THE STATE OF SOUTH CAROLINA

In the Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

S. Phillip Lenski, Administrative Law Judge

Case No. 2014-ALJ-17-0552-CC

Appellate Case No. 2021-000031

Lowe's Home Centers, LLC.....Appellant,

v.

South Carolina Department of Revenue.....Respondent.

FINAL BRIEF OF RESPONDENT

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INTRODUCTION

Appellant Lowe's Home Centers, LLC (Lowe's) is the world's second largest home improvement retailer with over 1,700 home improvement stores operating in all fifty states. Between August 1, 2008 through July 31, 2011 (Audit Period), Lowe's engaged in two types of installation contracts for its customers. Under these contracts, customers purchased material from Lowe's such as flooring or cabinets, and Lowe's subsequently engaged 3rd party contractors to install the materials in the customer's home or business. The issues in this matter revolve around where in that process do the items purchased by Lowe's become subject to sales and use tax. There are three distinct transactions at issue: (1) when Lowe's buys materials tax free (at wholesale) from its vendors; (2) when Lowe's withdraws materials for use in an installation contract; and, (3) when a Lowe's customer pays the retail price for the materials plus installation by a 3rd party contractor. Lowe's asserts that the taxable transaction occurs at Step 1, when it purchases the materials tax free at wholesale. The Respondent South Carolina Department of Revenue (Department) asserted in its Department Determination and at the contested case hearing that the taxable transaction occurs at Step 2, when Lowe's withdraws materials for use in the installation contracts. The ALC found that that the taxable transaction occurs at Step 3, when the customer pays the retail price for the materials plus the installation services. Applying sales tax at either Step 2 or Step 3 produces the same result because the tax is applied to the fair market value (FMV) of the materials (i.e., what Lowe's charges its customers).

Lowe's position in this matter is the ultimate example of wanting your cake and eating it too. Lowe's wants to be treated as a retailer when it is beneficial to them, but not be treated as a retailer when it does not benefit them. More specifically, Lowe's wants to act like a large scale retailer, be able to buy materials in bulk at discounted rates, and make those purchases tax free because they are being made at the wholesale level. Then, Lowe's wants to suddenly change from being a retailer and become

a contractor. Lowe's claims that it should then only be liable for the tax on the discounted price it paid to purchase goods from its vendors. Simply stated, Lowe's is asking for treatment that no contractor in South Carolina receives. Contractors cannot buy materials at wholesale. In South Carolina, a contractor must purchase everything at retail. Contractors do not get to make large bulk purchases and treat some of those materials as retail purchases and some as wholesale purchases. The inequity in Lowe's position in this matter cannot be ignored. Lowe's claims that it is a contractor, but asserts it is being treated unfairly because it is being held liable for the exact same amount of tax paid by its contractor customers. As explained more fully below, Lowe's essentially argues that it is entitled to a 40% reduced tax base as compared to all other contractors.

The first issue this Court must address in this matter is determining when the taxable retail sale transaction occurred in Lowe's installation contracts. According to Lowe's, the taxable transaction occurred when Lowe's purchased materials at wholesale prices from vendors. In order to make this finding, the Court would need to find that the sale of materials from a vendor to a wholesaler is simultaneously both a retail sale and a wholesale sale. Lowe's argues the materials that are subsequently used in installation contracts be treated as retail sales and the remaining purchases be treated as wholesales sales.

On the other hand, the Department asserts there are two alternative theories this Court may following in determining when the taxable transaction occurred. The Department asserts the tax may be applied when Lowe's withdraws an item from inventory and uses that item in the completion of an installation contract. Alternatively, tax may be applied to the transaction when the customer pays for the materials and services contained in the installation contract. While these two transactions are different, the tax due is the same under either scenario because in both instances the amount subject to tax is the price charged to the customer (the FMV of the materials).

Once the Court identifies when the taxable retail sale occurred, the second issue is determining the "gross proceeds of sales" of that retail sale. Because Lowe's argues the retail sale is the wholesale sale from the vendor to Lowe's, Lowe's asserts it should only pay use tax on its cost of the materials it purchased from the vendors rather than the higher retail price paid by Lowe's customers under the installation contracts. The Department asserts that Lowe's should pay tax on the FMV of each item withdrawn from inventory for completion of an installation contract. Or alternatively, as the ALC found, tax should be paid on the retail price charged to the installation contract customer.

The crux of Lowe's appeal is because it is a licensed retail merchant and contractor in South Carolina, it alone determines what capacity it operates when purchasing material used in the installation contracts. Lowe's essentially asks this Court to overlook the relevant statutes and regulations, disregard the underlying facts in this matter, give no deference to the Department's longstanding interpretation and application of the relevant law, and grant it a benefit no other contractor in South Carolina receives. As the ALC specifically concluded, Lowe's position in this matter gives it an advantage or benefit not available to other contractors in South Carolina because it "allows [Lowe's] to pay use tax on the wholesale cost of the materials unlike any other contractor, or even any other retailer, is absurd and contrary to the plain meaning of the Regulation, contradictory to the statutory scheme, and, could not have been intended by the General Assembly." (R. p. 27; Final Order, p. 26.) This Court should affirm the ALC's Final Order; alternatively, this Court should affirm as modified by relying upon the Department's position argued in its Department Determination and at the contested case hearing.

COUNTER-STATEMENT OF THE ISSUES ON APPEAL

I. DOES LOWE'S OWE SALES TAX AND INTEREST ON THE RETAIL SALES OF TANGIBLE PERSONAL PROPERTY (MATERIALS) SOLD TO LOWE'S CUSTOMERS IN CONJUNCTION WITH THE INSTALLATION CONTRACTS?

II. DID THE ADMINISTRATIVE LAW COURT CORRECTLY CONCLUDE THAT LOWE'S WAS REQUIRED TO REMIT SALES TAX TO THE DEPARTMENT BASED ON THE RETAIL PRICE OF MATERIALS SOLD TO LOWE'S CUSTOMERS ?

III. DID THE ADMINISTRATIVE LAW COURT CORRECTLY DETERMINE THAT LOWE'S EQUAL PROTECTION CLAIM MUST FAIL BECAUSE LOWE'S, AS A RETAILER, IS TREATED THE SAME AS SIMILARLY-SITUATED TAXPAYERS IN SOUTH CAROLINA?

STATEMENT OF THE CASE

On November 21, 2014, Lowe's initiated this matter by filing a request for a contested case hearing to challenge the Department's October 24, 2014 final agency Determination. *See* S.C. Code Ann. §§ 12-60-10 *et seq.*; (R. pp. 2, 835-854.) The Determination concluded that the withdrawal, use, or consumption of materials by Lowe's as part of its installation contracts is subject to sales tax in South Carolina pursuant to S.C. Code Ann. § 12-36-110(1)(c). (R. pp. 857-864; Department Determination, pp. 1-8.) In the Determination, the Department also concluded that the gross proceeds of sales must be valued at the fair market value of the materials as measured by the price these materials are sold to Lowe's customers as part of the installation contracts. *See* S.C. Code Ann. § 12-36-90(1)(c); (R. pp. 857-864; Department Determination, pp. 1-8.). The Determination assessed $2,206,054.28 in sales tax, $360,580.69 in interest, and $290,593.35 in penalties for a total assessment of $2,857,228.32 (with interest and penalties accrued through October 31, 2014). *Id.*

The ALC conducted a contested case hearing on April 20, 2016. On December 11, 2020, the ALC issued a Final Order upholding the Department's assessment of $2,206,054.28 in sales tax and $360,580.69 of interest, but declined to uphold the penalties asserted in the Determination. (R. pp. 2-33; Final Order, pp. 1-31.) In its Order, the ALC concluded the amount of additional sales tax assessed by the Department for the Audit Period was proper; however, the ALC declined to adopt the Department's position that the taxable retail sale is the withdrawal, use, or consumption of the installation contract materials by Lowe's. (R. p. 31; Final Order, p. 30.) Rather, the ALC determined

the taxable retail sale is the sale of the installation contract materials by Lowe's to its customers. *Id.* Further, the ALC concluded that the taxable value of the materials is the retail selling price of the materials as recorded in the installation contract invoice. (R. p. 28; Final Order, p. 27.)

On January 8, 2021, Lowe's filed its notice of appeal of the ALC's decision to the South Carolina Court of Appeals.

STATEMENT OF THE FACTS

1. Lowe's Operations

Lowe's is a national home improvement retail chain offering a complete line of home improvement products and services. (R. pp. 4, 719, 122, 237; Final Order, p. 3; Ex. 21, p.13; Hr'g Tr. 87:12-13; 202:2-4.) Lowe's operates approximately 1,700 home improvement stores across all fifty states, and each store averages 112,000 square feet of retail selling space. (R. pp. 723, 725; Ex. 22, p.2; Ex. 23, p.1.) During the Audit Period, Lowe's operated between forty (40) and forty-two (42) stores in South Carolina. (R. p. 69; Hr'g Tr. 34:8-11.) A typical Lowe's store stocks between 40,000 and 60,000 items, and an additional three to six million items are available through the store's Special Order Sales system. (R. pp. 145, 723, 725; Hr'g Tr. 110:7-23; Ex. 22, p. 2; Ex. 23, p. 1.) Generally, Lowe's engages in two types of retail transactions at its retail stores: traditional retail sales and installation contracts. (R. pp. 70-72; Hr'g Tr. 35:24-25; 36:25-37-6.)

2. Types of Lowe's Sales Transactions

a) Traditional Retail Sales

Ninety-four percent (94%) of Lowe's business derives from traditional retail sales of tangible personal property. That is, retail sales of home improvement materials in which a customer enters the store, selects an item from existing inventory on the shelf, proceeds to the cash register, and pays for the item. (R. pp. 4, 73; Final Order, p. 3; Hr'g Tr. 38:6-15.) Accordingly, for 94% of its transaction, Lowe's calculates the sales tax based upon the retail price, and the sales tax is charged to the customer.

(R. pp. 4, 73; Final Order, p. 3; Hr'g Tr. 38:19-20.) In a traditional retail sales transaction, a customer can leave the store with the purchased materials or can schedule the materials for later delivery or pickup. (R. pp. 149-150; Hr'g Tr. 114:1-115:16.) The sales tax collected from the customer by Lowe's during the retail sales transaction is later remitted to the Department. (R. p. 5; Final Order, p. 4.)

b) Installation Contracts

Lowe's began offering installation contract services to its customers in the mid-1990's. (R. p. 5; Final Order, p. 4.) Lowe's competitors in this type of transaction include "other home improvement warehouse chains and lumberyards as well as traditional hardware, plumbing, electrical and home supply retailers." (R. pp. 5, 613; Final Order, p. 4; Ex. 20, p. 5.)

Generally, an installation contract involves a customer purchasing material from Lowe's to be installed at the customer's residence or business: the customer meets with a Lowe's sales associate to determine what product(s) and installation service the customer seeks. Then, for a "detail fee," Lowe's sends a 3rd party installer to the customer's home to obtain detailed measurements and other information from the customer, which the 3rd party installer then conveys to the Lowe's sales associate, including any labor charge and the amount of materials needed to complete the project. Lowe's sales associate contacts the customer with the quote and requests the customer to return to the store to finalize the purchase of the materials for the project; the customer signs an installation service contract that separately identifies the labor and materials cost and contains the total cost of the project (labor and materials); and the customer brings the contract to the checkout counter and pays the entire balance of the contract. (R. pp. 74-76; Hr'g Tr. 39:3-41:4.)

Importantly, Lowe's does not provide installation services unless the customer purchases the materials from Lowe's. (R. pp. 142-143; Hr'g Tr. 107:23-108:7.) That is, Lowe's does not ever offer "unattached contracting services to its customers." (R. p. 6; Final Order, p. 5.) *See* R. p. 297; Hr'g Tr. 262:11-17 (Department witness testifying that Lowe's declined to provide installation services to her

unless she purchased the materials from Lowe's). The "overarching purpose of [Lowe's] operations – including installation contract services – is to facilitate a retail sale to retail customers." (R. p. 6; Final Order, p. 5.)

Third party installers provide the contractor services agreed to in the installation contracts – not Lowe's. Moreover, the 3rd party installers are not employed by Lowe's, the material used in the installation contracts are sold to the customer as part of the contract, and the materials are not sold to the 3rd party contractor. (R. pp. 5, 143-144, 901, 914; Final Order, p. 4; Hr'g Tr. 108:25-109:4; Ex. 34, p. 2; Ex. 36, p. 2.) Further, the 3rd party installer does not receive the entire "labor" fee charged to the customer as part of installation service contracts. (R. pp. 143-144, 901, 914; Hr'g Tr. 108:25-109:4; Ex. 34, p. 2; Ex. 36, p.2.)

Lowe's has two types of installation service contracts: (1) a "stock" installation contract, and (2) a "special order sales" or "SOS" installation contract. (R. pp. 6-7, 123; Final Order, pp. 5-6; Hr'g Tr. 88:7-12.). As a retailer, Lowe's purchases all its materials at wholesale meaning it does not pay sales tax to its vendor on purchases of materials used in either traditional retail sales transactions, stock installation contracts, or SOS installation contracts. (R. pp. 6, 128-129; Final Order, p.5; Hr'g Tr. 93:15-94:3.) Lowe's is permitted to purchase the materials free of tax because it purchases the materials using a resale certificate. *Id.* As discussed below, the chief difference between a stock installation contract and an SOS installation contract relates to whether Lowe's has the material "in stock" or whether Lowe's must order the materials from the vendor.

(1) Stock Installation Contract

In a stock installation contract, the customer purchases materials that are withdrawn from the stock of a Lowe's retail store where the customer signs the contract or from the stock of another Lowe's retail location. (R. pp. 6, 125-126; Final Order, p. 5; Hr'g Tr. 90:22-91:15.) If the store does not have the necessary materials, they can be shipped in from another retail location (in South Carolina

or another state). (R. pp. 6, 126; Final Order, p. 5; Hr'g Tr. 91:16-25.) In all instances, the materials used in stock installation contracts are withdrawn from Lowe's existing retail inventory. (R. pp. 6,128; Final Order, p. 5; Hr'g Tr. 93:7-14.)

When a Lowe's customer selects materials to purchase as part of a stock installation contract, the customer is charged the retail (or shelf) price for the materials. (R. pp. 6, 123-124; Final Order, p. 5; Hr'g Tr. 88:16-89:7.) Lowe's does not collect any sales tax from the customer when materials are purchased as part of the stock installation contract. (R. pp. 6-7, 124-125, 901; Final Order, pp. 5-6; Hr'g Tr. 89:21-14; Ex. 34, p.2.) Rather, Lowe's later remits use tax to the Department based upon the wholesale cost it paid to its suppliers to acquire the materials used in the stock installation contract. (R. p. 5; Final Order, p. 6.) The material used in Lowe's stock installation contracts may be delivered to the customer in one of three ways: (1) the customer picks the materials up from the retail store; (2) a Lowe's 3rd party installer picks up the materials from the retail store; or (3) Lowe's delivers the material to the customer's location. (R. p. 127; Hr'g Tr. 92:1-19.)

When Lowe's purchases stock materials from a vendor, it is unknown whether the materials will be used in either a traditional retail sale or a stock installation contract. (R. pp. 129-130; Hr'g Tr. 94:5-95:2.) Thus, Lowe's does not designate which specific materials will be used in a traditional retail sale and which materials will be used in a stock installation contract. (R. p. 130; Hr'g Tr. 95:3-16.) Further, materials sold in traditional retail sales cannot be separated from materials sold as part of stock installation contracts. (R. p. 130; Hr'g Tr. 95:9-16.)

Any Lowe's customer can purchase the same materials used in a stock installation contract without purchasing Lowe's installation services. (R. pp. 83, 130-131; Hr'g Tr. 48: 17-24; 95:22-96:24.) In sales that do not include installation, Lowe's charges the customer the retail price, increases the amount charged to account for sales tax based upon the retail price of the materials, and remits the sales tax to the Department. (R. pp. 84, 130-131; Hr'g Tr. 49:2-7; 95:22-96:24.) When Lowe's sells

the identical in-stock material as part of a stock installation contract, Lowe's still charges the customer the retail price for the materials but does not increase the amount charged to account for sales tax. (R. p. 132; Hr'g Tr. 97:7-23.) It is important to note that in both examples above, the customer is charged the same retail amount for the materials purchased, the only difference is the amount of tax applied. Rather than remit tax on the much higher retail amount, Lowe's asserts that it should only remit tax on the wholesale amount. This theory provides Lowe's with a 40% tax savings compared to contracts.

(2) Special Order Sales Installation Contract

The second type of installation contract provided by Lowe's is an SOS installation contract. (R. p. 123; Hr'g Tr. 88:7-12.) SOS installation contracts are "not radically different" from stock installation contracts. (R. p. 86; Hr'g Tr. 51: 11-13.) When materials are purchased from Lowe's through an SOS installation contract, the materials are not in stock at a Lowe's retail location and must be ordered by Lowe's. (R. pp. 7, 135; Final Order, p. 6; Hr'g Tr. 100:10-15.) The customer is charged the retail price for the materials, and like a stock installation contract, Lowe's does not collect any sales tax from the customer as part of the SOS installation. (R. pp. 133-134, 914; Hr'g Tr. 98:4-99:10, 99:11-13; Ex. 36, p. 2.)

When Lowe's purchases materials from a vendor to be used in an SOS installation contract and the materials are shipped directly to a Lowe's retail store, Lowe's places the material in the same location as stock materials waiting to be picked up by Lowe's 3rd party installers to be used in a stock installation contract. (R. pp. 88, 136-137; Hr'g Tr. 53:12-23; 101:18-102:16.) Lowe's does not pay tax to the vendor on purchases of materials used in SOS installation contracts because it purchases the materials using a resale certificate. (R. p. 138; Hr'g Tr. 103:7-13-17.)

Lowe's customers can purchase the same materials used in an SOS installation contract without purchasing Lowe's installation services.[1] (R. pp. 139, 150-151; Hr'g Tr. 104:2-8; 115:23-116:6.) In that situation, Lowe's charges the customer sales tax based upon the retail price of the material. (R. p. 139; Hr'g Tr. 104: 2-19.) When Lowe's sells the identical SOS material as part of the SOS installation contract in which a Lowe's 3rd party installer installs it, Lowe's does not charge the customer any sales tax on the material. (R. p. 140; Hr'g Tr. 105:21-25.) In that situation, Lowe's later remits a use tax to the Department based upon the wholesale price paid to the vendor to acquire the special order material for the installation contract. (R. p. 7; Final Order, p. 6.) Here again, in both instances the customer is charged the same retail price for the materials purchased, the only difference in the transaction is the amount of tax included by Lowe's.

Lowe's SOS installation contract is accompanied by a project estimate form which contains the following language: "**LOWES IS A SUPPLIER OF MATERIALS ONLY. LOWES DOES NOT ENGAGE IN THE PRACTICE OF** ENGINEERING, ARCHITECTURE, OR **GENERAL CONTRACTING. . . .**" (R. p. 911; Ex. 35, p. 6) (emphasis added). This particular project estimate form was generated by Lowe's during the Audit Period, and the materials (granite countertops) listed on the installation contract are the same materials referenced on the project estimate form. (R. p. 166-167, 905-911; Hr'g Tr. 131:25-132:22; Ex. 35.)

3. Contractor Licensing

Lowe's was licensed by the South Carolina Department of Labor, Licensing and Regulation (SCDLLR) as a General Contractor, effective June 23, 2011, just a little more than one month from the end of the Audit Period. Lowe's is not a competitor of General Contractors such as Pulte Homes;

[1] Although the ALC stated in its order that Lowe's "does not purchase special order materials for resale," Lowe's' witness testified that customers can purchase special order items without contracting with Lowe's for installation services. (R. p. 7; Final Order, p. 6; (R. pp. 139, 150-151; Hr'g Tr. 104:2-8; 115:23-116:6.)

rather, it is a competitor of smaller individual specialized contractors such as a roofing company or an individual that installs carpet or tile. (R. p.91; Hr'g Tr. 56:8-19.) Lowe's competitors (e.g., a retailer who installs carpet) and anyone who purchases materials from Lowe's must pay sales tax on the retail price (i.e., the price at which the materials are offered for sale by Lowe's), which is contrary to the position Lowe's has taken in this case. (R. p. 147; Hr'g Tr. 112:13-18.)

4. Retail Licenses and Resale Certificates

A retail license is issued by the Department to a taxpayer which allows the taxpayer to (1) sell tangible personal property at retail to the end consumer; (2) collect sales tax from the consumer; and (3) pay the collected tax to the Department. (R. p. 237; Hr'g Tr. 202:19-22.) A licensed retail merchant is a person who holds a retail license with the state of South Carolina and sells tangible personal property. (R. p. 237-238; Hr'g Tr. 202:23-203:1.) Lowe's is a licensed retail merchant in South Carolina. (R. pp. 9, 122, 237; Final Order, p. 8; Hr'g Tr. 87:12-13; 202:2-4.)

A resale certificate in South Carolina is a certificate issued by the Department that gives a taxpayer the privilege of extending it to his vendors so that the taxpayer can purchase merchandise at wholesale, free of the tax, because the taxpayer will in turn resell those items to the general public and collect sales tax. (R. p. 238; Hr'g Tr. 203: 11-15.) It can be extended by a taxpayer to other retailers or other wholesalers. (R. p. 238; Hr'g Tr. 203:6-8.)

Lowe's holds a retail license, a resale certificate, and a contractor's license in South Carolina. However, for sales tax purposes, Lowe's cannot act as a retailer and contractor in the same retail transaction. (R. p. 237; Hr'g Tr. 202:5-11.) Because a retailer purchases materials for resale, it purchases everything at wholesale. (R. p. 237; Hr'g Tr. 202:13-17). A contractor cannot sell at retail because it cannot hold a retail license and is not eligible for a resale certificate. (R. pp. 238-239; Hr'g Tr. 203:16-204:4.) A contractor cannot extend a resale certificate because "they have to buy everything at retail price. They are using [the materials] themselves and not reselling and the purpose of that

[resale certificate] is to – to buy at wholesale." (R. p. 239; Hr'g Tr. 204:7-10.) Similarly, a contractor cannot accept a resale certificate because "they are not a retailer and they are not reselling anything. . . ." (R. p. 238; Hr'g Tr. 203:21-22.) Thus, a "contractor" is required to purchase everything at retail and pay tax at the time of purchase. (R. pp. 238-239; Hr'g Tr. 203:16-204:4.)

5. The Department's Audit and Assessment of Lowe's

On August 11, 2011, the Department began an audit examination of Lowe's books and records. (R. pp. 425, 207; Ex. 1, Hr'g Tr. 172:8-13.)

After reviewing the information provided by Lowe's during the audit examination, the Department determined that Lowe's paid use tax on materials used in the installation contracts based upon Lowe's lower cost of the material rather than the sales price charged to the customer.[2] (R. pp.-17, 215-218, 445-451; Final Order, p. 16; Hr'g Tr. 180:19-183:1; Ex. 5.) Lowe's extended its resale certificate to each vendor for the purchase of the materials used in the installation contracts. (R. p. 239; Hr'g Tr. 204:11-19.) Because Lowe's is selling the materials to the customer and then contracting with a 3rd party to install the material, the Department's auditor determined Lowe's incorrectly paid use tax on the cost of its inventory rather than sales tax based upon the price charged to the customer according to the installation contract. (R. p. 226; Hr'g Tr. 191:3-11.)

Although Lowe's contends in this case that it did not make a retail sale of materials that were sold via the installation contracts, the Department determined Lowe's "marked up" the price of the material by approximately forty percent (40%).[3] (R. pp. 17, 218-219, 453-454; Final Order, p.; 16;

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[2] Lowe's remitted use tax to the Department at the time Lowe's withdrew or used the material in the performance of the installation contracts rather than paying the tax at the time the materials were purchased from the vendors.

[3] The Department conducted a prior audit (for the audit period March 1, 2002 to February 28, 2005) of Lowe's for the same issue and concluded in the prior audit the markup was approximately forty-two percent (42%). (R. pp. 219, 232, 577-579 Hr'g Tr. 184:8-12; 197:7-14; Ex. 14) Based upon

Hr'g Tr. 183:2-6, 183:7-184:5, Ex. 6.) The Department made this determination by comparing Lowe's acquisition costs to the retail prices paid by the customers according to the installation contracts. After establishing the cost of the materials used in the installed sales contracts for each store during the Audit Period and adding the 40% markup to the cost of the materials, the Department concluded the amount of outstanding sales tax still owed by applying the applicable sales tax rate for each jurisdiction, less the amount of use tax initially paid by Lowe's when the material were withdrawn from inventory and used in the installation contracts. (R. pp. 220-221, 223; Hr'g Tr. 185:16-186:24, 188:9-24.)

After completing the audit examination, the Department issued the Proposed Assessment to Lowe's on September 24, 2012, informing Lowe's that the total tax, interest, and penalties due in this matter for the sales tax liability of the installation contracts is $2,650,061.41. (R. pp. 225, 533, 440; Hr'g Tr. 190:5-19; Ex. 9, Bates Stamp p. 123; Ex. 3, Bates Stamp p. 111.) Lowe's did not present any testimony or evidence to challenge the Department's audit method or calculations in this matter, and Lowe's does not challenge the Department's audit method or calculations in its appellate brief.

6. The Department's Interpretation and Application of Relevant Law

John McCormack, General Manager for the Policy Section within the Department's Office of General Counsel, testified on behalf of the Department. (R. pp. 372-402; Hr'g Tr. (Day 2) 5:10-125:17.) Mr. McCormack has been employed with the Department for approximately thirty-six years. Since 1985, Mr. McCormack's work with the Department has been focused primarily in the area of sales tax. (R. pp. 373; Hr'g Tr. (Day 2) 9:14-10:12.) Mr. McCormack described the sales tax in South Carolina as a transactional tax imposed on persons engaged in the business of selling tangible personal property at retail, and it is imposed at a rate of six percent (6%) on the gross proceeds of sales. (R. p. 373; Hr'g Tr. (Day 2) 12:17-22.) Further, the Department determines what type of transactions are

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the Department's prior work and calculations, the Department determined the 40% markup in the instant matter was accurate. (R. p. 219; Hr'g Tr. 184:2-12.)

subject to sales tax by considering the imposition statute (§ 12-36-910), the definitional statutes of tangible personal property (§ 12-36-60) and sale at retail (§ 12-36-110), and the transaction itself to determine what is the retail sale. (R. pp. 373-375; Hr'g Tr. (Day 2) 12:23-13:14; 17:25-18:6.) In South Carolina, the purchaser of tangible personal property is not legally liable for the payment of sales tax; rather, the retailer is responsible. (R. p. 382; Hr'g Tr. (Day 2) 45:12-46:1.) However, a retailer can choose increase the amount charged to a customer and thereby pass the sales or use tax onto the purchaser. (R. p. 382; Hr'g Tr. (Day 2) 46:5-6.)

Mr. McCormack testified that he is familiar with Lowe's business activity as a retailer, and he is also familiar with Lowe's business practices with regard to the installation contracts in this matter. (R. pp. 374; Hr'g Tr. (Day 2) 13:15-17; 14:1-3.) Mr. McCormack further testified that Lowe's (and any retailer) is permitted to purchase materials at wholesale – that is, without paying sales tax at the time of purchase – by extending a resale certificate to the vendor of the materials. (R. p. 374; Hr'g Tr. (Day 2) 14:17-15:1.) But, South Carolina law does not permit a contractor to purchase anything at wholesale (i.e., free of tax at the time of purchase). (R. pp. 386, 399, 400; Hr'g Tr. (Day 2) 64:18-25; 114:18-19; 117:9-12.)

Mr. McCormack testified that every withdrawal, use, or consumption of materials by Lowe's for an installation contract is a retail sale in South Carolina: Lowe's purchased the materials at wholesale and then withdrew, used, or consumed the materials as part of Lowe's installation contracts during the Audit Period. (R. pp. 374, 383; Hr'g Tr. (Day 2) 15:2-7; 51: 4-12.). Therefore, the materials used by Lowe's in both the stock installation contracts and the SOS contracts are subject to sales tax in South Carolina. According to the uncontroverted testimony of Mr. McCormick, § 12-36-110(1)(c) mandates that a retail sale occurs when Lowe's withdraws, uses, or consumes the materials in the inventory of a local store as part of the installation contract performed in South Carolina. (R. p. 377; Hr'g Tr. (Day 2) 26:9-18.) Regardless of where the materials used in the stock installation contracts

are located before the transaction, Lowe's purchases the material from a vendor at wholesale and then withdraws, uses or consumers the material in the performance of the installation contract in South Carolina. (R. pp. 377, 395; Hr'g Tr. (Day 2) 26:18-28:15; 98:1-99:3. Thus, South Carolina sales tax applies on all these transactions and is based upon the fair market value of the materials as measured by the price at which the materials are sold to Lowe's customer as part of the installation contract. (R. pp. 377, 1977; Hr'g Tr. (Day 2) 25:5-26:7; Respt's Ex. 2, graphic representation of the Department's position.)

Lowe's acknowledged that it purchased all the materials that were used or consumed in the installation contracts (stock and SOS) at wholesale and did so by extending its resale certificate to the vendor of the materials. (R. pp. 128-129, 138, 374, 1977; Hr'g Tr. 93:20-94:3; 103:11-17; (Day 2) 14:19-15:1; 15:24-16:3; Resp't Ex. 2.) Thus, § 12-36-110(1)(c) applies to Lowe's who is "purchasing something at wholesale and instead of selling it in a traditional sale – is using and consuming it." (R. pp. 375, 394; Hr'g Tr. (Day 2) 18:13-19; 95:17-96:21.)

S.C. Code Ann. Reg. 117-309.17 defines fair market value for a withdrawal for use or consumption of something by a taxpayer who previously purchased the item at wholesale. (R. p. 375; Hr'g Tr. (Day 2) 19:9-12.) Regulation 117-309.17 applies to all retailers. (R. p. 376; Hr'g Tr. (Day 2) 21:1-3.) For example, Mr. McCormack testified that Regulation 117-309.17 would apply to a convenience store that purchases inventory to sell, but instead the owner of the convenience store takes an inventory item – like milk or bread – for personal use. The withdrawal of the milk for the owner's use is a retail sale, and the sales tax due is based upon what the convenience store would normally sell the item for to its customers, not on the amount the convenience store paid its vendors. (R. pp. 376, 130-131; Hr'g Tr. (Day 2) 21:6-17; *see* Hr'g Tr. 95:17-96:21 (application of interpretation to an office supply store). It is unnecessary to conduct an appraisal of items when applying Regulation 117-309.17 "because the regulation which has been approved by the General Assembly has set the

definition [of fair market value] as what the taxpayer normally sells that tangible personal property for allowing for all customary discounts." (R. p. 376; Hr'g Tr. (Day 2) 21:18-22:3.)

S.C. Code Ann. Reg. 117-324, entitled "Dual Business," requires retailers to purchase all items at wholesale and pay tax either (1) upon a sale to a customer or (2) when the retailer withdraws, uses, or consumes the item. (R. pp. 376, 400; Hr'g Tr. (Day 2) 22:11-22; 119:13-19.) In either instance, sales or use tax is due, and the tax is based upon the normal retail sales price. *Id.*

The Department's position in this matter, which ultimately is the same as the ALC's conclusion, also relies upon the South Carolina Supreme Court's decision in *Colonial Stores, Inc. v. South Carolina Tax Commission*, 253 S.C. 14, 168 S.E.2d 774 (1969). *Colonial Stores* stands for the proposition that the valuation method to apply for sales tax purposes when a retailer uses an item rather than sells it is the reasonable and FMV of the item rather than the wholesale cost of the item. (R. pp. 376, 391; Hr'g Tr. (Day 2) 23:14-24:19; 83:12-21.)

7. The Parties' Respective Expert's Opinion

Charles Crider, a Certified General Appraiser, testified on behalf of Lowe's. The ALC qualified Mr. Crider as an expert in the generally accepted meaning of fair market value. (R. p. 163; Hr'g Tr. 128:7-11.) Mr. Crider is not a certified public accountant and has never provided an appraisal for sales tax purposes. (R. p. 171; Hr'g Tr. 136:13-17.) Mr. Crider's testimony generally consisted of opining that the fair market value of the materials in this matter should be based on Lowe's acquisition cost (wholesale) of the materials. Nevertheless, Mr. Crider acknowledged that the "buyer" in an installation contract is a Lowe's retail customer. (R. p. 179; Hr'g Tr. 144:16.)

Hendrikus E.J.M.L. van Bulck, an Associate Professor with the University of South Carolina – Sumter, testified on behalf of the Department. (R. pp. 301-361; Hr'g Tr. 266:18-326:17.) Dr. van Bulck is a Certified Public Accountant in South Carolina and is accredited by the American Institute of Certified Public Accountants (AICPA) with the Accredited in Business Valuation Credential. (R.

p. 307; Hr'g Tr. 272:10-13.) The Court qualified Dr. van Bulck as an expert in valuation principles and practices. (R. pp. 316-317; Hr'g Tr. 281:22-282:6.)

Dr. van Bulck testified regarding the term "levels of trade" and how that is relevant when determining what "fair market value really means." (R. pp. 318-319; Hr'g Tr. 283:16-284:6.) Dr. van Bulck also testified regarding the concept of inventory at rest versus inventory that is moving. He testified that the valuation of inventory depends on the purpose for which you value it. (R. pp. 319-320; Hr'g Tr. 284:19-285:8.)

As a valuation expert, Dr. van Bulck testified that fair market value should be used to determine the value of the materials or inventory withdrawn, used, or consumed by Lowe's in the installation contracts. (R. p. 320; Hr'g Tr. 285:9-14.) Further, Dr. van Bulck testified that when determining the fair market value of such products withdrawn, used, or consumed in the installation contracts at issue, the retail level of trade should be used, and the rationale for using the retail level of trade is straightforward: "all transactions that involve installed items at Lowe's go through the [retail] store." (R. pp. 320-321; Hr'g Tr. 285:15-286:16.)

From a valuation perspective, Dr. van Bulck testified that it does not matter whether the materials in the installation contracts are withdrawn from Lowe's retail inventory or are a special order sale because "all these contracts are initiated at the retail level," and, moreover, "all of the activities are retail activities, whether they are installed or not." (R. pp. 321-322; Hr'g Tr. 286:17-287:6.)

He testified that for sales tax purposes, the retail level of trade is used to determine value. For business valuation purposes, the wholesale level of trade would be used "because that is inventory at rest." (R. p. 322; Hr'g Tr. 287:17-19.) He further testified that a wholesale level of trade valuation is different from the valuation in this matter "because when you value inventory for property tax purposes, in states that have a property tax, you value the inventory as a whole, you do not value

individual items. When a sales tax is calculated or a use tax is calculated, the sales tax is attached to the value of that specific item, not the inventory as whole." (R. pp. 322-323; Hr'g Tr. 287:20-288:5.)

Dr. van Bulck noted that the inventory or materials that are used in the installed sales transactions "are moving" – "the moment the customer walks in the store and buys the material or contracts for the materials, all the value that Lowe's renders, as a retailer, has attached to that product. . . ." (R. p 323; Hr'g Tr. 288:8-19.) "In other words, the customer comes through the front door, the customer does not go through the back loading dock, figuratively speaking." (R. p. 323; Hr'g Tr. 288: 16-19.)

STANDARD OF REVIEW

This Court may reverse the ALC's determination only if that decision was:

(a) in violation of constitutional or statutory provisions;
(b) in excess of the statutory authority of the agency;
(c) made upon unlawful procedure;
(d) affected by other error of law;
(e) clearly erroneous in view of the reliable, probative, and substantial evidence on the whole record; or
(f) arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.

S.C. Code Ann. 1-23-610(B); *Olson v. S.C. Dep't of Health & Envtl. Control*, 379 S.C. 57, 63, 663 S.E.2d 497, 500-501 (Ct. App. 2008); *Turner v. S.C. Dep't of Health & Envtl. Control*, 377 S.C. 540, 544, 661 S.E.2d 118, 120 (Ct. App. 2008); *Clark v. Aiken County Gov't*, 366 S.C. 102, 107, 620 S.E.2d 99, 101 (Ct. App. 2005). Resolution of this matter depends upon the rules of statutory construction. Statutory interpretation is a question of law. *DomainsNewMedia.com, LLC v. Hilton Head Island-Bluffton Chamber of Commerce*, 423 S.C. 295, 300, 814 S.E.2d 513, 516 (2018).

"The cardinal rule of statutory construction is to ascertain and effectuate the intent of the legislature." *Hodges v. Rainey*, 341 S.C. 79, 85, 533 S.E.2d 578, 581 (2000). The words of the statute "must be given their plain and ordinary language without resort[ing] to subtle or forced construction

to limit or expand [the statute's] operation." *Hitachi Data Sys. Corp. v. Leatherman*, 309 S.C. 174, 178, 420 S.E.2d 843, 846 (1992) (internal citations omitted).

Nevertheless, even if this Court engages in statutory construction, when construing a statute the cardinal rule is to ascertain the intent of the Legislature. *Georgia-Carolina Bail Bonds, Inc. v. County of Aiken*, 354 S.C. 18, 22, 579 S.E.2d 334, 336 (Ct. App. 2003 Further, "[t]he construction of a statute by the agency charged with its administration will be accorded the most respectful consideration and will not be overruled absent compelling reasons." *Brown v. S.C. Dep't of Health & Envtl. Control*, 348 S.C. 507, 515, 560 S.E.2d 410, 414 (2002) (quoting *Dunton v. S.C. Bd. of Exam'rs in Optometry*, 291 S.C. 221, 223, 353 S.E.2d 132, 133 (1987)); *see also Nucor Steel v. S.C. Pub. Serv. Comm'n*, 310 S.C. 539, 543, 426 S.E.2d 319, 321 (1992) (recognizing that where an agency is charged with the execution of a statute, the agency's interpretation should not be overruled without cogent reason).

ARGUMENT

This Court should affirm the ALC's decision because the ALC's findings of fact are supported by the substantial evidence in the record and there are no errors of law. While Lowe's argues this Court should employ certain rules of statutory interpretation, these rules are inapplicable where - as here - the language of the statutes and regulations at issue is plain and unambiguous. Nevertheless, even if the statutes are ambiguous, the Department is charged with administering the statutes and regulations at issue. Thus, the Department's construction of the statutes and regulations is entitled to deference and should not be overruled absent compelling reasons. *Kiawah Development Partners, II v. S.C. Dep't of Health and Envtl. Control*, 411 S.C. 16, 34, 766 S.E.2d 707, 718 (2014) (noting that South Carolina courts "give deference to agencies both because they have been entrusted with administering their statutes and regulations and because they have unique skill and expertise in administering those statues and regulations.").

Finally, although the ALC based its decision on a different legal theory than presented by the Department in its Determination and during the hearing below, the result under either analysis is entirely consistent: the sale of materials to Lowe's customers for use in the installation contracts is a retail sale in South Carolina. Because the sale of materials to Lowe's customers is a retail sale, Lowe's is responsible for remitting sales tax on the materials based upon the purchase price paid by its customers.

I. Lowe's is responsible for sales tax and interest on the retail sales of tangible personal property (materials) sold to Lowe's customers in conjunction with the installation contracts.

A. A retail sale occurs when Lowe's customers purchase materials to be used under the installation contracts.

Under South Carolina law, a sales tax of six percent on "the gross proceeds of sales, is imposed upon every person[4] engaged or continuing within this State in the business of selling tangible personal property at retail." S.C. Code Ann. §§ 12-36-910(A), 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). Lowe's operates retail stores in South Carolina and is in the business of selling tangible personal property within this State. Tangible personal property, as defined under the South Carolina Sales and Use Act, means "personal property which may be seen, weighed, measured, felt, touched, or which is in any other manner perceptible to the senses . . . ." S.C. Code Ann. § 12-36-60 (2014). The materials used in Lowe's installation contracts are clearly tangible personal property within the meaning of § 12-36-60. In this matter, Lowe's does not challenge that it is a retailer operating within South Carolina. (R. p. 122, 237; Hr'g Tr. 87:12-13; 202:2-4.) Thus, as a

[4]For 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 (2014).

retailer in South Carolina, Lowe's is subject to sales tax on the gross proceeds of its sales.[5] §§ 12-36-910(A), 12-36-1110 (2014).

Lowe's held a General Contractor license from SCDLLR for a portion of the Audit Period. (R. p. 11; Final Order, p. 10.) Thus, the question before the ALC was in what capacity did Lowe's perform or operate during the installation contracts in this matter.[6] As described below, the ALC correctly determined that the sale of "materials at the retail price by Lowe's to the customer as the final user and consumer of the materials installed pursuant to the installation contracts constitutes the last transfer of the materials for consideration and falls within the general definition of a retail sale" under South Carolina law. (R. p. 26; Final Order, p. 25.)

1. Lowe's actions determine the true nature of the installation contracts.

In this appeal, Lowe's primarily argues it is a contractor engaging in general construction when installing real property improvements for its customers under the terms of the installation contracts; thus, under Lowe's argument, the "retail sale" is the purchase of materials by a contractor. First, Lowe's only held its SCLLR-issued contractor's license for approximately 2 months of a 36-month audit period. The fact that Lowe's did not have this license at the time most of the installation contracts at issue were made illustrates that Lowe's is not relying on the contractor's license when it asserts that it was a contractor for the entire Audit Period. Moreover, Lowe's – acting as a retailer – purchases materials at wholesale from a vendor, sells those same materials at retail (approximately a 40% markup) to its customers, and subsequently sub-contracts with a 3rd party to install the materials

[5]Pursuant to S.C. Code Ann. § 12-36-950 (2014), "[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.

[6]Interestingly, Lowe's did not have this license at the time most of the installation contracts at issue were made, and thus, Lowe's did not rely on this license for the vast majority of the transactions at issue in this matter.

as part of the installation contract. Accordingly, the ALC correctly concluded the retail sale in this matter did not occur when Lowe's purchased materials at wholesale from its vendors (R. p. 20; Final Order, p. 19.)

S.C. Code Ann. § 12-36-110 defines "retail sale" as "all sales of tangible personal property except those defined as wholesale sales." While the statutes and regulations recognize that a retailer such as Lowe's can also hold a contractor's license, it cannot act as a General Contractor and retailer in the same transaction. Here, Lowe's actions establish that the transaction in which the customer purchases material *at retail* from Lowe's as part of the installation contract is a retail sale. First, Lowe's purchases both stock and special order materials used in the installation contracts from its vendors at wholesale – meaning free of any sales tax at the time of purchase. *See* S.C. Code Ann. §§ 12-36-120 (providing that wholesale sales means the sale of tangible personal property to a licensed retail merchant and does not include sales to users or consumers not for resale); *PalmettoNet, Inc. v. S.C. Tax Comm'n*, 318 S.C. 102, 106, 456 S.E.2d 385, 388 (1995) ("Wholesale sales are not subject to sales tax."); *see also Stanton Quilting Co., Inc. v. S.C. Tax Comm'n*, 281 S.C. 133, 314 S.E.2d 844 (1984) (holding that "the intent of the legislature was to exempt from sales tax sales to buyers who purchase for resale, not as consumers or for use themselves"). Lowe's acknowledged purchasing all stock material with the intent to resell those materials in either a traditional retail sale or through an installation contract. (R. pp. 129-130; Hr'g Tr. 94:5-95:2.)

Under South Carolina law, contractors are not permitted to extend or accept resale certificates because they are required to pay sales tax on all of their purchases at the time of purchase – every purchase a contractor makes is a retail sale because the contractor is the end user or consumer.[7]

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[7]For example, Lowe's acknowledges that when it purchases inventory, such as a dishwasher, that could be used in a stock installation contract and is also sold to customers in a traditional retail sale (without installation), it does not designate at the time of purchase from the vendor which dishwasher will be used in a stock installation contract and which dishwasher will be sold on the floor

As noted by the ALC, in order to obtain a resale certificate from the Department, a taxpayer (including Lowe's), "must certify that as a purchaser acquiring tangible personal property from a supplier, the taxpayer is engaged in the business of selling personal property of the type he is acquiring from that vendor and that, unless otherwise specified, all property being acquired from the vendor will be resold." (R. p. 24; Final Order, p. 23.) Further, the taxpayer acknowledges that if the tangible personal property is withdrawn for use and not sold, the taxpayer must remit sales tax based upon the "reasonable and fair market value[.]" *Id.* Finally, when the taxpayer extends the resale certificate, he recognizes he is legally liable for the sales and use tax on the transaction.

Lowe's does not dispute that it purchased all materials used in the installation contracts at wholesale, free of tax, by extending its resale certificate. (R. pp.128-129, 138; Hr'g Tr. 93:15-94:3, 103:14-17.) When extending the resale certificate to the vendors, Lowe's certified that it was purchasing these materials for resale. (R. p. 24; Final Order, p. 23.) Thus, Lowe's knew it would be required to remit sales tax on the fair market value of the materials when those materials were subsequently used or sold to its customers as part of the installation contracts. *See ARA Servs., Inc. v. S.C. Tax Comm'n*, 271 S.C. 146, 150, 246 S.E.2d 171, 172 (1978) (finding the sale of meals to a college where students subsequently purchased the meals from the college was "not the last transfer of the meals for consideration, and thus w[as a] wholesale transaction[]").

The fact that Lowe's customer pays the retail price for each material separate from the cost of the installation services establishes that the relevant transaction for sales tax purposes is the retail sale from Lowe's to its customer. The customer is paying the retail price of the materials (40% markup above Lowe's cost) "separate and apart from the fees and costs associated with the installation

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in a traditional retail sale. This is further evidence that Lowe's is not acting as a contractor when it purchases the materials from vendors. Such material is be held for "resale" by Lowe's, and this is in direct contravention of § 12-36-120(1) (defining "wholesale sale").

services." (R. p. 21; Final Order, p. 20.) Simply put, each customer's sales transaction is a retail sale subject to sale tax and is based upon the retail price paid to Lowe's by the customer.

Next, Lowe's argues the installation contracts are conveyances of real property improvements to customers rather than retail sales of materials. As support for its assertion, Lowe's points to the terms and conditions of the installation contract which state title to the materials purchased by the customer remains with Lowe's until after the materials have been installed and incorporated into the customer's home. However, the materials are carefully chosen by a customer "in a retail setting, purchased by the customer at the retail price, and, at the direction of the customer, installed in his or her home." (R. p. 22; Final Order, p. 21.) Further, the record evidence establishes that both average retail customers not buying an installed item, as well as installation contract customers often leave the store without the materials he or she purchased and therefore taking possession is not determinative of the applicable tax rate.[8] In either of these transactions, the customer pays full retail price for the items chosen and "leaves the store without physical possession of the materials purchased. This is especially true with the traditional retail sale of SOS materials because Lowe's does not have these materials in stock and must order the materials from a vendor on behalf of the customer. (R. p. 135; Hr'g Tr. 100:10-15.) As the ALC correctly concluded, when a customer purchases SOS materials through a traditional retail sale, it is undisputed that a retail sale occurs when the customers pays for the materials at the cash register, and the customer holds title to the SOS materials. "It matters not that he leave the store without physical possession" of the materials. (R. p. 23; Final Order, p 22.)

Finally, Lowe's installation services is *solely contingent* upon the customer purchasing the materials from Lowe's. As concluded by the ALC, the fact that Lowe's strict policy of refusing

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[8]Significantly, in a traditional retail sale the customer may choose to have the items or materials he purchased either picked up or delivered at a later time. (R. pp. 149-150; Hr'g Tr. 114:1-115:16.) For SOS materials, a customer may only take physical possession once Lowe's orders and subsequently receives the specially-ordered materials. (R. p. 22; Final Order , p. 21.)

installation services unless the customer purchases the materials from Lowe's confirms Lowe's "primary objective in offering these ancillary services [is] to facilitate a retail sale to customers." (R. p. 21; Final Order, p. 20.). Because Lowe's will not offer installation services to customers who do not purchase the materials from Lowe's, "it is illogical to conclude, as [Lowe's] does, that the purchase of the materials is simply subsumed into the service portion of the installation contract." (R. p. 21; Final Order, p. 20.) Moreover, once a customer signs the installation services contract, the "labor" portion of the contract is performed entirely by a Lowe's 3rd party installer. No employee of Lowe's performs any service with regard to the contracting portion of the contract. *See* R. pp. 74, 144; Hr'g Tr. 39:3-41:4; 109:10-13 (Lowe's witness testifying that even the initial measurements prior to execution of installation service contract are taken by the 3rd party installer); R. pp. 81-82; Hr'g Tr. 46:1-47:3 (Lowe's witness testifying that 3rd party installer performs installation service). The purpose of Lowe's operations – including its installation services – is to facilitate a retail sale to its retail customers.[9] Thus, the ALC correctly concluded that the purchase of the materials by the customer and withdrawn or used by Lowe's in the installation contracts to be the "crux" of the retail sales transaction. *Id.*

Accordingly, Lowe's own actions establish that it acts as a retailer for sales tax purposes in the installation contracts. The fact that Lowe's can operate as a retailer or a contractor "at distinct times during the installation contract transaction does not . . . affect the nature of the underlying transaction; it remains a retail sale."[10] (R. p. 27; Final Order, p. 26.) Accordingly, this Court should affirm the

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[9] *See* R. p. 722; Ex. 22, p. 1; R. p. 725; Ex. 23, p.1 ("Lowe's retail customers include individual homeowners and renters who complete a wide array of projects from do-it-yourself (DIY) to do-it-for-me (DIFM)." (emphasis added).

[10] Lowe's complains the Auditor did not initially review the installation contracts prior to issuing the proposed notice of assessment.

First, the Department conducted a prior audit (for the audit period March 1, 2002 to February 28, 2005) of Lowe's for the same issue, and after reviewing the contracts during the prior audit, reached

ALC as the Department properly assessed Lowe's for the additional sales tax on the materials used in the installation contracts during the Audit Period.

2. S.C. Code Ann. Reg. 117-324 (Dual Business Regulation) does not apply to contractors.

In its brief, Lowe's asserts that it purchases installation contract materials as a contractor despite extending its resale certificate to purchase those materials at wholesale from the vendors. Notably, wholesale purchases of building materials by a contractor is directly prohibited by S.C. Code Ann. Regs. 117-314.1-117-341.2 (providing that contractors are required to purchase materials at retail price and to pay tax on that higher retail price at the time of purchase). Nevertheless, Lowe's cites to the Dual Business Regulation as support for its assertion that it was required to purchase the installation contract materials at wholesale using its resale certificate:

> Operators of businesses who are both making retail sales and withdrawing for use from the 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.

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the same conclusion that Lowe's was improperly remitting use tax on the cost of the materials rather than remitting sales tax on the retail price paid by the customers for the materials used in the installation contract. In fact, the only difference between the prior audit and the current audit is the auditor concluded in the prior audit the markup was approximately 42% percent, and the markup in the current audit was approximately 40%. (R. pp. 219, 232, 577-579, 219; Hr'g Tr. 184:8-12; 197:7-14; Ex. 14; Hr'g Tr. 184:2-12.) Moreover, after reviewing the contracts for this audit, the Department auditor testified that it "cemented" the determination that Lowe's improperly remitted use tax on its cost of the materials rather than sales tax on the retail price of the material sold to a customer. (R. p. 254-255; Hr'g Tr. 219:5-220:22.)

Second, as discussed *infra*, South Carolina law and the underlying facts evidencing Lowe's' actions with regard to the wholesale purchase and subsequent retail sale of the materials to its customers determine what the retail sale is in this matter.

Finally, S.C. Code Ann. § 12-36-950 provides that all gross proceeds are subject to tax until the contract is established. Further, the liability for the sales tax is on Lowe's. Thus, Lowe's has the burden of proof in this matter, and it did not (and cannot) argue that any provision within the installation contract shifts the sales tax liability to its customer. Ultimately, based on the facts of the transaction, Lowe's owed sales tax on the retail sale. Lowe's cannot change that by boilerplate terms in a contract in which the customer has no input.

> 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 other who make isolated or accommodation sales and who have not set themselves up as being engaged in selling.

S.C. Code Ann. Regs. 117-324 (emphasis added). As the ALC correctly determined, the plain language of the regulation "makes it abundantly clear" that it does not apply to contractors because contractors cannot purchase at wholesale. (R. p. 25; Final Order, p. 24; *see also* S.C. Code Ann. Regs. 117-314.1 – 314.2). Lowe's reads this regulation as applying to all other contractors, just not themselves. Stated differently, Lowe's wants to be viewed as a contractor when it benefits them and not as a contractor when it doesn't. Thus, Lowe's argument is meritless and not supported by the plain language of the regulation. *Hitachi*, 309 S.C. at 178, 420 S.E.2d at 846 (1992) (stating the words of the statute "must be given their plain and ordinary language without resort[ing] to subtle or forced construction to limit or expand [the statute's] operation.")

It is important to note that the Dual Business Regulation does not state or support the assertion that dual businesses are to pay tax on the wholesale price. To the contrary, the Dual Business Regulation recognizes that those retailers must pay the applicable sales tax in one of two future events: (1) when the retailer sells the materials or (2) when the retailer withdraws the materials from its business or inventory and then uses or consumes the materials. So while the retailer purchased those goods at wholesale, it must later either report their sales as retail sales or withdrawals for use. Accordingly, this Regulation actually supports the ALC's ruling and the Department's Determination. If the General Assembly intended for the Regulation to be read as Lowe's asserts, it could have simply stated that dual businesses purchases all good at wholesale and pay tax on the wholesale price. That is not what the Regulation states because that is not what the General Assembly intended.

Moreover, the ALC correctly concluded that Lowe's argument leads to an absurd conclusion, and should be rejected by this Court as well:

> It is apparent Lowe's manipulates the relevant regulations and the statutory scheme to identify as a retailer when it is advantageous to purchase materials at wholesale, tax free from a supplier and to later identify as a contractor when it is advantageous to remit taxes based upon the amount paid to acquire the materials and at the time the materials are used or withdrawn. [Lowe's] interpretation of Regulation 117-3245 to permit Lowe's, as a retailer, to purchase materials at wholesale combined with its assertion that the taxable retail sale in installation contract transactions is the exact same sale of the same materials by vendors to Lowe's, as a contractor, leads to an absurd result. Under such a conundrum, Lowe's would reap a benefit not befalling any other contractor – never having to pay taxes based on the retail sales price for materials because it has the distinct (and unfair) advantage of being able to purchase those materials at wholesale as a retailer by extend its resale certificate, unlike any other contractor.

(R. p. 25; Final Order, p. 24.) *See Jones v. State Farm Mut. Auto. Ins. Co.*, 364 S.C. 222, 232, 612 S.E.2d 719, 724 (Ct. App. 2005) (concluding "[c]ourts will reject a statutory interpretation which would lead to a result so plainly absurd that it could not have been intended by the legislature or would defeat the plain legislative intention."). Lowe's "beneficial manipulation" of the regulation with regard to installation contracts clearly leads to an absurd result that could not have been intended by our legislature, and the Department respectfully requests this Court to affirm the ALC's conclusion that the Dual Business Regulation does not apply as urged by Lowe's. (R. p. 26; Final Order, p. 25.)

3. Lowe's ability to operate as a contractor cannot change the nature of a sales tax transaction that occurred in the past.

Lowe's attempts to confuse the issue by claiming that its wholesale purchases are simultaneously retail purchases pursuant to S.C. Code Ann. § 12-36-110(1)(a) and (e). Section 12-36-110(1)(a) provides that a sale of building materials to a construction contractor is a sale at retail. Section 12-36-110(1)(e) provides that sales to contractors for use in their performance of construction contracts are also retail sales. Subsections 12-36-110(1)(a) and (e) do not apply to Lowe's initial purchase of the materials. Both of these subsections are premised on the fact that there will be no further sale of the building materials. Contrary to Lowe's argument, these statutes do not allow a retailer to purchase goods at wholesale and then later determine that such sale should be converted to

a retail sale. Lowe's purchases every material at wholesale as a sale for resale. The materials are not separated into groups designated for one use (retail sales) or other use (installation contracts). For installation contracts, when it withdraws the material from inventory for the 3rd party installer to provide contracting services, Lowe's resells the material to itself and thus, the withdrawal for use is classified as a retail sale and the tax must be measured on the gross proceeds from that sale.

If this Court accepts Lowe's argument, every item – not only materials withdrawn, used, or consumed in installation service contracts but also materials purchased for resale in traditional sales transaction as well – purchased by Lowe's would be subject to sales tax upon the purchase from the vendor. Such a result would lead to an absurd conclusion as 94% of Lowe's sales are traditional retail sales. See *Jones v. State Farm Mut. Auto. Ins. Co.*, 364 S.C. 222, 232, 612 S.E.2d 719, 724 (Ct. App. 2005) (concluding "[c]ourts will reject a statutory interpretation which would lead to a result so plainly absurd that it could not have been intended by the legislature or would defeat the plain legislative intention."). Simply put, the statute is designed to set up a methodology where the only person that can buy materials at wholesale is a retailer because a contractor has to buy everything at retail.

If Lowe's is in fact acting as a contractor in the installation contracts, it would purchase (and pay sales tax at the time of purchase) the materials solely used for installation contracts and store all such materials separately from the retail business's material. *See* S.C. Code Ann. Reg. 117-314 ("Sales 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."). Moreover, by arguing that it is a contractor in this matter, Lowe's is attempting to characterize a past transaction (purchase at wholesale) based upon some future event (using the materials in an installation contract). Sales tax is a transactional tax in which the transfer by a retailer of tangible personal property to the end user for a consideration is subject to tax. Lowe's cannot claim it is a retailer for the tax benefit of purchasing materials at wholesale and then subsequently assert it is a contractor when it uses the material to realize another tax benefit: paying

sales tax based upon Lowe's lower cost of the materials rather than the price at which the materials are offered for sale by Lowe's.

B. In the alternative, a retail sale occurs when Lowe's withdraws, uses, or consumes the material during the performance of the installation contracts.

At the hearing below, Department witnesses testified to the Department's position in this matter: that every withdrawal, use or consumption of materials by Lowe's for an installation contract is a retail sale in South Carolina. (R. pp. 374, 383; Hr'g Tr. (Day 2) 15:2-7; 51:4-12). Further, the measure for sales tax purposes of such retail sale is the fair market value of the tangible personal property. (R. pp. 374, 383-384, 1977; Hr'g Tr. (Day 2) 15:8-10; 51:4-52:21; Resp't Ex. 2.) To the extent the Court disagrees with the ALC's analysis regarding the "retail sale" in this matter, the South Carolina Sales and Use Tax Act, specifically § 12-36-110(c)(1), provides that a retail sale occurs when Lowe's withdraws, uses, or consumes materials as part of its installed sales transactions are retail sales pursuant to S.C. Code Ann. § 12-36-110(1)(c). Thus, even if the Court does not affirm the ALC's analysis – the Department's assessment remains correct as South Carolina law requires Lowe's to remit sales tax on the withdrawal, use, or consumption of materials as part of its installation contracts.

As noted above, Lowe's does not challenge that it is a retailer operating within South Carolina. (R. pp. 122, 237; Hr'g Tr. 87:12-13; 202:2-4.) Therefore, Lowe's is a retailer in South Carolina and is subject to sales tax on the gross proceeds of its sales.[11] S.C. Code Ann. §§ 12-36-910(A), 12-36-1110 (2014). Because Lowe's is a retailer in South Carolina, it is permitted to purchase the materials it uses in the stock and SOS installation contracts at wholesale. S.C. Code Ann. § 12-36-110 (2014) defines "[s]ale at retail and retail sale" as "all sales of tangible personal property except those defined as

[11]Pursuant to S.C. Code Ann. § 12-36-950 (2014), "[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.

wholesale sales." Further, S.C. Code Ann. § 12-36-110(1)(c) (2014) defines "sale at retail" and "retail sale" include:

> the withdrawal, use, or consumption of tangible personal property by anyone who purchases it at wholesale.

(emphasis added.) *See* S.C. Code Ann. §§ 12-36-120, 12-36-910; *see also Stanton Quilting Co., Inc. v. S.C. Tax Comm'n*, 281 S.C. 133, 314 S.E.2d 844 (1984) (holding that "the intent of the legislature was to exempt from sales tax sales to buyers who purchase for resale, not as consumers or for use themselves").

As discussed supra, the only reasonable conclusion here is that Lowe's intended to purchase the material at wholesale for resale to its customers as part of the installation contracts. *See also* R. p.130; Hr'g Tr. 95:3-16) (Lowe's acknowledged at the time of purchase from the vendor and subsequent placement in the retail store, it did not designate (as it does not know at that time) which specific materials will be used for a traditional retail sale and which materials will be used in a stock installed sales transaction); R. p. 130; Hr'g Tr. 95:9-16 (materials sold as an traditional retail sales transaction are not separated in a Lowe's retail store from material sold as part of the stock installed sales transaction. Thus, at the time Lowe's purchases the materials from the vendor, such purchases are wholesale sales that fall within the language of § 12-36-120(1).

Because the materials used in the stock and SOS installation contracts were purchased at wholesale by Lowe's, the Court must determine whether § 12-36-110(1)(c) applies to the transactions at issue. As noted earlier, a sale at retail includes the withdrawal, use or consumption of tangible personal property previously purchased at wholesale. Lowe's acknowledges that in all instances, the materials are withdrawn from Lowe's inventory and used or consumed in the stock installation contracts. (Hr'g Tr. 93:7-14.) Lowe's further acknowledges that the materials used as part of a Lowe's SOS installation contract in South Carolina are "use[d] or consume[d] . . . in the connection of its business." (R. p. 138-139; Hr'g Tr. 103:22-104:1.) Pursuant to § 12-36-110(1)(c), a retail sale occurs

when Lowe's withdraws, uses, or consumes the materials as part of the stock and SOS installation contracts performed in South Carolina. Thus, the materials used in the stock installation contracts and SOS installation contracts are subject to sales tax in South Carolina when withdrawn, used, or consumed by Lowe's.

C. The Department's long standing policy regarding retailers who also provide contracting servicers supports the ALC's determination that Lowe's does not act as a contractor in the installation contracts.

The Department's long standing policy regarding retailers who also provide contracting services analyzes additional facts and circumstances in making the determination of whether a person is acting as a contractor:

> [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.

(Ex. 63, South Carolina Sales and Use Tax Manual, Chapter 16 at p. 4 (2015 Spring ed.). All of these additional factors weigh against Lowe's position.

If a retailer truly serves as a contractor 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 should be purchased as a contractor with sales tax being paid at the time of the purchase of the raw building materials.

Here, Lowe's is not acting as a contractor based on the facts and circumstances in this matter. Lowe's advertises itself as a retailer in its financial documents.[12] Ninety-four percent of Lowe's sales are traditional sales at retail that do not include installation services. *See* R. p. 615; Ex. 20, p. 7. Lowe's displays its products used in its installed sales at its retail stores or in catalogues within its large retail stores. Lowe's does not perform labor for general contractors as a subcontractor nor does it provide contracting services to its customers without the customers simultaneously purchasing the materials to be installed from Lowe's. In fact, based on the factors set forth above, the only factor that may show that Lowe's is acting as a contractor is that it had a contractor's license in South Carolina for a small portion of the Audit Period. The fact that Lowe's did not have this license at the time most of the installed sales at issue were made illustrates that Lowe's is not relying on the license when it asserted that it was a contractor for the entire Audit Period.[13]

D. Lowe's reliance on the decisions from other jurisdictions is misplaced.

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[12] *See* R. pp. 612-613; Ex. 20, p. 4-5 ("world's second largest home improvement retailer"; "The home improvement retailing business includes many competitors"); R. p. 707; Ex. 21, p.1 ("We continue to focus on retail excellence, which requires us to provide an engaging store experience in the most efficient manner possible."), p. 8 (Lowe's promise to its customers "rests on a foundation of retail excellence, requiring us to continually improve our customer service, product offering and store presentation."), p. 13 ("Business Description - Lowe's Companies, Inc. is a $50.2 billion **retailer**[.]) (emphasis added); R. p. 722; Ex. 22, p. 1 ("Whether our customers shop in store, online, by phone, or at their home or place of business with a Lowe's employee, Lowe's is ready to help."); R. p. 725; Ex. 23, p.1 ("A Fortune 100 company and the world's second largest home improvement retailer."), p. 1 ("We serve retail and professional (Pro) customers."), p. 2 ("Regardless of the channel customers choose [in-store, online, on-site, contact centers], Lowe's strives to provide them with a seamless experience and an endless aisle of products, enabled by our flexible fulfillment capabilities."); R. p. 734-745; Ex. 26 (North American Industry Classification System (NAICS) definition for 444100, Home Centers). Because Lowe's is "the world's second largest home improvement retailer", it can maintain a large stock of regular inventory and can sell numerous special order items through its online site (or in-store with the help of a sales associate).

[13] Interestingly, evidence was introduced in this matter which contained the following statement by Lowe's: "LOWES IS A SUPPLIER OF MATERIALS ONLY. LOWES DOES NOT ENGAGE IN THE PRACTICE OF ENGINEERING, ARCHITECTURE, OR GENERAL CONTRACTING. . . ." *See* R. p. 911; Ex. 35, p. 6.

Although Lowe's cites to cases it is involved in with other jurisdictions and which it asserts supports its position in this matter, these cases are inapplicable and distinguishable from the issues in this case. *See* also Department's Motion to Strike. Most importantly, the applicable statutory scheme in each of the cases cited by Lowe's is far different from the statutory scheme in South Carolina. *None* of those states' laws include language similar to the withdrawal language provided under § 12-36-110(1)(c). Second, none of those states has a statute or regulation that specifically defines FMV like Regulation 117-309.17 in the context of the corresponding withdrawal statute. Third, the taxing authority in one case promulgated a regulation making a distinction between time and material and lump sum contracts, and that issue was not before the ALC in this matter.[14] Finally, Lowe's asserts that in each of the cases, the Court or similar authority determined that Lowe's "should not be charging sales tax to its customers." (R. p. 118-120; Hr'g Tr. 83:23-25, 85:7-10.) Whether or not Lowe's charges sales tax to its customers is irrelevant in this matter: while Lowe's has the option to pass the sales tax onto to the customer, sales tax in South Carolina is imposed on the seller, and the seller is legally liable for the sales tax. *See* S.C. Code Ann. §§ 12-36-950, 12-36-910, 12-36-1110.

II. The ALC correctly held that Lowe's was required to remit sales tax to the Department based on the retail price of materials sold to Lowe's customers.

A. Lowe's is required to remit sales tax to the Department based on the retail selling price of the installation contract materials at the time of the purchase by Lowe's customers.

[14]During the hearing, Mr. McCormack clarified that the Department's position in this matter did not bifurcate the installation service contract into two separate transactions in making the determination that a retail sale had occurred. Rather, the Department has maintained, since the issuance of the Department Determination on October 24, 2014, that the retail sale in this matter is the withdrawal, use, or consumption of materials by Lowe's in the installed sales transactions. (R. p. 384; Hr'g Tr. (Day 2) 56:14-17.) Importantly, Mr. McCormack noted that because the end result is the same in either scenario, that could lead to confusion. *See* R. pp. 384-385; Hr'g Tr. (Day 2) 55:5-57:20. Thus, to the extent this Court considers the decisions from other jurisdictions, the Department's position does not require any analysis regarding the bifurcation of the installation contract.

Once the ALC properly determined the retail sale is the sale of materials by Lowe's to the customer as part of the installation contract, the ALC correctly relied upon S.C. Code Ann. 12-36-90(1)(b) (Gross Proceeds statute) to determine whether Lowe's properly remitted sales tax based on its cost to acquire the materials. S.C. Code Ann. 12-36-90(1)(b) defines "gross proceeds of sales" as "the value proceeding or accruing from the sale, lease, or rental of tangible personal property," in include, in pertinent part, "(b) the proceeds from the sale of tangible personal property." *See also* S.C. Code Ann. Regs. § 117-318 (providing "'gross proceeds of sales' is the basis for calculating the sales tax"). Relying on § 12-36-90(1)(b), the ALC appropriately determined, in this matter, "proceeds from the sale" is the retail sales price the customer pays for the materials in the installation contract; thus, "the taxable value of the materials is the retail selling price of the materials as recorded in the installation contract invoice." (R. p. 28; Final Order, p. 27.) Finally, the ALC concluded that although the Department relied on an alternative theory, the resulting monetary assessment by the Department is correct because both the Court and the Department used the same basis for assessing the additional tax: the retail selling price of the materials paid by Lowe's customers as part of the installation contract. Thus, the Department requests the Court to affirm the ALC's decision to uphold the Department's assessment in this matter.

B. In the alternative, the gross proceeds of sales from the materials used in the performance of the installation contracts is based upon the fair market value of the materials (as measured by the price paid by Lowe's customers).

To the extent this Court determines the withdrawal, use, or consumption of the materials used in both the stock and SOS installation contracts are the retail sales subject to sales tax pursuant to § 12-36-110(1)(c), the gross proceeds of sales results in the same assessment imposed by the Department and upheld in the ALC's Final Order.

The term "gross proceeds of sales" also 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. § 12-36-90(1)(c). Therefore, the taxable value of the tangible personal property purchased by Lowe's at wholesale and subsequently withdrawn from Lowe's business or inventory for its own use is the fair market value of that tangible personal property.

However, the analysis does not end with § 12-36-90(1)(c). FMV as used in § 12-36-90(1)(c) is not defined in the Sales and Use Tax Act. To that end, S.C. Code Ann. Regs. 117-309.17 (2014) defines FMV in the context of the installed sales transactions at issue in this matter. S.C. Code Ann. Regs. 117-309.17, entitled "Withdrawals From Stock, Merchants", states:

> 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.

Lowe's contends the Department's interpretation of Regulation 117-309.17 is inconsistent with the generally accepted meaning of FMV in the context of retail inventory. (R. p. 164; Hr'g Tr.129:15-18.) Specifically, Lowe's argues that Regulation 117-309.17, as applied in this matter, requires the gross proceeds of sales to be valued at Lowe's cost of the materials rather than the retail price of such materials sold to a retail customer as part of the installation contract. As support for its assertion, Lowe's introduced testimony from Mr. Crider who asserted that FMV in this matter must be valued at Lowe's cost of the materials because this matter involves a retailer's inventory.

While the Department acknowledges Mr. Crider is knowledgeable in the field of real property appraisals and methodologies, his analysis is irrelevant in matters concerning retail sales tax transactions. First, Mr. Crider incorrectly asserts the retail sale in this matter is the sale of inventory from one retailer to another. (R. p. 164; Hr'g Tr. 129:15-18). This is simply incorrect. The retail sales

are the individual transactions – either the retail sale from Lowe's to the customer or Lowe's withdrawal, use, or consumption – initiated by Lowe's upon the execution of the installation services contract with Lowe's retail customers. *See* R. pp. 69-70, 73; Hr'g Tr. 34:14-35:3; 38:17-22 (Mr. Price discussing sales tax as a transactional tax on *one customer*). Mr. Crider further testified that this matter involves the wholesale level of trade (i.e., bulk sale of inventory to another retail competitor). (R. p. 165; Hr'g Tr. 130:8-15.) Again, this is incorrect. First and most importantly, the General Assembly has clearly determined that the level of trade under the withdrawal statute is the retail level of trade. *See* § 12-36-110 (defining "Sale at *retail*; *retail* sale.") (emphasis added).

Second, Mr. Crider's opinion is founded upon the sale of a retailer's *entire* inventory rather than focusing on the individual sales transactions. Mr. Crider's analysis simply identified the wrong buyer and seller as the transaction at issue here is not a sale from Lowe's to a competing home improvement retailer. But *see* R. p. 179; Hr'g Tr. 144:12-16.) (Mr. Crider acknowledging that the "buyer" in the installed sales contracts is a Lowe's retail customer). Nevertheless, Lowe's cites to *The Housing Authority of the City of Charleston v. Olasov*, 282 S.C. 603, 608, 320 S.E.2d 478, 481 (Ct. App. 1984) and *Hendrix v. Lexington Cty. Assessor*, Docket No. 03-ALJ-17-0475-CC (S.C. Admin. Law Div. July 20, 2005) to support Mr. Crider's argument the FMV of the materials should be valued at cost as if Lowe's is selling its entire inventory to another retailer. These cases are not applicable in this matter for numerous reasons: (1) this matter involves retail sales transactions with Lowe's customers (transactional) and does not involve selling inventory from one retailer to another retailer; (2) the South Carolina Supreme Court's decision in *Colonial Stores* (discussed *infra*) squarely fits the transactions in this matter; and (3) *Housing Authority* and *Hendrix* are valuation cases for property tax purposes.[15]

[15]Valuation for property tax purposes is not the same as a sales tax valuation. For property tax purposes, the inventory is "at rest" and is valued as of certain valuation date. *See e.g.*, S.C. Code Ann. § 12-37-610 (2014) (stating that persons are liable for taxes and assessments on the real property in which he owns an interest in "as of December thirty-first of the year preceding the tax . . . .").

Simply put, Lowe's expert values the inventory as a whole rather than valuing the gross proceeds of sale based on individual transactions. Here, the inventory or materials used by Lowe's in the installation contracts are not being sold as a "whole" to another retailer. Rather, the materials are sold in individual transactions to Lowe's customers. This is precisely the basis of a sales tax – it is a transactional tax on the sale of tangible personal property and each transaction stands on its own. *See* R. p. 373-374; Hr'g Tr. (Day 2) 12:17-13:14.) Further, Mr. Crider's analysis fails to consider the fact that a sales tax would *never* be imposed on the sale of inventory from one retailer to another retailer because such transaction would be considered a wholesale sale in South Carolina. *See* § 12-36-120(1) (defining wholesale sale). Finally, there is a distinction between property appraisals in general and valuing property for a specific reason. (R. pp. 308-309; Hr'g Tr. 273:10-274:1.) Generally, appraisals are conducted to assign an "estimated value" of the property. *Id.* This is unlike a value determined for sales tax purposes. At the time the sales tax transaction is initiated and completed, the fair market value of the item is immediately determined as the buyer has agreed to purchase the item from the seller for a specific price. There is no need to estimate the value – the seller and buyer have determined that value at the time of purchase.

Regulation 117-309.17 informs taxpayers of the appropriate taxable amount (i.e., the gross proceeds of sale) on items purchased at wholesale and subsequently withdrawn from the taxpayer's business or inventory. Pursuant to the first sentence of the Regulation 117-309.17, the 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."

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sales tax purposes, the inventory is actually sold in a real transaction on a specific date. Thus, Mr. Crider incorrectly values Lowe's inventory "at rest" rather than inventory being sold in a retail transaction. The Department's expert's analysis in fact supports the valuation for sales tax purposes by focusing on the retail level of trade. *See* R. pp. 318-322; Hr'g Tr. 283:16-287:6.

Moreover, the Department's interpretation of Regulation 117-309.17 is consistent with the South Carolina Supreme Court's decision in *Colonial Stores, Inc. v. South Carolina Tax Commission*, 253 S.C. 14, 168 S.E.2d 774 (1969).[16] In *Colonial Stores*, the Court observed that 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." The Court thus recognized that when a taxpayer purchases an item for resale and then – instead of reselling it – it is the FMV of the item that is subject to tax and not what the taxpayer paid to purchase the item.

The Department has consistently applied its interpretation of Regulation 117-309.17 to transactions like the transactions at issue in this case. *See* R. pp. 283-287, 393-394; Hr'g Tr. (Day 1) 248:21-249:4, 250:5-23, 251:21-252:1; (Day 2) 92:21-93:8. "The construction of a statute by the agency charged with its administration will be accorded the most respectful consideration and will not be overruled absent compelling reasons." *Brown v. S.C. Dep't of Health & Envtl. Control*, 348 S.C. 507, 515, 560 S.E.2d 410, 414 (2002)(quoting *Dunton v. S.C. Bd. Of Examin'rs in Optometry*, 291 S.C. 221, 223, 353 S.E.2d 132, 133 (1987)); *see also Nucor Steel v. S.C. Pub. Serv. Comm'n*, 310 S.C. 539, 543, 426 S.E.2d 319, 321 (1992) (recognizing that where an agency is charged with the execution of a statute, the agency's interpretation should not be overruled without cogent reason).

In addition, the Department's interpretation and application of Regulation 117-309.17 is consistent with general valuation principles. Dr. van Bulck testified regarding the levels of trade and how that is relevant when determining how FMV is defined in certain situations. (R. pp. 318-319; Hr'g Tr. 283:16-284:6.) Dr. van Bulck also testified regarding the concept of inventory at rest versus inventory that is moving. He testified that the valuation of inventory depends on the purpose for

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[16] 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.

which it is valued. (R. pp. 319-320; Hr'g Tr. 284:19-285:8.) Thus, when determining the FMV of materials withdrawn, used, or consumed by Lowe's in the installed sales at issue, the retail level of trade should be considered, and the rationale for using the retail level of trade is straightforward:

> Because all transactions that involve installed items at Lowe's go through the store. Whether it's the physical store, their parking lot, or whether it's the virtual store on the internet, all transactions go through their store. All the services that Lowe's renders, and they're listed on the chart, that add value to the products, which includes convenience, location, opening hours, display of products, collection, assortment, education of customers, all of these things that Lowe's admits are prerequisites for their existence and are necessary for them to be able to compete in this marketplace, they attach to that product. They can't unattach them. So, when the customer, whether there's a customer that is just a consumer like myself or an installer who buys at Lowe's, all of those services become part of the value of the product and that is the retail market.

(R. pp. 320-321; Hr'g Tr. 285:15-286:16.)

Lowe's is a retailer, and the simple fact is that "all of the contracts are initiated at the retail level." (R. p. 321; Hr'g Tr. 286:22-24.) It is inappropriate to value the materials at the wholesale level of trade (i.e., a retailer-to-retailer sale of inventory). As stated earlier, Lowe's initial purchase of the materials is a wholesale sale; thus, no sales tax is due upon this transaction. In the second transaction, Lowe's withdraws, uses, or consumes the material – a retail sale per § 12-36-110(1)(c) – and Lowe's must pay sales tax on the gross proceeds of sales as measured by the price at which these materials are offered for sale by Lowe's. Lowe's simply cannot measure the tax due upon the second transaction on the value of the materials under the first (or initial) transaction. Each transaction stands on its own. The materials are withdrawn, used, or consumed by Lowe's because a customer initiates an installed sales transaction with Lowe's. "T]he moment the customer walks in the store and buys the item or contracts for the items, all the value that Lowe's renders, as a retailer, has attached to that product . . . . **In other words, the customer comes through the front door, the customer does not go through the back loading dock, figuratively speaking.**" (R. p. 323; Hr'g Tr. 288:8-19)

(emphasis added). That is the ultimate purpose of Lowe's – to facilitate the retail sale of materials to a customer coming through the front door.

Simply put, Regulation 117-309.17 applies in this case, and the Department's interpretation of Regulation 117-309.17 is reasonable as "the price at which these materials are offered for sale by the person withdrawing them" is based precisely upon Lowe's customer walking in and purchasing the materials at the price Lowe's has advertised such materials. *See Home Medical Systems, Inc.*, 382 S.C. at 565, 677 S.E.2d at 587 (*citing Drummond*, 378 S.C. at 370, 662 S.E.2d at 591 (stating the fact that "another definition exists does not mean the ALC is empowered to invalidate an otherwise proper regulatory definition."); *cf. Goodman*, 318 S.C. at 490, 458 S.E.2d at 532) (stating that unless a regulation improperly alters or adds to a statute, a court may not invalidate it)). Thus, to the extent the Court determines the withdrawal, use, or consumption of the materials used in both the stock and SOS installed sales transaction at issue are retail sales subject to sales tax pursuant to section 12-36-110(1)(c), the gross proceeds of sales for the stock and SOS installed sales transactions must be valued at the fair market value of the materials as measured by the price at which these materials are sold by Lowe's as part of the installation contracts.

III. The ALC correctly determined that Lowe's equal protection claim must fail because, as a retailer, Lowe's is treated the same as similarly-situated taxpayers in South Carolina.

On appeal, Lowe's challenges the Department Determination by arguing that it is not afforded equal protection of the laws because the Department is treating it differently from other contractors. The irony of Lowe's arguments, particularly its equal protection argument cannot be ignored. It is ironic the company that advertises to the public that it is where "the pros go" and proudly states that professional contractors buy their supplies from Lowe's, is not complaining that it is being treated unfairly by being asked to pay the exact same amount of tax it charges its professional contractor customers when they buy supplies from Lowe's. In reality, while Lowe's complains they are being

treated differently than other contractors, their real discontent is based on the fact they are being treated exactly the same way every contractor that shows at Lowe's is being treated. If Lowe's were to sell the materials used in installation contracts to all customers and contractors at the wholesale price it claims to apply to it, there would be no tax, interest, or penalties at issue in this matter. Lowe's does not do that, and the fact that Lowe's will not do that evidences the fact they are not being treated unfairly, rather they do not want to be treated the same as their customers.

The Department, in its application of § 12-36-110(1)(c), is not treating Lowe's any differently than similarly-situated taxpayers. Further, the ALC correctly concluded that Lowe's is not acting as a contractor in the transactions as issues; thus, any argument that it received disparate treatment than other similarly situated contractors is both meritless and moot. The Department has consistently interpreted and applied the relevant sales tax statutes and regulations to South Carolina taxpayers the same way it applied the statutes and regulations to Lowe's. On the other hand, Lowe's interpretation of the relevant statutes and regulations permits it to be treated unlike any other contractor or retailer in South Carolina to the benefit of Lowe's. This cannot be an equal protection violation. Lowe's interpretation is absurd and contrary to the plain meaning of the regulations and statutory scheme, and could not have been intended by the General assembly.

A. The Department, following South Carolina law, treats Lowe's the same as similarly situated taxpayers.

Pursuant to the South Carolina Constitution, "no 'person shall be denied the equal protection of the laws.'" *Bodman v. State*, 403 S.C. 60, 69, 742 S.E.2d 363, 367 (2013) (citing S.C. Const. art. I, § 3). For an equal protection claim to stand, it is necessary for the party to show "that similarly situated persons received disparate treatment." *Bodman*, 403 S.C. at 69, 742 S.E.2d at 367. Moreover, "[a] crucial step in the analysis of any equal protection clause is the identification of the pertinent class. . . ." *Id.* (quoting *Sloan v. Bd. of Physical Therapy Exam'rs*, 370 S.C. 452, 481, 636 S.E.2d 598, 613 (2006).

Simply put, equal protection does not require that all taxpayers be treated the same; rather, only similarly situated taxpayers be treated the same.

Here, the Department is not treating Lowe's differently than other similarly situated taxpayers. *See* R. p. 393; Hr'g Tr. (Day 2) 92:14-93:8.[17] Rather, South Carolina law treats retailers who also provide contracting services differently from contractors "because they are different types of taxpayers." (R. p. 74; Hr'g Tr. 39:12-13.) South Carolina law requires a retailer who also provides contracting services to purchase at wholesale and subsequently pay sales tax based upon either the resale of the materials or the retailer's withdrawal of the materials. *See* S.C. Code Ann. §§ 12-36-110(1)(c), 12-36-120(1), and S.C. Code Ann. Reg. 117-309.17; *see also* R. p. 285; Hr'g Tr. 250:5-23 (Department witness testifying that she performed an audit examination of a retailer that also operated as a contractor, specifically a retail carpet store that also installed carpet; that the carpet store sold carpet at retail and subsequently installed such carpet, and that the carpet store was required to pay sales tax to the Department based upon the retail price of the carpet sold to its customers even when the carpet store also installed the carpet.)

Conversely, South Carolina law deems <u>every</u> purchase a contractor makes to be a retail sale (i.e., vendor required to pay tax at the time of purchase). S.C. Code Ann. § 12-36-110(1)(a). Stated differently, a contractor in South Carolina can <u>never</u> purchase materials at wholesale because contractors are the end consumer. South Carolina law makes the distinction of the different tax bases between retailers who also provide contracting services and contractors "because they're different entities." (R. p. 155;Hr'g Tr. 120:9-10.)

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[17]A Department witness testified that the Department has applied its interpretation of § 12-36-110(1)(c) to other retailers who also provide contracting services. (R. p. 393; Hr'g Tr. (Day 2) 92:17-93.) However, due to disclosure issues, the witness "can't name any particular one." (R. p. 394; Hr'g Tr. 93:6-7.) *See* S.C. Code Ann. § 12-54-240(A) (2014) (prohibiting the Department from "divulg[ing] or mak[ing] known in any manner any particulars set forth or disclosed in any report or return required" to be filed unless permitted by "proper judicial order.").

On appeal, Lowe's cites to S.C. Code Ann. Reg. §§ 117-314, 117-314.1, and 117-314.2 for the proposition that its purchase of materials to be used in the installation contracts are retail sales. Lowe's further asserts that the Department divides "South Carolina contractors into two arbitrary categories" and "seeks to impose different tax burdens on the two groups for engaging in the exact same activity." (Appellant's Br., p. 47.) However, Lowe's argument conveniently fails to acknowledge § 12-36-110(1)(c), S.C. Code Ann. Regs. § 117-324 "Dual Business", and its use of a Resale Certificate when purchasing all of its inventory, including materials used in the installation contracts.

Moreover, Lowe's treats itself differently than other home improvement contractors because Lowe's does not offer wholesale pricing for its contractor customers. *See* R. p. 147; Hr'g Tr. 112:13-18 (Lowe's witness testifying that carpet installers (i.e., home improvement contractor) are charged sales tax by Lowe's upon the retail purchase of carpet from Lowe's); R. pp. 90-91; Hr'g Tr. 55:23-56:19 (Lowe's witness testifying that Lowe's competitors are home improvement contractors like carpet or tile installers); *see also* Home Depot U.S.A., Inc., d/b/a The Home Depot v. S.C. Dep't of Rev., Docket No. 15-ALJ-17-0253-CC (J. Anderson, Mar. 12, 2018) (concluding Home Depot acted as a retailer when it purchased materials for use in installation contracts), appealed docketed at Appellate Case No. 2018-000631, Order of Dismissal, Aug. 29, 2018. Accordingly, the Department, in its application of section 12-36-110(1)(c), is not treating Lowe's any differently than similarly-situated taxpayers, and Lowe's equal protection rights in this matter have not been violated.

B. Lowe's application of § 12-36-110(1)(c) gives itself a competitive advantage over other contractors in South Carolina.

Lowe's next argues that it is at a competitive disadvantage with home improvement contractors in South Carolina. The Department disagrees. Because Lowe's is a large retailer, it has the ability to purchase large quantities of materials at reduced wholesale prices. (R. p. 145; Hr'g Tr. 110:3-6 (Lowe's acknowledging that as a national retailer, it receives discounts from vendors based on the volume of items that it purchases.) As noted by Dr. van Bulck, home improvement contractors

are generally small operators in South Carolina and therefore do not have the "economies of scale advantage that Lowe's has as a retailer." (R. pp. 354-355; Hr'g Tr. 319:15-320:6.) In fact, "Lowe's has an enormous economic advantage as a retailer because they can engage in large acquisition contracts that the small contractors simply can't. Small contractors, small installers, buy typically at retail outlets, such as Lowe's and maybe other providers . . . ." *Id.*

Furthermore, when a home improvement contractor purchases materials from Lowe's, it must pay sales tax on the marked up retail price (approximately 40%) of the materials. (R. p. 355; Hr'g Tr. 320:9-15.) The home improvement contractor must also charge for labor in order to make a profit, which results in a higher price charged to the home improvement contractor's customers. In reality, Lowe's generally holds a significant competitive advantage over the home improvement contractors.

Finally, Lowe's cites to *Allegheny Pittsburgh Coal Co. v. County Commission of Webster County, West Virginia*, 488 U.S. 336, 345, 109, S.Ct. 633, 639, 102 L.Ed.2d 688 (1989) and *In the Matter of the Sales Tax and Use Tax Protest of Lowe's Home Centers, LLC a/k/a Lowe's Homes Centers, Inc.*, Okla. Tax Commission Order, Case No. P-09-195-H, p. 45-50 (Feb. 26, 2015)[18] to support its argument that the Department "chose to arbitrarily impose a materially greater tax burden on Lowe's than is imposed on all other contractors doing the same work. (Appellant's Br. pp. 48-49.) This is entirely unfounded for a variety of reasons discussed *supra*: (1) the Department is not treating Lowe's differently than other similarly situated taxpayers (*see* R. pp. 393-394; Hr'g Tr. (Day 2) 92:14-93:8); (2) South Carolina law (i.e., the General Assembly) treats retailers who also provide contracting services differently from contractors "because they are different types of taxpayers" (*see* R. pp. 74, 154; Hr'g Tr. 39:12-13; Hr'g Tr. 119:4-19); and (3) Lowe's position allows it to hold a significant competitive advantage over all other home improvement contractors.

[18] The Department's Motion to Strike objects to the inclusion of the Oklahoma Findings and any argument related to "Attachment 1" as described in Lowe's initial appellate brief.

Accordingly, the Department, in its application of § 12-36-110(1)(c), is not treating Lowe's any differently than similarly-situated taxpayers, and the Department respectfully requests the Court to affirm the ALC's determination that Lowe's equal protection rights in this matter have not been violated.

CONCLUSION

For the reasons explained more fully above, this Court should affirm the ALC's decision. The substantial evidence in the record supports the ALC's decision, and the ALC did not make any errors of law that affected the decision.

Respectfully Submitted,

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Columbia, South Carolina
June 29, 2021

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THE STATE OF SOUTH CAROLINA

In the Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

S. Phillip Lenski, Administrative Law Judge

Case No. 2014-ALJ-17-0552-CC

Appellate Case No. 2021-000031

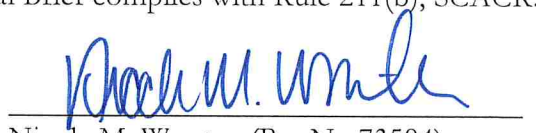
Lowe's Home Centers, LLC ..... Appellant,

v.

South Carolina Department of Revenue ..... Respondent.

CERTIFICATE OF COUNSEL

The undersigned certifies that the Final Brief complies with Rule 211(b), SCACR.



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