purchase price paid by a taxpayer must be a factor in determining FMV. In the instant case, LHC paid its vendor a fair price for the withdrawn TPP and remitted tax based on that price. In addition, the price a willing Contractor would pay for the

¹¹ A screenshot of LHC's licensing information is attached hereto as Exhibit 3.

¹² *Northbridge Associates, LLC v. Charleston Cnty. Assessor*, S. C. Admin. Law Ct., 2008 WL 5416996, at *9 (November 25, 2008). The determination of FMV should take into consideration all relevant factors regardless of whether the tax to be applied to such value is a sales tax or property tax.

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 Page 6

property is a factor that is relevant in the calculation of FMV. LHC operates a contracting line of business, and the price a Contractor of LHC's size would pay for TPP (considering the costs incurred by such a large Contractor and its negotiating power) is an essential consideration. LHC asserts that its cost is the price a large Contractor would pay for the withdrawn TPP because LHC could have purchased identical property at the same cost price and tax would have been calculated on that basis. Similarly, the price at which a Contractor becomes competitively disadvantaged should have been considered. Deeming a 40% mark-up of the cost price to be the FMV places LHC at a competitive disadvantage. In fact, neither LHC nor any other Contractor could purchase construction materials at a 40% mark-up and remain in business in South Carolina. This arbitrary approach compels LHC to price its services at a rate that is not competitive with other Contractors whose tax costs are calculated on a lower sales price. A 40% mark-up simply does not reflect the FMV of the property to LHC.

Finally, the Department provides no evidence that a 40% mark-up to the cost price equates to the FMV of the property in the hands of a Contractor. Rather, the Department takes the overly simplistic position that the retail price paid by an individual consumer making a "one off" purchase at an LHC store location is the FMV of the withdrawn TPP. The lack of evidence to support this value is sufficient reason to abate the Proposed Assessment.

The Department's Position Creates Disparate Treatment Of Contractors

The South Carolina legislature did not anticipate an application of the Gross Proceeds Statute that would result in radically disparate treatment of Contractors. The Department's position that LHC should add a 40% mark-up to its up purchase price results in a higher tax on Contractors who engage in more than one line of business. An increase in tax of this magnitude negatively affects LHC's ability to compete as a Contractor.

The Gross Proceeds Statute does not contemplate the treatment of Contractors and should not be interpreted in a manner that creates an unequal "playing field" within the contracting industry. The Gross Proceeds Statute assumes that withdrawals will be made from a retailer's inventory, which a non-retailing Contractor will never possess. Even the Department's regulations do not anticipate that Contractors who are purchasing at wholesale and holding inventory as "sales of building materials to contractors . . . for resale" are subject to sales tax at the time of the Contractor's purchase. Rather, the Gross Proceeds Statute naturally addresses circumstances in which a retailer withdraws TPP for use in its retail operations. A retailer might, for example, withdraw cleaning supplies for custodial purposes, or make facility repairs using bricks and lumber from its existing wholesale supplies. In these circumstances, the retailer is not put at a competitive disadvantage by paying tax on the retail price to individual consumers. Applying the Gross Proceeds Statute to impose a 40% mark-up on products that are withdrawn by LHC for use in a contracting line of business that is subject to its own competitive pressures, including pricing pressures, is not what was contemplated by the legislature. If the FMV of the TPP were calculated by considering all of the relevant facts and circumstances, the FMV of the withdrawn TPP would not be LHC's cost plus a 40% mark-up.

ATI-2340674v3

South Carolina Department of Revenue
December 21, 2012
Page 7

The Negligence Penalty Should Be Abated

The Proposed Assessment provides the following explanation of the negligence penalty imposed pursuant to S.C. CODE ANN. § 12-54-43(F)(1) (the "Penalty Statute"):

The negligence penalty has been applied to all periods for the installed sales transactions which were taxed at cost and not at retail price as stated in SC Code Section 12-36-90. This issue was addressed in the last SC Sales Tax Audit for the periods 3/1/2002 through 2/28/2005 which was completed and assessed in January 2007.

The Penalty Statute provides that the Department must demonstrate that the "underpayment of tax . . . is due to negligence or disregard of regulations."¹³ Here, the Department can show neither.

The Department points to the fact that the "issue was addressed in the last SC Sales Tax Audit" to show that LHC was aware of the Department's position and was thus negligent in the tax treatment of its Installation Contracts during the Assessment Period. While LHC settled the same issue during the prior audit for purposes of expediency, it did not (and does not) agree with the Department's position. In addition, LHC did not ignore relevant regulations. Instead, and as discussed above, LHC determined that the Gross Proceeds Statute supports its position with respect to the FMV of the TPP consumed by LHC in the performance of its real property improvement services. Because LHC neither acted negligently nor disregarded relevant Department regulations, the penalties reflected in the Proposed Assessment should be abated in full.

CONCLUSION

For the reasons discussed above, the Department should abate the portion of the Proposed Assessment related to installed sales in its entirety. LHC correctly determined and remitted sales tax based upon the FMV of the TPP that it used to fulfill the terms of its Installation Contracts.

If you have any questions, please do not hesitate to contact me at (404) 581-8012.¹⁴

¹³ S.C. CODE ANN. § 12-54-43(F)(1).

¹⁴ An executed Power of Attorney form is attached hereto as Exhibit 4.

JONES DAY

South Carolina Department of Revenue
December 21, 2012
Page 8

Sincerely,



John Allan

AT1-2540674v3

14-ALJ-17-0552-CC_0000059

EXHIBIT 3

14-ALJ-17-0552-CC_0000060

JONES DAY

1420 PEACHTREE STREET, N.E. • SUITE 600 • ATLANTA, GEORGIA 30309 3059
TELEPHONE: +1 404.581.3838 • FACSIMILE: +1 404.581.8330

August 2, 2013

VIA CERTIFIED MAIL & EMAIL: CRAWFOP@SCTAX.ORG

CONFIDENTIAL TAXPAYER INFORMATION

South Carolina Department of Revenue
Audit Services
454 S. Anderson Road, Suite 202
P.O. Box 12099
Rock Hill, South Carolina 29731
Attn: Paulette Crawford

Re: Protest Of Proposed Assessment - Lowe's Home Centers, Inc. (FEIN: 56-0748358)

Dear Ms. Crawford:

This correspondence serves as a supplement to the December 21, 2012 protest (the "Protest")¹ of the proposed assessment dated September 24, 2012 (the "Proposed Assessment")² issued by the South Carolina Department of Revenue (the "Department") to Lowe's Home Centers, Inc. ("LHC" or the "Taxpayer"). The Proposed Assessment asserts that LHC is liable for additional state and local sales tax, interest and penalties applicable to the tax period beginning August 1, 2008 and ending July 31, 2011 (the "Audit Period").

During the Audit Period, the Department examined LHC's treatment of real property improvement service agreements ("Home Improvement Contracts") under South Carolina law. The Department's position is that LHC was required to remit sales tax based on the withdrawal of goods on a 40% mark-up of LHC's cost price, which the Department believes LHC would receive if the property were sold at retail to an individual consumer. The Department does not, however, dispute that LHC is a contractor.³ The Department determined that tax is due on the withdrawal of the goods from LHC's inventory.⁴ As LHC is a home improvement contractor that purchases a high volume of materials in order to perform real property improvement services, a 40% markup to cost price does not reasonably reflect the market value of the construction materials used by LHC in its Home Improvement Contracts. LHC is the purchaser of items used in its Home Improvement Contracts⁵ and to tax items purchased for those contracts

¹ A copy of the Protest is attached hereto as Exhibit 1.

² A copy of the Proposed Assessment is attached hereto as Exhibit 2.

³ The South Carolina Department of Labor, Licensing and Regulation has licensed LHC as a general contractor and assigned it license number 116664. A screenshot of LHC's licensing information is attached hereto as Exhibit 3.

⁴ The Department did not assess sales tax on the customer's purchase, evidencing that the Taxpayer correctly treated itself as a real property improvement contractor and properly exempted these transactions from sales tax.

⁵ A "retail sale" includes "[S]ales to contractors for use in the performance of construction contracts." S.C. CODE ANN. § 12-36-110(1)(e).

AT1-2571373v3

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MADRID • MEXICO CITY • MILAN • MOSCOW • MUNICH • NEW YORK • PARIS • PITTSBURGH • RIYADH • SAN DIEGO
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14-ALJ-17-0552-CC_0000061

JONES DAY

South Carolina Department of Revenue
August 2, 2013
Page 2

at an artificially higher base would place LHC at a competitive disadvantage to similarly situated real property improvement contractors. The South Carolina legislature has not created a separate class of taxpayers such that contractors who also sell at retail constitute a separate class from those who exclusively engage in contracting. To impose a new and artificially higher rate of tax on contractors who also sell at retail, for administrative convenience, is an action that is not sanctioned by the South Carolina legislature and would violate the equal protection clause of the South Carolina Constitution.⁶

The most recent (and only) purchase price paid by LHC should be determinative of the taxable Fair Market Value ("FMV") of the withdrawn goods. LHC asserts that the price upon which it should accrue use tax is the price it paid for the withdrawn property because LHC could have purchased identical property at the same cost price and remitted sales tax at the time of purchase.⁷ Under those circumstances, the Department would not dispute that an appropriate amount of tax had been paid by LHC. Thus, the fact that LHC accrued use tax on the cost price of the property at the time of withdrawal (plus an additional amount of approximately 7%, as discussed below) does not justify an additional mark-up or have any bearing on the FMV of the property.

As to the Department's position that an additional markup should be applied by LHC to the cost price of its withdrawn inventory, we initially point out that the FMV of the property LHC purchased is the price for which LHC purchased the property. Nonetheless, LHC has already internally marked up its inventory items by an additional 7% and accrued South Carolina tax on the increased tax base. The calculation below illustrates the inventory adjustment:

Inventory (before mark-up)	Mark-up Amount	Inventory Value (after mark-up)	Mark-up (as a percentage of inventory value before mark-up)
\$8,908,985,635	\$631,553,782	\$9,540,539,417	7.09%

Any further mark-up is unwarranted under South Carolina law.⁸

We appreciate your consideration of the information provided herein. Once you have had a chance to review, I would appreciate the opportunity to discuss this matter with you. If you have any questions, please do not hesitate to contact me at (404) 581-8012.⁹

⁶ S.C. CONST. art. I, § 3.

⁷ Given its position as one of the nation's largest home improvement contractors, LHC is able to secure the most favorable pricing based on the volume of its purchases.

⁸ S.C. CONST. art. I, § 3.

⁹ An executed Power of Attorney form is attached hereto as Exhibit 4.

JONES DAY

South Carolina Department of Revenue
August 2, 2013
Page 3

Sincerely,

John Allan *with express permission*
EA

John Allan

ATI-2571373v3

14-ALJ-17-0552-CC_0000063

EXHIBIT 4

14-ALJ-17-0552-CC_0000064

LOWE'S HOME CENTERS INC
1000 LOWE'S BOULEVARD
MOORESVILLE, NC 28117
(704) 758-1000

License number: 118884
License type: GENERAL CONTRACTOR
Status: ACTIVE
Expiration: 10/31/2014
First Issuance Date: 08/23/2011
Classification: BDS
President / Owner: ROBERT A NIBLOCK
Vice President: GARY E GROSS

Supervisee
STEVEN RAY RICHARDS - (CCC)
LEWIS DALE JOHNSON - (CCC)

[Click here for classifications key.](#)

EXHIBIT 5

14-ALJ-17-0552-CC_0000066

2005-06-06

13:43

(912)287-0841

ID17-INSTALLED SALES

P 4/2

South Carolina
Residential Builders Commission
Home Builder
JAMES YALE

LOWES HOME CENTERS INC
1519 WINDWALK CIRCLE
SURFSIDE BEACH SC 29979
Lic #: RBB 18430
Effective Date: 06/09/2004

Expires: 06/30/2005

South Carolina Residential Builders Commission

Hereby Certifies that

JAMES YALE

has met all of the requirements of the South Carolina Residential Builders Commission for licensing as a Residential Builder. This certificate is subject to annual renewal of the license.

18430

License Number

06/30/2005

Expiration Date

[Signature]

James L. Kelman
Secretary/Deputy Director
Residential Property
Design and

14-ALJ-17-0552-CC_0000067

2002 - 2003
Expires June 30, 2003
S.C. Residential Builders Commission

JAMES W YALE
LOWES HOME IMPROVEMENTS, INC.
1519 WINDWARD DRIVE
SURFSIDE BEACH, SC 29575

Lic # 018430
Exp Date 06/12/2002

South Carolina Residential Builders Commission

Hereby Certifies that

JAMES W YALE

has met all of the requirements of the South Carolina Residential Builders Commission for licensing as a Residential Builder. This Certificate is subject to annual renewal of the license.

018430

License Number

06/30/2003

Expiration Date

Robert L. Selman

Robert L. Selman
Assistant Deputy Director
Office of Property,
Environmental Design and
Contractual Services

*** TOTAL PAGE.02 ***

14-ALJ-17-0552-CC_0000068

South Carolina Residential Builders Commission

Hereby Certifies that

JAMES W YALE

has met all of the requirements of the South Carolina Residential Builders Commission for licensing as a Residential Builder. This Certificate is subject to annual renewal of the license.

018430

License Number

06/30/2002

Expiration Date



Robert L. Selman
Assistant Deputy Director
Office of Property,
Environmental, Design and
Contractual Services

2001 - 2002

Expires June 30, 2002

S.C. Residential Builders Commission

Home Builder

JAMES W YALE
LOWES HOME CENTERS INC
1519 WINDWALK CIRCLE
SURFSIDE BEACH SC 29575

Lic # 018430

Eff Date 11/09/2001

*** TOTAL PAID ***

14-ALJ-17-0552-CC_0000069

South Carolina
Residential Builders Commission

Home Builder

JAMES ROYAL III

LOWE'S HOME CENTERS, INC.
3870 PASSFIELD LANE
MT PLEASANT SC 29466
Lic #: RBB - 20453
Effective Date: 07/15/2008

Expires: 06/30/2006

South Carolina Residential Builders Commission

Hereby Certifies that

JAMES ROYAL III

has met all of the requirements of the South Carolina Residential Builders Commission for licensing as a Residential Builder. This Certificate is subject to annual renewal of the license.

20453

License Number

06/30/2006

Expiration Date



Robert L. Schuman
Assistant Deputy Director
Office of Property,
Environmental, Design and
Construction Services

South Carolina
Residential Builders Commission

Home Builder

DUROCHER W TROY

LOWE'S HOME CENTER INC
907 HOWARD STREET
COLUMBIA SC 29209
Lic #: RBB - 21547
Effective Date: 07/10/2008

Expires: 06/30/2010

South Carolina Residential Builders Commission

Hereby Certifies that

DUROCHER W TROY

has met all of the requirements of the South Carolina Residential Builders Commission for licensing as a Residential Builder. This Certificate is subject to annual renewal of the license.

21547

License Number

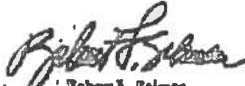
06/30/2010

Expiration Date



Robert L. Salzman
Assistant Deputy Director
Office of Property,
Environmental, Design and
Construction Services

South Carolina
Residential Builders Commission
TROY W DUROCHER
LOWE'S HOME CENTER
907 HOWARD STREET
COLUMBIA SC 29203
Lic # RBB-11847
Effective Date: 06/30/2008
Expires: 06/30/2008

South Carolina Residential Builders Commission	
Hereby Certifies that	
TROY W DUROCHER	
has met all of the requirements of the South Carolina Residential Builders Commission for licensing as a Residential Builder. This Certificate is subject to annual renewal of the license.	
21547	 Robert L. Seimon Assistant Deputy Director Office of Property, Environmental, Design and Commercial Services
06/30/2008	
License Number	Expiration Date

** TOTAL PAGE.01 **

14-ALJ-17-0552-CC_0000072

South Carolina
Residential Builders Commission
Home Builder
TROY W DUROCHER
LOWES HOME CENTER, INC.
407 HOWARD STREET
COLUMBIA, SC 29205
Lic # RBR - 21547
Effective Date: 01/19/2006
Expires: 06/30/2006

South Carolina Residential Builders Commission	
Hereby Certifies that	
TROY W DUROCHER	
has met all of the requirements of the South Carolina Residential Builders Commission for licensing as a Residential Builder. This Certificate is subject to annual renewal of the license.	
21547	License Number
06/30/2006	Expiration Date
 Robert L. Seaman Assistant Deputy Director Office of Property, Environmental Design and Contractual Services	

** TOTAL PAGE.02 **

JOINT EXHIBIT 33

LOWE'S HOME CENTERS INC
1000 LOWE'S BOULEVARD
MOORESVILLE, NC 28117
(704) 758-1000

License number: 116664
License type: GENERAL CONTRACTOR
Status: ACTIVE
Expiration: 10/31/2014
First Issuance Date: 08/23/2011
Classification: BDS
President / Owner: ROBERT A NIBLOCK
Vice President: GARY E GROSS

Supervises
STEVEN RAY RICHARDS - (COG)
LEWIS DALE JOHNSON - (COG)

[Click here for classifications key](#)

2005-06-06

13:45

(912)287-0841

1017-INSTALLED SALES

F 2/2

South Carolina
Residential Builders Commission
Home Builder
JAMES YALE

LOWES HOME CENTERS INC
1519 WINDWALK CIRCLE
SURFSIDE BEACH SC 29575
Lic #: RBB, 18430
Effective Date: 06/09/2004

Expires: 06/30/2005

South Carolina Residential Builders Commission

Hereby Certifies that

JAMES YALE

has met all of the requirements of the South Carolina Residential Builders Commission for licensing as a Residential Builder. This certificate is subject to annual renewal of the license.

18430

License Number

06/30/2005

Expiration Date

[Signature]

Robert L. Selman
South Carolina Deputy Director
Department of Property,
Insurance and Design and
Construction

2002 - 2003
Expires June 30, 2003
S.C. Residential Builders Commission

JAMES W YALE
LOWES HOMECENTERS INC
1519 WINDWARD
SURFSIDE BEACH SC 29575

Lic # 018430
Eff Date 06/12/2002

South Carolina Residential Builders Commission

Hereby Certifies that

JAMES W YALE

has met all of the requirements of the South Carolina Residential Builders Commission for licensing as a Residential Builder. This Certificate is subject to annual renewal of the license.

018430

License Number
06/30/2003

Expiration Date



Robert L. Selman
Assistant Deputy Director
Office of Property,
Environmental, Design and
Contractual Services

** TOTAL PAGE.02 **

14-ALJ-17-0552-CC_0000076

South Carolina Residential Builders Commission

Hereby Certifies that

JAMES W YALE

has met all of the requirements of the South Carolina Residential Builders Commission for licensing as a Residential Builder. This Certificate is subject to annual renewal of the license.

018430

License Number

06/30/2002

Expiration Date



Robert L. Selman
Assistant Deputy Director
Office of Property,
Environmental, Design and
Contractual Services

2001 - 2002

Expires June 30, 2002

S.C. Residential Builders Commission

Home Builder

JAMES W YALE
LOWES HOME CENTERS INC
1519 WINDWALK CIRCLE
SURFSIDE BEACH SC 29575

Lic # 018430

Eff Date 11/09/2001

** TOTAL PAGE.02 **

14-ALJ-17-0552-CC_0000077

South Carolina
Residential Builders Commission

Home Builder

JAMES ROYAL III

LOWE'S HOME CENTERS, INC.
3578 PASSFIELD LANE
MT PLEASANT SC 29466
Lic #: RBB - 28463
Effective Date: 07/15/2006

Expires: 06/30/2006

South Carolina Residential Builders Commission

Hereby Certifies that

JAMES ROYAL III

has met all of the requirements of the South Carolina Residential Builders Commission for licensing as a Residential Builder. This Certificate is subject to annual renewal of the license.

20453

License Number

06/30/2006

Expiration Date



Robert L. Selman
Assistant Deputy Director
Office of Property,
Environmental, Design and
Contractual Services

South Carolina
Residential Builders Commission

Home Builder
DUROCHER W TROY

LOWE'S HOME CENTER INC
907 HOWARD STREET
COLUMBIA SC 29204
Lic #: RBB - 21547
Effective Date: 07/10/2008

Expires: 06/30/2010

South Carolina Residential Builders Commission

Hereby Certifies that

DUROCHER W TROY

has met all of the requirements of the South Carolina Residential Builders Commission for licensing as a Residential Builder. This Certificate is subject to annual renewal of the license.

21547

License Number

06/30/2010

Expiration Date



Robert L. Solman
Assistant Deputy Director
Office of Property,
Environmental, Design and
Contractual Services

South Carolina
Residential Builders Commission


TROY W DUROCHER

LOWE'S HOME CENTERS INC
907 HOWARD STREET
COLUMBIA SC 29305
Lic #: RRB-21547
Effective Date: 06/06/2006

Expires: 06/30/2008

South Carolina Residential Builders Commission

Hereby Certifies that

TROY W DUROCHER

has met all of the requirements of the South Carolina Residential Builders Commission for licensing as a Residential Builder. This Certificate is subject to annual renewal of the license.

21547

License Number

06/30/2008

Expiration Date



Robert L. Salmen
Assistant Deputy Director
Office of Property,
Environmental, Design and
Contractual Services

** TOTAL PAGE.01 **

14-ALJ-17-0552-CC_0000080

South Carolina
Residential Builders Commission

Home Builder
TROY W DUROCHER

LOWES HOME CENTER, INC
897 HOWARD STREET
COLUMBIA SC 29205
Lic #: RDB - 21547
Effective Date: 01/19/2006
Expires: 06/30/2006

South Carolina Residential Builders Commission

Hereby Certifies that

TROY W DUROCHER

has met all of the requirements of the South Carolina Residential Builders Commission for licensing as a Residential Builder. This Certificate is subject to annual renewal of the license.

21547
License Number

06/30/2006
Expiration Date

Robert L. Seiman
Robert L. Seiman
Assistant Deputy Director
Office of Property,
Environmental, Design and
Contractual Services

** TOTAL PAGE.02 **

JOINT EXHIBIT 34

STORE COPY



INSTALLATION SERVICES CUSTOMER CONTRACT - FLOOR - HWOOD/ LAMINATE

VALIDATION AREA

LOWE'S OF AIKEN, SC, STORE # 639
2470 WHISKEY RD.
AIKEN, SC 29803

SALESPERSON: ESPERANZA WIDENER
SALESPERSON ID: 954643
Document Print Date : 08/08/2008

This is only a Quote for the merchandise and services printed below. This becomes an agreement upon payment and an endorsement by a Lowe's register validation. Upon such payment and endorsement, the entire agreement, including the specifically completed pages of this document, the Terms and Conditions included with this document and any other addenda or attachments hereto, shall be referred to herein as this "Contract."

PLEASE READ THIS ENTIRE DOCUMENT, INCLUDING THE "TERMS AND CONDITIONS," BEFORE SIGNING.

Lowe's Registration or Contractor License Number / Lowe's Contractor Name

S O L D T O	Customer Name		Home Phone
	GARY AIKENS		803-649-1883
	Customer Address		Other Phone
	101 QUEENS COURT		304-839-7309
	City	State / Province	Zip / Postal Code
	AIKEN	SC	29803
Installation Address			
101 QUEENS COURT			
Installation City		Installation State/Province	Installation Zip/Postal Code
AIKEN		SC	29803

MERCHANDISE AND INSTALLATION SUMMARY

MERCHANDISE SUMMARY	
864 : 51070800032 : STK : CRYSTAL WHITE QUARTER ROUND 5107 : CRYSTAL WHITE QUARTER ROUND 5107 : LP SPECIALTY PRODUCTS - QTY 22	
114729 : STK : 100SF MOISTURE BLOCK UNDERLAYMENT : 100SF MOISTURE BLOCK UNDERLAYMENT - QTY 4	
181107 : 36053 : STK : 4N1 HNSRP HKRY/CNWN WLNT/FRSD OK : 4N1 HANDSCRAP HICKRY/CANYON WALNUT : PERGO, INC. - QTY 3	
257389 : STK : 11.62SF HANDSCRAP HICKRY LAMINATE : 11.62SF HANDSCRAP HICKRY LAMINATE - QTY 35	
257389 : STK : 11.62SF HANDSCRAP HICKRY LAMINATE : 11.62SF HANDSCRAP HICKRY LAMINATE - QTY 3	
Materials Price	\$ 1445.07

INSTALLATION DESCRIPTION					
Job Type : Replacement Total Square Feet of Product to Install : 432 Existing Flooring : Carpet Carpet Removal Charge : No Laminate Pattern Installed : Straight Lay (No Pattern) Reconnect of Ice Maker Supply Line : No Subfloor Leveling or Damage Repair : No Moisture Reading : 9 Transition Material : Laminate Linear Feet of New Moulding : 130 Labor Category : Laminate Customer Understands Laminate Project Scope : Yes Additional Miles Traveled Over 20 : 0 Haul Away : No Comments : customer insisted for white	Room : Living room and hall Color of Laminate : handscraped hickory Installer Take Up Flooring : No Underlayment Type on Laminate Install : Not Required Installer Moving Oversized Furniture/Appliances : No Subfloor Composition : Concrete Moisture Reading Taken : Yes Transitions : Yes Remove and Reuse Existing Moulding : No New Moulding Description : white If Required Who Will Cut Down Interior Doors : None Permit Required : No Describe Work Needed to Bring up to Code : None Describe Other Work Needed : None				
<table border="1" style="display: inline-table; border-collapse: collapse;"> <tr> <td style="padding: 2px 5px;">Labor Charges</td> <td style="text-align: right; padding: 2px 5px;">\$ 1132.28</td> </tr> <tr> <td style="padding: 2px 5px;">Detail Deduction</td> <td style="text-align: right; padding: 2px 5px;">-\$ 35.00</td> </tr> </table>		Labor Charges	\$ 1132.28	Detail Deduction	-\$ 35.00
Labor Charges	\$ 1132.28				
Detail Deduction	-\$ 35.00				

Additional Specifications:
Notation: Lowe's will not make structural modifications or remove vinyl flooring. Installer will remove shoe molding but cannot be responsible for any breakage or unpainted surface that shows. Additional Specifications: The Environmental Protection Agency (EPA) has requested that Lowe's notify installation customers that a lead based paint hazard may exist in dwellings built prior to 1978. See pamphlet EPA 747-K-99-001 for details.

TOTAL CHARGES OF ALL MERCHANDISE AND SERVICES	*where applicable labor is taxable, check local tax restrictions.
SUB-TOTAL	\$ 2542.35
*SALES TAX	\$ 0.00
DELIVERY	\$ 0.00
ORDER TOTAL	\$ 2542.35

STORE COPY

BALANCE DUE

Work is to commence upon reasonable availability of Contractor which is anticipated to be _____ [fill in date].

Estimated completion date is _____ [fill in date].

NOTICE TO CUSTOMER

All items listed in this contract and specification sheet(s) are to be installed under conditions agreed upon at time of purchase and at the price appearing on this contract form. This assumes sound existing substructures, superstructure and points of attachments. Extra labor or material incident to installation necessitated by defective substructures, superstructure, points of attachment, or the moving of fixtures or appliances to be billed at extra cost to customer. DO NOT SIGN THIS CONTRACT UNTIL COMPLETE AND YOU HAVE READ THE TERMS AND CONDITIONS OF THIS CONTRACT. BY SIGNING BELOW, YOU ARE ACKNOWLEDGING THAT YOU HAVE READ, UNDERSTAND AND AGREE TO THE TERMS AND CONDITIONS SET FORTH ON THIS CONTRACT. YOU ARE ENTITLED TO A COPY OF THIS CONTRACT AT THE TIME OF SIGNATURE.

WITNESS OUR HAND(S) AND SEAL(S) BELOW THIS 8 DAY OF 8, 08.

Lowe's Home Center, s Inc.

By [Signature] (Seal)

2470 Whiskey Rd.
Address

Chicken SC 29803
City State / Province Zip / Postal Code

[Signature]
Owner

Spouse

Customer acknowledges receipt of a true copy which was completely filled in prior to Customer's execution hereof. **You the customer may cancel this transaction at any time prior to midnight on the third business day after the date of this transaction. See the attached Notice of Right to Cancel for an explanation of this right.**

TERMS AND CONDITIONS

LOWE'S DEFINED. It is understood that various independent and separate corporations use this form. Therefore, within this Contract, the term "Lowe's" shall refer individually to one of the following corporations as evidenced on the signature page of this Contract: "Lowe's Home Centers, Inc." (a North Carolina corporation and wholly owned subsidiary of Lowe's Companies, Inc., a North Carolina corporation).

GENERAL DESCRIPTION. By this installed sales contract (the "Contract"), Customer agrees to purchase and Lowe's agrees to sell the goods and/or materials (the "Goods") and the services to install same (the "Installation Services") in or on the above-identified premises (the "Premises") for the stated total cash price (the "Price") and according to the specifications and other provisions of the Contract documents, including (a) this Contract form, (b) the Addendum, if and to the extent applicable, (c) and any attached sketches, materials lists, floor plans, and/or specification sheets.

INSTALLATION SERVICES. Customer authorizes Lowe's (a) to arrange for the Installation Services to be performed by an experienced independent contractor (the "Installer") (licensed when legally required), (b) to issue a work order to the Installer to perform the Installation Services, (c) to inspect the Installer's work, and (d) to pay the Installer after completion of the work and after receipt of a certificate, signed and dated by Customer, that the work has been satisfactorily completed (the "Certificate of Completion"). Customer understands that Lowe's will rely upon the Certificate of Completion in paying the Installer for the Installation Services.

GOODS. Lowe's will arrange for delivery of the Goods to the Premises. Any surplus materials upon completion of the Installation Services shall remain the property of Lowe's and shall be returned to Lowe's by the Installer.

PRICE. The Price owed by Customer to Lowe's covers the Goods, Installation Services, and applicable taxes. The Price assumes sound existing substructures, superstructure and points of attachments. The price shall be increased by the cost and reasonable profit to Lowe's of having to provide additional Goods and/or Installation Services as a result of defective substructures, superstructures, or points of attachments.

PAYMENT. Payment of the Price by Customer to Lowe's is due in full upon execution of the Contract.

WAIVER OF LIENS FOR CONTRACTS OF \$3,000 OR LESS. If this Contract is for a Price of \$3,000 or less, Lowe's, on behalf of itself, its Installer, and any subcontractor(s), hereby fully and unconditionally relinquishes, waives and releases any and all mechanic's liens, materialman's liens and other liens in the Premises which Lowe's might have or acquire, by operation of law or otherwise, as a result of this Contract. In addition, because responsibility for paying its Installer belongs to Lowe's and not to Customer, Lowe's has required the Installer, on behalf of itself and any subcontractor(s), to fully and unconditionally relinquish, waive and release any and all mechanic's liens, materialman's liens and other liens in the Premises which the Installer or subcontractor might have or acquire now or in the future, by operation of law or otherwise, as a result of this Contract.

ENTIRE AGREEMENT. This Contract accurately states the entire agreement between Customer and Lowe's concerning this sale of Goods and Installation Services and replaces and supersedes all prior agreements and understandings relating thereto, both oral and written. Any additions or changes to this Contract must be in writing signed by Customer and Lowe's.

MANUFACTURER WARRANTY FOR GOODS / LOWE'S WARRANTY FOR INSTALLATION SERVICES. Customer is entitled to any warranty provided by a manufacturer of the Goods sold under this Contract. The Installer will provide Customer with any manufacturer consumer warranty information accompanying the Goods, and Customer may also obtain such information by contacting Lowe's. Lowe's does not warrant the Goods. Lowe's does warrant that the Installation Services will be performed by the Installer in a good and workmanlike manner. Lowe's warranty for Installation Services shall extend for a period of one year from the date the Certificate of Completion is signed by Customer or for such greater period as may be required by applicable law governing consumer warranties for workmanship (the Warranty Period). Customer must give Lowe's written notice within the Warranty Period of any warranty claim relating to Installation Services. Customer agrees that its sole and exclusive remedy against Lowe's for a warranty claim is reinstallation in a good and workmanlike manner, including the repair or replacement of any Goods if and to the extent reasonably necessary to correct the defective Installation Services. Customer shall have no other remedy against Lowe's for a warranty claim, including without limitation remedy for loss or damage caused by normal wear and tear, loss or damage which has not been reasonably mitigated, loss or damage caused by acts of God, incidental or consequential damages for lost profits, sales, injuries to persons or property, or any other incidental or consequential damages. Lowe's warranty for Installation Services shall be in lieu of any other warranty expressed or implied, including without limitation any implied warranty of merchantability or fitness for a particular purpose. In connection with any warranty claim, Customer agrees, at no cost to Lowe's, to prepare the Premises, including the removal and replacement of fixtures incident to the repair area, so that Lowe's, or its designee, can correct the defective Installation Services without undue delay.

LICENSES, PERMITS, SAFETY RULES, BUILDING CODES, ZONING ORDINANCES, AND OTHER LAWS. Lowe's shall be responsible to Customer for obtaining any and all licenses and building permits which are legally required to perform the Contract. If Customer obtains permits on his own, Customer will be precluded from claiming against certain state guaranty funds relating to home improvements. Lowe's shall also be responsible to Customer for the Contract's being performed in compliance with all applicable safety rules and all existing building codes, zoning ordinances and other laws. Lowe's shall not

STORE COPY

be responsible for any pre-existing violations of safety rules, building codes, zoning ordinances or other laws. If a change occurs to any applicable safety rule, building code, zoning ordinance or other law which requires additional Goods and/or Installation Services to perform the Contract, Customer agrees to pay Lowe's the cost and reasonable profit for such additional Goods and Installation Services and to execute a resulting change order or new replacement Contract as requested by Lowe's.

CUSTOMER'S WARRANTY AGAINST VIOLATIONS OF EASEMENTS, COVENANTS, AND THIRD PARTY RIGHTS. Customer warrants that performance of this Contract by Lowe's and its Installer will not violate any existing real property easements, covenants, or rights of third parties holding an interest in the real property being improved.

UNDISCLOSED CONDITIONS IN PREMISES. If Installer discovers any defect, weakness or dangerous condition including, but in no way limited to, mold, mildew, rot, asbestos or infestation ("Undisclosed Condition") in the Premises' structure, substructure, super-structure or points of attachment, Customer must remedy the Undisclosed Condition at Customer's sole cost and expense and to Lowe's sole satisfaction or refuses to permit inspection of the Premises as set forth below, Lowe's may terminate this Contract without remedy or recourse to Customer. If Customer and Lowe's disagree as to whether an Undisclosed Condition exists, Lowe's will obtain the services of an inspector at Lowe's sole cost and expense whose report shall be final and conclusive as to whether an Undisclosed Condition exists.

ARBITRATION. If Customer has any questions or complaints regarding the Contract, Customer may contact the Lowe's Manager or Installed Sales Specialist whose names and telephone number appear elsewhere on the Contract. All disputes and claims between Customer and Lowe's concerning this Contract which either party believes cannot be resolved informally, including without limitation any warranty claims, shall be resolved by binding arbitration conducted by a single arbitrator under the current auspices, rules and consumer procedures and protocols of the American Arbitration Association (as amended) and in accordance with applicable state and federal laws. The parties to this Agreement specifically agree that no class action arbitration of any type may be ordered by a Court or arbitrator(s) under this Agreement and, in addition, that there shall be no joinder of parties, except for joinder of parties to the transaction covered by this Agreement. The arbitration shall be held in the city or county where the Premises are located or in such other convenient location as the parties may mutually agree. No discovery shall be allowed except as may be agreed to in writing by the parties. Either party may demand arbitration, and the arbitrator's final award shall be issued within ninety (90) days after service of the arbitration demand on the other party.

REMEDY FOR BREACH. If Customer breaches this Contract, Lowe's, or its assigns, shall be entitled to recover the greater of liquidated damages in the amount of 20% of the total Contract price or such actual damages as Lowe's, or its assignees, prove. Also, if Customer fails to pay Lowe's in accordance with this Contract, Lowe's shall be entitled to recover its legal costs, including reasonable attorney's fees, in connection with arbitrating, obtaining judgment on an arbitration award, or otherwise pursuing Customer for collection. Customer agrees that Lowe's reasonable attorney's fees shall constitute 15% of the amount owed under the Contract, arbitration award or judgment.

UNAVOIDABLE DELAY OR FAILURE IN PERFORMANCE EXCUSED. Any delay or failure by Lowe's or its Installer in performing this Contract because of strike, fire, flood, acts of God, inability to obtain Goods, or any other causes beyond the reasonable control of Lowe's or its Installer shall be excused and shall not be breaches of this Contract.

MISCELLANEOUS. This Contract shall be interpreted under and governed by the law of North Carolina. If any provision of this Contract is contrary to any law to which it is subject, such unlawful provision shall be ineffective without invalidating the other provisions which shall remain in full force and effect. All parties to this Agreement acknowledge that if this Agreement is executed, or to the extent this Agreement is to be performed, within the states of Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, Oregon, Utah, Washington, Wyoming, it is an Agreement exclusively with Lowe's HIW, Inc. and no rights or remedies shall be available from any other Lowe's entity. If this Agreement is executed, or to the extent this Agreement is to be performed, outside of Alaska, Arizona, California, Colorado, Hawaii, Idaho, Montana, Nevada, Oregon, Utah, Washington, Wyoming, it is an Agreement with Lowe's Home Centers, Inc. and no rights or remedies shall be available from any other Lowe's entity. The terms of this Agreement shall inure to the benefit of Lowe's Companies, Inc., as well as its wholly owned subsidiaries. It is agreed that Lowe's Companies, Inc. or any of its wholly owned subsidiaries may bring any action for recourse or remedy sought by Lowe's. It is further agreed that the other party to this Agreement shall be limited to seeking recourse or remedy exclusively from the specific Lowe's corporation with which this Agreement is executed, as evidenced on the signature page, and none other.