

**STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT**

Lowe's Home Center, LLC,

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

Petitioner,

FINAL ORDER

vs.

South Carolina Department of Revenue,

Respondent.

RECEIVED

Jan 08 2021

SC Court of Appeals

APPEARANCES:

For Petitioner: Kendrick Smith, Esquire
John M. Allan, Esquire

For Respondent: Nicole M. Wooten, Esquire
William Condon, Esquire

STATEMENT OF THE CASE

This matter comes before the South Carolina Administrative Law Court (ALC or court) following Lowe's Home Centers, LLC's¹ (Lowe's or Petitioner) request for a contested case hearing pursuant to S.C. Code Ann. § 12-60-460 (2014). Lowe's contests the October 24, 2014 Final Determination of the South Carolina Department of Revenue (Department or Respondent) assessing Petitioner for South Carolina sales tax, interest, and penalties² for the period of August 1, 2008 through July 31, 2011 (Audit Period).

The Petitioner asserts that during the Audit Period, while serving as the prime contractor on installation contracts to perform real property improvements to customers' homes in South

¹ Lowe's Home Centers, Inc., converted to Lowe's Home Centers, LLC, effective November 1, 2013. Lowe's Home Centers, Inc., was the taxpayer during the tax period at issue in this appeal. For all purposes, Lowe's Home Centers, LLC, is the successor in interest to Lowe's Home Centers, Inc.

² The assessment included \$2,206,054.28 in tax, \$360,580.69 in interest, and \$290,593.25 in penalties for a total of \$2,857,228.32 (with interest and penalties accrued through October 31, 2014).

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Carolina, Lowe's was the final user and consumer of the tangible personal property utilized to complete the real property improvements. As such, like other contractors engaged in the home improvement business in South Carolina, Lowe's contends that it only owes sales and/or use tax on the gross proceeds it paid to its suppliers to procure the materials used in the installation contracts. The customers who purchased and received the real property improvements pursuant to the installation contracts were not charged the customary sales tax on these installation contract transactions.

Conversely, in its original assessment and Final Determination, the Department took the position that Lowe's was not a "true contractor" in an installation contract transaction and opined that an installation contract was merely the sale of materials by Lowe's, as a retailer, to its customer who also purchased the ancillary installment of the materials to be performed by a third-party contractor.³ Applying this theory for sales tax purposes, the Department originally determined that the triggering taxable event was the retail sale of the installation contract materials to the customer. However, subsequently, at the hearing and in filings with the court, the Department offered conflicting testimony and theorized that the triggering event for sales tax purposes was not the retail sale of materials to the installation contract customer but was, instead, the withdrawal, use, or consumption of the materials by Lowe's during the installation portion of the contract. Therefore, the Department's ultimate argument was that the withdrawal or use of the materials by Lowe's during the installation was a "deemed sale" of the materials by Lowe's to itself so, as the final user and consumer of the materials, Lowe's should be required to pay sales tax on the materials at the time it withdrew, used, or consumed them.⁴ Further relying on this theory, the Department determined the gross proceeds of these deemed retail sales should be based upon the fair market value of the materials as measured by the price that Lowe's offered the items for sale to installation contract customers. Accordingly, the Department found that Lowe's underpaid tax on the materials used in the installation contracts during the Audit Period and assessed Lowe's for additional sales tax on a forty (40) percent markup that, presumably, would have been Petitioner's retail margin had it sold the materials directly to customers outside of the installation contract. In

³ See Tr. 191; Joint Ex. 32, Final Determination at 5.

⁴ Because the "deemed sale" by way of the withdrawal, use, or consumption of the materials by Lowe's is the theory of the case the Department argued before the court, the court will, heretofore, rely on that theory when discussing Respondent's arguments and the Department's Determination in this Order.

addition to the underpaid taxes, the assessment also includes the interest accrued during the Audit Period and penalties.⁵

FINDINGS OF FACT

Having personal and subject matter jurisdiction over this contested case, the court held a hearing in this matter on April 20, 2016 after proper notice to the parties. To allow the parties to complete testimony, the court reconvened the hearing on June 7, 2016. After careful consideration of all testimony, exhibits,⁶ and arguments presented at the hearing of this case, and taking into account the credibility and accuracy of the evidence, this court makes the following findings of fact by a preponderance of the evidence.

Lowe's Operations and Practices

Lowe's is a national home improvement retail chain currently operating in all fifty states as a limited liability company organized under the laws of the State of North Carolina. As a retailer, Lowe's offers a complete line of home improvement products and, during the Audit Period, operated approximately forty (40) retail stores in South Carolina.⁷ Lowe's participates in two categories of business: the traditional retail sale and installation contract services.

Traditional Retail Sales. The majority of the Petitioner's business is derived from traditional retail sales of home improvement materials wherein a customer enters the store, selects an item from existing inventory on the shelf, proceeds to the cash register, and pays for the item. In these transactions, known as traditional retail sales of tangible personal property,⁸ Lowe's adds a tax calculation at the point of sale and charges the customer sales tax. Whether the customer then leaves the store with the purchased materials, schedules a later pick up, or has the materials

⁵ The Department determined negligence penalties were appropriate in this matter based upon Petitioner's disregard of a regulation previously addressed by the Department in a prior audit of Petitioner involving the same issue. See discussion *infra*, pp. 16.

⁶ Joint Exhibits 1-10 and 13-63 were admitted, without objection, prior to the presentation of testimony. During the presentation of testimony on April 20, 2016, the court admitted Joint Exhibits 11 and 64 and admitted the Respondent's Exhibits 1 and 2 during testimony on June 7, 2016.

⁷ During the Audit Period, Lowe's did not own or operate a regional distribution center in South Carolina.

⁸ The South Carolina Sales and Use Tax Act defines tangible personal property as personal property that can be seen, weighed, measured, felt, touched, or perceptible to the senses in any other manner. See S.C. Code Ann. § 12-36-60 (2014).

delivered, title to the tangible personal property transfers to the customer upon the retail sale. The sales tax, which is calculated based upon the retail or selling price of the materials, is collected from the customer during the sales transaction and remitted to the Department by Lowe's.

Installation Contract Services. Beginning in the mid-1990's, Lowe's began offering home improvement installation contract services to customers as a second line of business. Competitors in this service market include other large home improvement stores, such as Home Depot, as well as smaller contractors. Installation contract services can range from the simple purchase and installation of a kitchen appliance to much more involved and complex projects like the installation of new flooring, windows, roofing, or the complete remodel of a kitchen, bathroom, or other room.

An installation contract with the Petitioner is typically formed when an in-store sales associate helps a customer select home improvement materials for purchase and the customer opts to utilize the contracting services offered by Lowe's to install the materials and effectuate the home improvement. Considering itself the primary contractor throughout the installation contract transaction, for a "detail fee," Lowe's engages a third-party subcontractor to take detailed measurements of the customer's home in order to prepare an estimate of the expected labor costs and other items needed for the installation.⁹ Combining the cost of the labor and secondary materials quoted by the third-party subcontractor to perform the installation with the price of the improvement materials selected by the customer, Lowe's contacts the customer to quote the overall price for the project and requests that the customer return to the store. A sales associate prepares a written installation contract¹⁰ that separately identifies the labor and material costs which the parties then review and execute. Before leaving the store, the customer brings the executed contract to the checkout counter and pays the entire balance of the installation contract. Upon satisfactory completion of the installation, the customer signs a Certificate of Completion. Although the third-party subcontractor actually performs the installation, Lowe's asserts it is responsible for obtaining any and all licenses and building permits legally required for the home improvement project.

⁹ While Lowe's contracts with third-party installers to provide the services agreed to in installation contracts, the third-party installers are not employed by Lowe's and the materials used in the installation contracts are sold to the customer as part of the contract, not the third-party installer. Further, the third-party installer does not receive the entire labor fee charged as part of the installation contract.

¹⁰ Nationwide, Lowe's utilizes a standardized form as its written installation service contract.

Significantly, Lowe's only provides installation services as an option accompanying a purchase from Lowe's. Imbedded within the overall cost of the installation contract is the regular retail price of the materials to be installed and those materials must be fully paid for prior to the commencement of the installation. Lowe's does not offer contracting services outside of those encapsulated in the installation contracts and the installation contracts at issue are not offered without the customer's simultaneous purchase of the home improvement items directly from Lowe's. In other words, Lowe's does not offer the option of unattached contracting services to its customers. Clearly, the overarching purpose of Petitioner's operations – including installation contract services – is to facilitate a retail sale to retail customers.¹¹ Moreover, traditional retail sales that do not include installation services constitute the vast majority of the company's sales.¹²

Materials Used in Installation Contracts

Lowe's classifies the materials purchased by customers for use in installation contracts as either "stock" or "special order." During the Audit Period, around 40% (forty) of the materials used in installation contracts came from stock. Lowe's special ordered the remaining 60% (sixty) of installation contract materials from its vendors to meet customers' specific needs. As a retailer, Lowe's purchased both types of materials from these vendors at wholesale (cost), free of sales tax, using its resale certificate.

Stock Materials. Stock materials can be sold through either a traditional retail sale or an installation contract sale where the material to be installed is simply withdrawn from existing Lowe's inventory. At the time of purchase from its suppliers and during the subsequent placement of the stock materials in various retail stores, Lowe's does not designate what stock material will later be purchased through a traditional retail sale or what stock material will be used as part of an installation contract. In a stock installation contract, stock materials are withdrawn from the Petitioner's existing inventory at either the Lowe's store where the customer signs the installation contract, a Lowe's retail distribution center, or another Lowe's retail store.

In a traditional retail sale, the customer pays the retail or shelf price for the material and the applicable sales tax on that retail price at checkout, and Lowe's then remits the sales tax to the

¹¹ See Ex. 22, p. 1; 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).").

¹² See Ex. 20, p. 7 (Installation contract sales accounted for approximately only 6% of total sales in fiscal year 2011.).

Department. However, when a customer selects stock materials for purchase as part of an installation contract, Lowe's charges the customer the same retail price for the materials but does not collect the sales tax from the customer. Rather, Lowe's simply remits a 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. Additionally, Lowe's remits this use tax to the Department at the time it withdraws or uses the materials in performing the installation, not at the time the materials were initially purchased at wholesale from the vendors or purchased by the customer when the entire contract price is paid.

Special Order Sales. Special order materials are not found in the existing inventory of Lowe's and must be ordered from a vendor to fit the specific needs of a particular customer. Unlike stock items, Lowe's does not purchase special order materials for resale and the items are never placed into any store inventory for traditional retail purchases. As with the purchase of stock materials, Lowe's purchases all special order materials from its vendors at wholesale, free of sales tax, using its resale certificate. And, like stock material, special order materials can be purchased through either a traditional retail sale or as part of an installation contract. When purchased through a traditional retail sale without the installation services, Lowe's collects sales tax from the customer based on the retail price of the special order materials. However, when the exact same special order material is sold as part of an installation contract, Lowe's does not collect sales tax from the customer and, instead, 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 customer.

Relevant Statutes and Regulations

In South Carolina, a "sales tax, equal to five percent of the gross proceeds of sales, is imposed upon every person engaged or continuing within this State in the business of selling tangible personal property at retail." S.C. Code Ann. § 12-36-910(A) (2014). Accompanying this is the use tax, which is "imposed on the storage, use, or other consumption in this State of tangible personal property purchased at retail for storage, use, or other consumption in this State, at the rate of five percent of the sales price of the property, regardless of whether the retailer is or is not engaged in business in this State." S.C. Code Ann. § 12-36-1310 (2014). An additional one percent tax is also applied to the sales and use tax pursuant to S.C. Code Ann. § 12-6-1110 (2014).

Retail Sale Statute. A “retail sale mean[s] all sales of tangible personal property except those defined as wholesale sales.” S.C. Code Ann. § 12-36-110 (2014). Retail sales include, in relevant part,

- (a) sales of building materials to construction contractors, builders, or landowners for resale or use in the form of real estate;
- (c) the withdrawal, use, or consumption of tangible personal property by anyone who purchases it at wholesale;
- (e) sales to contractors for use in the performance of construction contracts.

Id. The South Carolina Sales and Use Tax Act defines tangible personal property as personal property that can be seen, weighed, measured, felt, touched, or perceptible to the senses in any other manner. *See* S.C. Code Ann. § 12-36-60 (2014). Further, in South Carolina, the purchaser of tangible personal property is not legally liable for the payment of sales tax; rather, the retailer is considered responsible but can choose to pass such sales tax on to the purchaser. Thus, a retail license issued by the Department allows a taxpayer to sell tangible personal property at retail to the end consumer and to collect the sales tax from that consumer to remit to the Department.

Gross Proceeds Statute. The sales tax on a taxable retail sale is measured by the gross proceeds of sales. Gross proceeds is defined as “the value proceeding or accruing from the sale, lease, or rental of tangible personal property.” S.C. Code Ann. § 12-36-90(1)(b) & (c) (2014); *see also* S.C. Code Regs. Ann. 117-318 (providing “[g]ross proceeds of sales’ is the basis for calculating the sales tax”). For the purpose of calculating tax, gross proceeds of sales is based upon the “sales price” of the tangible personal property sold. *See* S.C. Code Regs. Ann. 117-318. Additionally, of import in this matter, “[i]t is presumed that all gross proceeds are subject to the tax until the contrary is established,” and “[t]he burden of proof that the sale of tangible personal property is not a sale at retail is on the seller.” S.C. Code Ann. § 12-36-950 (2014).

Wholesale. On the other hand, sales tax is not assessed for wholesale sales, which are discounted sales (at cost) of “tangible personal property to licensed retail merchants, jobbers, dealers, or wholesalers for resale, and do not include sales to users or consumers not for resale.” S.C. Code Ann. § 12-36-120 (2014); *see 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.”).

Resale Certificate. While a Department-issued retail license allows a taxpayer to sell tangible personal property at retail to the end consumer and to collect and remit sales tax to the

Department, a resale certificate provides a taxpayer with the advantage of purchasing merchandise at wholesale, free of tax, because the taxpayer certifies he will resell the items to an end user and collect the sales tax. Only a taxpayer engaged in the business of selling tangible personal property can obtain a resale certificate and the taxpayer completes the certificate by writing his retail license number on it. In addition, a resale certificate can be extended by a taxpayer to other retailers or other wholesalers. During the Audit Period, Lowe's extended its resale certificate to each vendor for the purchase of materials used in the installation contracts and, as such, purchased those materials at the advantageous wholesale price and free of tax.

Retailer vs. Contractor. In identifying the types of transactions subject to sales tax, the Department considers the imposition statute (§ 12-36-910), the statutes defining tangible personal property (§ 12-36-60), wholesale sales (§ 12-36-120), and sales at retail (§ 12-36-110), and the nature of the transaction itself in order to determine what constitutes the taxable retail sale. Thus, in determining when and how sales or use tax should be assessed, it is important to ascertain not only the type of sale – retail or wholesale – but also the identity of the party involved in the sale – a retailer versus a contractor. Crucially, the sales and use tax regulations provide further guidance about how these taxes are to be applied based on the classification of the taxpayer as either a retailer or contractor.

Retailer

South Carolina law defines a “retailer” 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 is a licensed retailer in South Carolina and holds a resale certificate used to purchase materials at wholesale from its suppliers. At the beginning of the Audit Period, Lowe's operated forty (40) stores in South Carolina and, at the close of the Audit Period, operated forty-two (42) stores in the state. Lowe's advertises to be the “world's second largest home improvement retailer”¹³ and operates approximately 1,700 home improvement stores that each average approximately 112,000 square feet of retail selling space.¹⁴ A typical store stocks between 40,000 and 60,000 items with an additional three to six million items available through the Lowe's

¹³ See Ex. 20, p. 4-5; Ex. 21, p. 1,8,13; Ex. 23, p. 1, 2; Ex. 26.

¹⁴ Ex. 22, p. 2; Ex. 23, p.1.

Special Order Sales system.¹⁵ The overwhelming majority of the Petitioner's sales (approximately 96 percent)¹⁶ are traditional retail sales that do not include installation services. Moreover, when Lowe's provides installation contracting services to customers, it only does so with the customers' simultaneous purchase of the materials to be installed. Collectively, the evidence and testimony presented support the court's factual finding that Petitioner falls within the definition of a retailer under the laws of South Carolina.

The Dual Business Regulation. Regulation 117-324 of the South Carolina Code of Regulations provides guidance for taxpayers who have a substantial retail business, but also withdraw or use materials from the same stock of goods. The Dual Business Regulation provides:

Operators of businesses who are both making retail sales and withdrawing for use from the same stock of goods are to purchase at wholesale all of the goods so sold or used and report both retail sales and withdrawals for use under the sales tax law.

This ruling applies only to those who actually carry on a retail business having a substantial number of retail sales and does not apply to contractors, plumbers, repairmen, and others who make isolated or accommodating sales and who have not set themselves up as being engaged in selling. Where only isolated sales are made, tax should be paid on all of the taxable property purchased with no sales tax return being required of the seller making such isolated or "accommodation" sales.

S.C. Code Regs. Ann. 117-324 (2012) (emphasis added). The Dual Business Regulation makes clear that the rule does not apply to contractors or others who might make occasional retail sales or, by implication, those who are not substantially engaged in retail sales. Instead, Regulation 117-324 applies to retailers and instructs them to purchase all goods to be sold at wholesale, without tax, and to report the retail sales of those goods. Importantly, the Dual Business Regulation further instructs these retailers, who may also happen to "withdra[w] for use from the same stock of goods," to additionally report such withdrawals for use under the sales tax law. *Id.*

Contractor

Although Title 12 of the South Carolina Code does not provide a definition of the term "contractor," the accompanying sales and use tax regulations define a "contractor" as "any person, firm, association or corporation making repairs, or additions to real property." S.C. Code Regs. Ann. 117-314.2 (2012). Further, Title 40 governing professions and occupations in South Carolina

¹⁵ Tr. 34:8-11; Ex. 22, p. 2; Ex. 23, p. 1.

¹⁶ See Ex. 20, p. 7.

defines a “contractor” as “a general or mechanical contractor regulated under this chapter.” S.C. Code Ann. § 40-11-20(4) (2011). Specifically, a “general contractor” is defined as “an entity which performs or supervises, or offers to perform or supervise, general construction” and a “mechanical contractor” is “an entity which performs or supervises, or offers to perform or supervise, mechanical construction.” S.C. Code Ann. § 40-11-20(8), (9) (2011). Recognizing the definitions provided in Title 40 are outside of Title 12’s statutory scheme, such definitions provide guidance and are not in conflict with the definition of “contractor” found in Regulation 117-314.2 of the South Carolina Code of Regulations (2012). *Cf. City of Camden v. Fairfield Elec. Co-op., Inc.*, 372 S.C. 543, 548, 643 S.E.2d 687, 690 (2007) (holding that when the term “premises” was not defined in the applicable title, the circuit court properly applied the definition provided in another title of the code).

By contracting with customers to install home improvements, including repairs and additions to real property, Lowe’s qualifies as a contractor under Regulation 117-314.2. Pursuant to Title 40, the supervision of third-party installers or subcontractors during construction projects predicated upon the installation contracts at issue also qualifies Lowe’s as a contractor under the statutory definition. *See* § 40-11-20(4), (8), (9). Moreover, during at least part of the Audit Period, Lowe’s held a General Contractor license issued by the South Carolina Department of Labor, Licensing and Regulation (SCDLLR) and is held to the same standards as other contractors in South Carolina who hold these licenses. Accordingly, the court also finds ample evidence to support the factual finding that Lowe’s is a contractor under South Carolina law.

Regulation 117.314. In contrast to the Dual Business Regulation that applies to retailers, Regulation 117-314 discusses construction and the acquisition of materials by contractors in the context of sales and use tax law providing that “[s]ales of building materials to contractors, builders, or landowners for resale or use in the form of real estate are retail sales in whatever quantity sold.” S.C. Code Regs. Ann. 117-314 (2012). Regulations 117-314.1 and 117-314.2 further provide that sales of building materials to contractors or building materials for use in adding to, repairing, or altering real property are subject to sales or use tax at the time of purchase. S.C. Code Regs. Ann. 117-314.1 to 117-314.2 (2012). Thus, whereas a retailer can use a resale certificate to acquire materials at wholesale, free of tax, and later remit the sales or use tax owed upon the subsequent retail sale or withdrawal of the items for use, a contractor must pay retail price for materials and must pay sales tax on that retail price at the time of purchase.

Taxes Remitted During the Audit Period

During the Audit Period, Lowe's remitted use tax for the materials, both stock and special order, used in installation contracts based upon the wholesale cost it paid to vendors to acquire the materials, free of sales tax, by extending its resale certificate. The use tax Lowe's remitted to the Department was not paid at the time these materials were purchased from the vendors but was remitted at the time Lowe's withdrew or used the materials in the performance of the installation contracts.

Essentially, the Petitioner asserts it acts as a contractor, not retailer, in the installation contract transactions at issue. Relying on language found in the installation contracts stating that title to the materials remains with Lowe's until it is installed in the customer's home, Lowe's argues that the customer pays and leaves the store with no tangible personal property but, instead, possesses a contractual right to receive the future real property improvement. Lowe's also points out that it bears all risk should the improvement materials become damaged, lost, or destroyed or should the installation be performed incorrectly or in a substandard manner. Then, only upon completion of the project to the customer's satisfaction and the execution of the Certificate of Completion, Lowe's considers the materials to be converted from tangible personal property still titled to Lowe's to real property owned by the customer.

Dovetailing on the assertion that, as opposed to a retailer, the Petitioner acts a contractor performing real property improvements during installation contract transactions, Lowe's argues it engages in a "sale at retail" under subsection (c) of the Retail Sale Statute when it purchases the materials from its vendors for use in performing the installation contracts. *See* S.C. Code Ann. § 12-36-110(e) (retail sales include sales to contractors for use in the performance of construction contracts). Thus, classifying itself as a contractor and, therefore, the final user and consumer of the materials, Lowe's argues it owes tax on the gross proceeds it paid to vendors to procure the installed tangible personal property. And, by paying the use tax based upon what it paid to acquire the materials (wholesale cost) at the time those materials are withdrawn, used, or consumed in performing real property improvements for customers, Lowe's asserts compliance with the

requirements of the Dual Business Regulation governing retailers while simultaneously maintaining its status as a contractor under South Carolina law.¹⁷

Under another theory premised upon the materials becoming incorporated into real property upon completion of the installation, Lowe's alternatively argues that this incorporation into real property classifies the taxable transaction as a "sale at retail" of "building materials to [a] construction contractor[]" for "use in the form of real estate" under subsection (a) of the Retail Sales Statute. *See* S.C. Code Ann. § 12-36-110(a) (retail sales include sales of building materials to construction contractors, builders, or landowners for resale or use in the form of real estate). Then, under this alternative sale at retail theory provided by subsection (a), the Petitioner argues that according to the terms of the Gross Proceeds Statute, the sales tax due on this purported sale at retail would be "the proceeds from the sale of tangible personal property" by the supplier to Lowe's, which still involves the lesser wholesale price. *See* S.C. Code Ann. § 12-36-90(b) (defining when sales or use tax is to be applied when triggered by a "sale at retail").

Lumping both theories together, Lowe's contends that all of its purchases of materials used in installation contracts, whether stock or special order,¹⁸ fit within the Retail Sale Statute at either section (a), encompassing the sale of building materials to construction contractors for resale or use in the form of real estate, or section (e), addressing sales to contractors for use in the performance of construction contracts. Under either section, the Petitioner argues the sales tax

¹⁷ Lowe's argues that while the Retail Sale Statute and Regulation § 117-314 provide that, ordinarily, a contractor shall pay sales tax on the amount paid to acquire tangible personal property (the retail price) at the time of acquisition, the Dual Business Regulation required Lowe's to purchase all tangible personal property, whether sold in a traditional retail sale or as part of an installation contract, at wholesale and without paying the sales tax upon acquisition. Instead, still maintaining it was acting as a contractor during installation contract transactions, Lowe's asserts it complied with the retailer's Dual Business Regulation by paying tax at the time the materials were later withdrawn, used, or consumed by Lowe's as a contractor during the installation portion contract. *See* S.C. Code Ann. Reg. 117-324.

¹⁸ With respect to special order installation contract transactions, Lowe's also argues that, as a matter of law, special order materials are only procured as needed and are not placed into inventory in order to facilitate the later withdrawal from inventory for use or consumption contemplated under subsection (c) of the Retail Sales Statute. Therefore, under Petitioner's theory, the sale of special order materials pursuant to an installation contract can only fit under either subsection (a) or (e), thereby rendering the Department's theory that these sales fall under subsection (c) as one contrary to the facts. *Compare* § 12-36-110(c) (a sale at retail includes the withdrawal, use, or consumption of tangible personal property by anyone who purchases it at wholesale) *with* § 12-36-110(a) (a retail sale includes the sale of building materials to construction contractors for use in the form of real property) *and* (e) (a retail sale includes sales of materials to contractors for use in the performance of construction contracts). *See also* discussion *infra*, Conclusions of Law, pp. 22-23.

would be based on the lesser amount Lowe's paid to acquire the materials and not on any figure associated with the later sale to a customer involving the greater retail price.

The Petitioner additionally argues the assessment results in an equal protection violation because the Department deliberately imposed a different tax burden on Lowe's, as a contractor, than it imposes on other construction contractors performing identical work in South Carolina. Alleging the Department's disparate tax treatment violates its constitutional right to equal protection,¹⁹ Lowe's argues the additional tax burden imposed by the assessment adversely impacts its ability to compete with other contractors for home improvement installation work in the state. Succinctly put, in calculating sales and use taxes, Lowe's argues that since it functions as a contractor during installation contract transactions, the Department must treat Petitioner just as it does any other contractor performing substantially similar transactions.

The Department's Interpretation, Audit, and Assessment

The Department's Interpretation. As discussed, "retailers" are defined as persons "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 maintains a retail license in South Carolina, operates retail stores in South Carolina, advertises itself as a retailer, and is in the business of selling tangible personal property. While Lowe's asserts it acts as a contractor during the installation contract transactions at issue, it is the Department's position that Lowe's functions as a retailer in these transactions. The Department points out that although the Petitioner, as a retailer, can hold a contractor's license, for sales tax purposes, Lowe's cannot act as both a retailer and contractor in the same transaction. Further, as a retailer who purchases materials for resale, Lowe's can purchase those materials at the lower wholesale cost utilizing its resale certificate. In contrast, the Department argues a contractor cannot sell at retail and, therefore, is required to purchase all materials at the higher retail price and must pay sales tax based on that higher price at the time of purchase.

To identify transactions that are subject to sales tax, the Department considers the imposition statute (§ 12-36-910), the statutes defining tangible personal property (§ 12-36-60), wholesale sales (§ 12-36-120), and sales at retail (§ 12-36-110), and the nature of the transaction

¹⁹ See U.S. Const. Amend. XIV; S.C. Const. Art. I, § 3; see also *Bodman v. State*, 403 S.C. 60, 69, 742 S.E.2d 363, 367 (2013) (citing S.C. Const. Art. I, § 3 stating that "no 'person shall be denied the equal protection of the laws'").

itself in order to determine what constitutes a taxable retail sale. Considering those factors with respect to the installation contract transactions at issue, the Department identified the taxable retail sale as the withdrawal, use, or consumption of the materials by Lowe's in the performance of the installation contracts under subsection (c) of the Retail Sale Statute. *See* S.C. Code Ann. § 12-36-110(c) (a retail sale includes the withdrawal, use, or consumption of tangible personal property by anyone who purchases it at wholesale). In essence, the withdrawal, use, or consumption of the materials by Lowe's during the performance of the installation contracts was identified by the Department as a "deemed sale" of the materials to Lowe's, itself, under subsection (c). The Department also concluded that in instances when materials must be procured from stock inventory in another state or special ordered from a vendor outside of South Carolina, a retail sale occurs when Lowe's uses the material in the performance of installation services in South Carolina and South Carolina sales tax applies.

Upon determining that these deemed retail sales fall under subsection (c) of the Retail Sale Statute, the Department looked to the Gross Proceeds Statute and Regulation 117-309.17 together to determine how to measure the sales tax due. *See* S.C. Code Ann. § 12-36-90 and S.C. Code Ann. Reg. 117-309.17 (2014). Specifically, the Department applied subsection (c) of the Gross Proceeds Statute and determined the sales tax due should be based upon the fair market value of the tangible personal property Lowe's previously purchased at wholesale and withdrew from its own business inventory or stock to use or consume in the performance of installation contracts. *See* § 12-36-90(1)(c). However, because "fair market value" as used in § 12-36-90(1)(c) is not defined in the Sales and Use Tax Act, the Department looked to Regulation 117-309.17, which addresses withdrawals of stock by merchants or retailers, to define "fair market value" in the context of installation contract transactions.²⁰ Regulation 117-309.17, which the Department interprets as applicable to all retailers, provides:

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.

²⁰ A witness for the Department testified that Regulation 117-309.17, entitled "Withdrawals from Stock, Merchants," would, for example, apply to a convenience store that purchases inventory to sell but, instead of a traditional retail sale to a customer, the owner of the store takes an item of inventory – like milk – for personal use. In such an example, the witness testified the withdrawal of the milk for the owner's use is a deemed sale, and the sales tax due is based upon what the convenience store would normally sell the item for to a customer in a traditional retail sale. *See* Tr. 21:6-17; *see also* Tr. 95:17-96:21 (applying the same interpretation to an office supply store).

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.

Id. Utilizing the definition of “value” found in Regulation 117-309.17, the Department determined the fair market value for the materials withdrawn, used, or consumed in the installation contracts to be the price at which the materials were offered for sale by Lowe’s. Further, the Department found it unnecessary to conduct an appraisal of items when applying Regulation 117-309.17 because, having been approved by the General Assembly, regulations in South Carolina have the full force and effect of the law. Thus, the Department determined that the General Assembly set the definition for “fair market value” as what the taxpayer normally sells the item for, allowing for all customary discounts, and, as such, assessed Lowe’s for the unpaid sales tax based upon the retail price at which the materials were offered for sale by Lowe’s as part of the installation contract transactions.

The Audit. As the lead auditor responsible for conducting the audit at issue, Paulette Crawford testified that she mailed an audit appointment letter and packet to inform Lowe’s of the Department’s intention to conduct an audit and to specify the location(s), types of tax, and time period being audited by the Department.²¹ Given the large volume of records to be reviewed as part of the audit examination, Lowe’s and the Department agreed to conduct an electronic audit and further agreed to review the transactions for April 2011 for half of the stores located in South Carolina during the Audit Period and to apply the findings from the month of April 2011 to the entire thirty-six (36) month Audit Period.

For the month of April 2011, the Department received approximately four million lines of data to review and broke the data into two categories: installation contract sale transactions and “other taxable sales.” Lowe’s did not contest the assessment with regard to other taxable sales and paid the total tax and interest due on that category of sales. The only matter before this court is the proper assessment of sales tax in the installation contract transactions.

²¹ Ms. Crawford has been employed as an auditor at the Department for twenty-eight years and primarily conducts sales and use tax audit examinations of various taxpayers, to include manufacturers, retailers, contractors, and hospitals.

As to the installation contract transactions, Lowe's provided documents reflecting its acquisition costs (wholesale) for the materials, the sales price of the materials to the customer, and the tax Lowe's paid to the Department on those materials. The Department determined that Lowe's paid use tax on the materials purchased through the installation contract transactions based upon its lower acquisition cost for those materials, rather than the sales price charged to the customer. Comparing Petitioner's acquisition cost of the materials to the retail prices paid by the customers, the Department determined Lowe's "marked up" the price of the materials by approximately 40% (forty).²²

Lowe's also provided the use tax remitted on the materials withdrawn and used in the installation contract transactions for each South Carolina store during each month of the Audit Period. After determining the applicable local tax rate, the Department then divided the use tax paid by Lowe's to the corresponding tax rate to determine the cost of the materials used in the installation contracts for each store during the Audit Period.²³ Adding the 40% markup to the cost of installation contract materials for each store during the Audit Period, the Department determined 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 materials were withdrawn from inventory and used in the installation contracts.

The Assessment. Upon completion of the audit and submission for supervisory review, Ms. Crawford mailed the Proposed Assessment to the Petitioner by letter dated September 24, 2012. Pursuant to State law, the Department added interest to the sales tax assessment.²⁴ Additionally, Ms. Crawford recommended that negligence penalties be applied in this instance due to Petitioner's alleged disregard of Regulation 117-309.17 that was previously addressed by Ms. Crawford in a prior audit with Lowe's involving the same issue.²⁵ The Proposed Assessment

²² Ms. Crawford conducted a prior audit (for the audit period of March 1, 2002 to February 28, 2005) of Lowe's for the same issue and determined in the prior audit the markup was approximately 42% (forty-two). Based upon her prior work and calculations, Ms. Crawford determined the 40% (forty) markup to be accurate in the instant matter.

²³ The state sales tax rate in South Carolina is six percent. However, some jurisdictions may add a local sales tax for various projects, which can increase the total sales tax depending upon the location of the retail store. The Department provided a detailed breakdown of the total tax, interest, and penalty due in each county.

²⁴ Section 12-54-25(A) of the South Carolina Code provides "[i]f any tax is not paid when due, interest is due on the unpaid portion from the time the tax was due until paid in its entirety." S.C. Code Ann. § 12-54-25(A) (2014).

²⁵ See Tr. 234:13-235:17; Tr. 213:1-23; Ex. 14.

determined that the total tax, interest, and penalties due in sales tax liability for installation contract transactions during the Audit Period to be \$2,650,061.41.²⁶

ISSUES

1. Did the Department properly assess Lowe's for additional sales and use tax on its installation contracts during the Audit Period?
2. Did the Department correctly determine the fair market value of the materials used in the installation contracts?
3. Does the Department's Determination violate the Equal Protection Clause?
4. Are the interest and penalties the Department included in that assessment for the Audit Period necessary and proper?

CONCLUSIONS OF LAW

Jurisdiction over this case is vested with the court pursuant to S.C. Code Ann. § 12-6-460 (2015), S.C. Code Ann. § 1-23-600 (Supp. 2015), and S.C. Code Ann. §§ 1-23-310 *et seq.* (2005 & Supp. 2015). In presiding over this contested case, the court serves as the finder of fact and makes a *de novo* determination regarding the matters at issue. *See Be Mi, Inc. v. S.C. Dep't of Revenue*, 408 S.C. 290, 297, 758 S.E.2d 737, 740 (Ct. App. 2014) ("In reaching a decision in a contested [] matter, the ALC serves as the sole finder of fact in the *de novo* contested case proceeding." (citation omitted)); *Brown v. S.C. Dep't of Health & Envtl. Control*, 348 S.C. 507, 512, 560 S.E.2d 410, 413 (2002) (explaining that a contested case before the ALC is "in the nature of a *de novo* hearing with the presentation of evidence and testimony"). The weight and credibility assigned to evidence presented at the hearing of a matter is within the province of the trier of fact. *See S.C. Cable Television Ass'n v. S. Bell Tel. & Tel. Co.*, 308 S.C. 216, 222, 417 S.E.2d 586, 589 (1992). The trier of fact may also give an expert's testimony the weight he or she determines it deserves, *Florence Cty. Dep't of Soc. Servs. v. Ward*, 310 S.C. 69, 425 S.E.2d 61 (Ct. App. 1992), and may accept the testimony of one expert over that of another. *S.C. Cable Television Ass'n, supra*.

²⁶ In comparison to Exhibits 3 and 9, it appears there is a typographical error in the transcript of the hearing regarding the total amount due. (Tr. 190:5-19).

The court must make its factual findings based on a preponderance of the evidence. S.C. Code Ann. § 1-23-600(A)(5) (Supp. 2014); *see also Anonymous (M-156-90) v. State Bd. of Med. Examiners*, 329 S.C. 371, 375-78, 496 S.E.2d 17, 19-20 (1998); *National Health Corp. v. Dep't of Health and Envtl. Control*, 298 S.C. 373, 379, 380 S.E.2d 841, 844 (Ct. App. 1989). Because Lowe's is challenging the Department's Determination that it is liable for sales tax on installation contract transactions, Lowe's has the burden of proof to show by a preponderance of the evidence that the Department was incorrect in its determination. *See Leventis v. Dep't of Health and Envtl. Control*, 340 S.C. 118, 132-33, 530 S.E.2d 643, 651 (Ct. App. 2000) (holding that, generally, the complaining party bears the burden of proof).

Sales and Use Tax on Installation Contracts

Having found that Lowe's is both a contractor and a retailer based on the evidence presented,²⁷ the court must determine in which capacity Lowe's functions during the installation contract transactions at issue. To make such a determination, it is necessary to identify the point during these transactions at which a retail sale the material to be installed occurs.

Lowe's argues that under the plain and unambiguous terms of the Contractor Statute, S.C. Code Ann. § 40-11-20, and according to the evidence presented, it was a "prime contractor" and "general contractor" engaging in "general construction" when installing real property improvements for customers under the terms of its installation contracts. Thus, as a contractor, Lowe's contends that all of its purchases of materials used in installation contracts, whether stock or special order purchases, fit neatly within the Retail Sale Statute of S.C. Code Ann. § 12-36-110 at either subsection (a), encompassing the sale of building materials to construction contractors for resale or use in the form of real estate, or subsection (e), addressing sales to contractors for use in the performance of construction contracts.

To buttress this position, Lowe's finds it significant that after review and execution of the installation contract, the customer proceeds to the checkout counter, pays the overall, combined price listed in the contract for the materials and labor costs, and then leaves the store without those materials but, instead, a contractual right to receive a future real property improvement in his or her home. In fact, characterizing these transactions as "substantially different" than typical retail

²⁷ See discussion *supra*, Findings of Fact, pp. 8-10.

transactions – where, upon payment for the materials, the customer takes title and possession of the tangible personal property before leaving the store – Lowe’s asserts that, under the terms and conditions of the installation contract, title to the material remains with Lowe’s until after it has been installed and incorporated into the home. Thus, Lowe’s argues that installation contracts are essentially just agreements to install materials, such that the customer’s purchase of those materials is simply subsumed into the contract for services. However, that argument does not comport with the true nature of the installation contract transactions at issue.

The court finds that the Petitioner’s characterization of installation contract materials as items purchased by a contractor at wholesale to be used in construction – as opposed to items purchased by a customer at retail to be installed – is not in line with the relevant statutory scheme of the Sales and Use Tax Act and, if applied as Lowe’s suggests, would lead to an absurd result not intended by the Legislature. Here, looking at the true nature of the installation contract transaction, the court finds that a retail sale occurs when the customer pays for the materials listed in the installation contract.

First, the sale of installation contract materials to a customer fits within the statutory description of a traditional retail sale. A “sale” is defined in pertinent part as “any transfer, exchange, or barter, conditional or otherwise, of tangible personal property for a consideration.” S.C. Code Ann. § 12-36-100 (2014). A “retail sale” generally “mean[s] all sales of tangible personal property except those defined as wholesale sales.” § 12-36-110. And, under the statutory scheme, a “retail sale” is consistently the sale to the final purchaser of the tangible personal property and that final purchaser is the entity taxed so as to avoid pyramiding taxes at each level of sale. The Court of Appeals identified this principle in *Hercules Contractors & Engineers, Inc. v. South Carolina Tax Commission* when it noted:

The rationale by which materials which improve real property are taxed while those which are used to manufacture personal property are not, is equally obvious. When real property is subsequently sold, no sales or use tax is collected, and thus, if the materials which went into the property were not taxed, the tax would be forever lost. On the other hand, when personal property is sold to the consumer, sales or use tax is collected. If the materials sold for use in manufacturing personal property were taxed, they would be taxed a second time when the property was ultimately sold. A purpose of the exemption at issue here is to avoid the pyramiding of taxes and thereby prevent the increase of sales price to the ultimate consumer.

280 S.C. 426, 434-35, 313 S.E.2d 300, 305-06 (Ct. App. 1984).

Keeping with the statutory definition and scheme, in a traditional retail sale at Lowe's the customer selects an item of tangible personal property offered for sale, brings the item to the cash register, and pays the retail sales price (consideration) for the item, including sales tax. Such a sale of tangible personal property is not "defined as [a] wholesale sale[]" since the customer pays the retail sales price. See § 12-36-110. Moreover, because the retail sale to the customer is considered the final sale of the tangible personal property, the customer is the entity taxed so as to avoid the pyramiding of taxes as addressed in *Hercules*.

In an installation contract transaction, like in a traditional retail sale, the customer selects the materials he wishes to purchase, even if specially ordered, from the tangible personal property offered for sale by Lowe's. Additionally, in keeping with the statutory definitions of "sale" and "retail sale," the customer pays for the materials at the cash register and pays the retail price for those materials, just as he would in a traditional retail sale. Although the installation contract customer may pay for the materials through payment of the entirety of the installation contract invoice, the price of each item is listed individually and separately from any labor costs on the invoice and, as in a traditional retail sales transaction, the customer is actually paying the retail price for each item individually, separate and apart from the fees and costs associated with the installation services.

Second, as previously discussed,²⁸ the offer of installation services by Lowe's is solely contingent upon the customer's purchase of the materials to be installed. The fact that the option of installation services is so strictly conditioned upon an underlying purchase reflects the Petitioner's primary objective in offering these ancillary services – to facilitate a retail sale to customers. Since there is no offer of installation services without the necessary purchase of the subject materials from Lowe's, it is illogical to conclude, as the Petitioner does, that the purchase of the materials is simply subsumed into the service portion of the installation contract where Lowe's functions as a contractor. Rather, the purchase of the materials is the primary, foundational transaction and the installation services are merely incidental and secondary in nature. Thus, the purchase of the materials by the customer is not only a retail sale by statutory definition, it is, tellingly, a retail sale upon which the installation contract is contingent. Moreover, because the retail sale is the primary transaction, it does not follow that the purchase of materials would be

²⁸ See *supra*, Findings of Fact, pp. 5.

subsumed into the service portion of the installation contract (during which Lowe's functions as a contractor) as the Petitioner argues. Instead, finding the purchase of the materials to be the crux of the transaction, it is only logical to conclude exactly the opposite – that the service portion of the contract is subsumed into the purchase of the materials (during which Lowe's functions as a retailer).

Third, continuing to assert the purchase of materials is subsumed into a sale for the service of installing those materials, Lowe's posits that installation contract transactions are "substantially different" than retail sales because, under the terms and conditions of the contract, title to the materials purchased remains with Lowe's until after the materials have been installed and incorporated into the customer's home. Of course, the materials that are the subject of the installation and the assessment are not simply supplies, such as nails and glue, that are incidentally used by a contractor to facilitate the installation. Rather, they are the specific materials selected by the 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. It is insignificant that the customer leaves Lowe's without the purchased materials in hand.²⁹ The service or labor portion of the installation contract simply reflects what the customer expects Lowe's, as a contractor, to do with the materials he or she has just purchased from Lowe's, the retailer.

Aside from the Petitioner's assertion that title to the material remains with Lowe's until after the installation is complete, there is no evidence to indicate that the installation contract customer leaving the store without items in hand does not obtain title to the materials at the point of sale, just as he would in a traditional purchase of the identical items without the additional installation service.³⁰ This notion is illustrated by the purchase of special order items in the context of both installation contract transactions and traditional retail sales. In both types of transactions, the customer pays full retail price for the items selected and leaves the store without physical

²⁹ In fact, in a traditional retail sale the customer may choose to have the items purchased either picked up or delivered at a later time or may special order the materials and can only take physical possession at a later date once the custom items have been produced.

³⁰ The Petitioner carries the burden of proof and offered no evidence that a customer might view the purchase of materials through an installation contract as anything other than a retail purchase. Additionally, lacking evidence to the contrary, the court can only presume that if an installation contract customer chose to cancel the service portion of the contract but wished to take possession of the materials he has already paid for, he could do so without Lowe's claiming title or ownership over the materials.

possession of that purchase since Lowe's has yet to procure the special order material from one of its suppliers on behalf of the customer. If the special order item is purchased through a traditional retail transaction, it is undisputed that a retail sale occurs upon the customer's payment for the item and, thereafter, the customer holds title to his purchase. It matters not that he leaves the store without physical possession of the item.

Likewise, in an installation contract transaction involving the sale of the very same special order item but with the additional purchase of installation services, it remains of no consequence that the customer leaves the store without the item he has just purchased in hand. Lowe's must still acquire the special order item specifically for that customer from one of its vendors in order to complete the service portion of the installation contract. As with the traditional sales transaction, the retail sale is the customer's purchase of the special order item from Lowe's, not the sale of the special order item to Lowe's from its vendor, as Lowe's argues. In both instances, the customer's exchange of consideration for the item is the retail purchase and the customer holds title to the property purchased. In fact, aside from the payment of sales tax, the sale of special order materials through either a traditional retail sale or pursuant to an installation contract is, for all relevant intents and purposes, essentially the same and the court finds no compelling reason to distinguish between the two in the context of sales and use tax.

Further, specifically addressing only special order installation contracts, Lowe's argues it should be treated as a contractor and not as a retailer since it does not purchase these materials with the intent to resell them.³¹ Unlike a retailer, a contractor must purchase all materials at retail because he has no intent to resell them. Lowe's admits to purchasing all stock materials at wholesale with the requisite intent to resell them in either a traditional retail sale or through an installation contract. According to Lowe's, the intent to resell stock material becomes evident when Lowe's places the items into inventory to be purchased by a customer. In contrast, when purchasing special order material, Lowe's argues it lacks the requisite intent to resell since special order items are purchased for a specific customer and are never placed into inventory to be resold. Therefore, according to Lowe's, because it lacks a retailer's intent to resell, it is acting only as a contractor when procuring special order materials. Furthermore, since special order items are

³¹ See § 12-36-120 (establishing that purchases at wholesale can only be made by licensed retail merchants, jobbers, dealers, or other wholesalers who have the intent to resell the items purchased).

never placed into inventory, Lowe's argues those items can never be withdrawn from inventory so as to be identified by the Department as a retail sale under subsection (c) of the Retail Sales Statute. *See* § 12-36-110(c) (defining a retail sale as the withdrawal, use, or consumption of tangible personal property by anyone who purchases it at wholesale). Unfortunately for the Petitioner, the arguments surrounding special order purchases are flawed for several reasons.

Despite its insistence that, as a contractor, Lowe's does not purchase special order items for installation contracts with the intent to resell them, Lowe's admits to utilizing its resale certificate during the Audit Period to purchase those special order items in order to comply with the Dual Business Regulation aimed at retailers. *See* S.C. Code Regs. Ann. 117-324 (addressing businesses who operate primarily as retailers but who also occasionally withdraw or use stock in a manner that is secondary to the primary retail business). Essentially, while maintaining it acts as a contractor during all installation contract transactions, Lowe's simultaneously argues that, as a retailer subject to the Dual Business Regulation, it is required to purchase all materials, including special order items, at wholesale using its resale certificate, even if it does not intend to offer those special order items for resale.

To obtain a resale certificate in South Carolina, a taxpayer, to include 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. Further, the taxpayer also acknowledges that if the tangible personal property is withdrawn for use and not resold, the taxable transaction will be reported to the Department as a withdrawal from stock and the taxpayer will remit the tax based upon the reasonable and fair market value, but not less than the original purchase price. Finally, the taxpayer also acknowledges that by extending the resale certificate to acquire the property at wholesale from the supplier, he is assuming liability for the sales and use tax on any transactions between himself and the supplier.

There is no dispute that Lowe's purchased all materials – whether stock, special order, sold in a traditional retail sale, or intended for use in installation contracts – at wholesale, free of tax, through use of its resale certificate. By extending this certificate to vendors for purchases, Lowe's certified it was purchasing all material, including special order material, for resale. If Lowe's truly intended to purchase its special order installation contract materials as a contractor without the

intent to resell them, it should not have extended its resale certificate. Such purchases are in direct contrast to the same purchases by other contractors, who are required to purchase materials at retail price and to pay tax on that higher retail price at the time of purchase. *See* S.C. Code Regs. Ann. 117-314.1 - 117-314.2.³² Nevertheless, Lowe's insists that as a contractor it was required to purchase special order materials at wholesale using its resale certificate, regardless of its intentions for the materials, under the Dual Business Regulation because:

Operators of businesses who are both making retail sales and withdrawing for use from the same stock of goods *are to purchase at wholesale all of the goods so sold or used* and report both retail sales and withdrawals for use under the sales tax law.

S.C. Code Regs. Ann. 117-324 (emphasis added). The plain language of Regulation 117-324 makes it abundantly clear that it is not applicable to contractors and, as such, works to directly discredit Petitioner's argument that as a contractor it was required to purchase at the lesser wholesale cost to comply with the regulation.³³

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. Petitioner's interpretation of Regulation 117-324 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 extending its resale certificate, unlike any other contractor. Courts must reject “a statutory interpretation which would lead to a result so plainly absurd that it could not have been

³² It is interesting that while insisting upon its status as a contractor, Lowe's argues it is required to comply with the Dual Business Regulation of 117-324 geared towards retailers while failing to address its noncompliance with Regulation 117-314 governing construction and providing that contractors should remit sales tax at the time materials are purchased.

³³ *See* Regulation 117-324 (the Dual Business Regulation “applies only to those who actually carry on a retail business having a substantial number of retail sales and *does not apply to contractors, plumbers, repairmen, and others who make isolated or accommodating sales and who have not set themselves up as being engaged in selling*”) (emphasis added).

intended by the legislature or would defeat the plain legislative intention.” *Jones v. State Farm Mut. Auto. Ins. Co.*, 364 S.C. 222, 232, 612 S.E.2d 719, 724 (Ct. App. 2005). In this instance, the Petitioner’s beneficial manipulation of the Dual Business Regulation in the context of the installation contract transactions does, in fact, lead to a result that clearly could not have been intended by the General Assembly.

Further, by characterizing the items installed as materials installed by a general contractor, the Petitioner asserts that its status as a contractor changes the nature of the installation contract transaction from a customer’s purchase of the materials from Lowe’s the retailer to a customer’s purchase of the *installation* of those materials from Lowe’s the contractor. The court disagrees. Acknowledging that nothing in the South Carolina statutes prohibits a retailer from also acting as a general contractor and having previously found that Lowe’s statutorily qualifies as both a retailer and a contractor, the court finds that Lowe’s acts in its capacity as a retailer for sales and use tax purposes in installation contract transactions. Unlike a contractor, Lowe’s purchases materials for the installation contracts at wholesale using its resale certificate and resells the materials to the customer in its retail store at the retail price. The customer, not Lowe’s, is the final purchaser of the materials and it is the transaction with the customer that constitutes the taxable retail sale upon which sales tax should have been remitted at the time of purchase. Unlike Lowe’s, a contractor, who is not in the business of selling and unable to extend a resale certificate to purchase materials at wholesale, must purchase materials at retail and pay sales tax on the higher retail price at the time of purchase. Thus, the contractor is the final purchaser of the materials and it is the transaction between the contractor and the supplier that constitutes the taxable retail sale. *See* S.C. Code Ann. § 12-36-110 (a), (e).

In conclusion, the court finds that the sale of the 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 contract constitutes the last transfer of the materials for consideration³⁴ and falls within the general definition of a retail sale under the statutory scheme. *See* § 12-36-110. Finding this sale to be the taxable retail transaction, the court concludes that during an installation contract transaction,

³⁴ *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[.]”).

Lowe's acts as a retailer at the time the materials are purchased by the customer and, thereafter, acts a contractor in overseeing the installation of the materials purchased in the installation contract. The fact that Lowe's acts in both capacities at distinct times during the installation contract transaction does not, as Lowe's insists, affect the nature of the underlying transaction; it remains a retail sale. Furthermore, the interpretation of the Dual Business Regulation suggested by the Petitioner to allow it 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. Therefore, the Department properly assessed Lowe's for additional sales and use tax on its installation contract transactions during the Audit Period.

The Department's Interpretation

The Department is an agency of South Carolina created by law to administer and enforce the revenue laws of this State. S.C. Code Ann. § 12-4-10 (2014). As such, the Department is tasked to promulgate regulations and to develop rules necessary to enhance uniformity, enforcement, and administration of State tax laws. S.C. Code Ann. §§ 12-4-310(2) and 12-4-320(1) (2014). Generally, "[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) (citation omitted).

In this case, the Department ultimately argues that Lowe's acts as a retailer during installation contract transactions and, in accordance with subsection (c) of the Retail Sale Statute, identified the taxable transaction as a "deemed sale" of the materials by Lowe's to itself upon the withdrawal, use, or consumption of the materials by Lowe's during performance of the installation contracts. The court takes exception to this argument since the need to identify a "deemed sale" as the taxable transaction becomes unnecessary in light of the court's determination that a taxable retail sale occurs when the installation contract customer purchases the materials to be installed. This is especially true in light of the Department's determination that the fair market value of the installation materials is the price at which the materials are offered for sale by Lowe's. Based upon the facts presented in this case, the court disagrees with the Department's final conclusion that a retail sale occurs upon Petitioner's withdrawal, use, or consumption of the installation

contract materials in the context of a “deemed sale” when a taxable retail sale by Lowe’s, as a retailer, has already taken place.

Gross Proceeds of Sales

Having identified the taxable retail sale as the sale of materials by Lowe’s to the installation contract customer, the court must look to the Gross Proceeds Statute to determine whether Lowe’s properly remitted sales tax based upon its cost to acquire the materials at issue. Statutorily, sales tax is measured by the gross proceeds of sales, which is defined as “the value proceeding or accruing from the sale, lease, or rental of tangible personal property,” to include, in pertinent part, “(b) the proceeds from the sale of tangible personal property.” S.C. Code Ann. § 12-36-90(1)(b) (2014); *see also* S.C. Code Regs. Ann. 117-318 (providing “[g]ross proceeds of sales’ is the basis for calculating the sales tax”). Here, the “proceeds from the sale” is the retail sales price the customer pays for the installation contract materials and, as such, the taxable value of the materials is the retail selling price of the materials as recorded in the installation contract invoice.³⁵ Therefore, Lowe’s should have remitted sales tax based on the retail selling price of the installation contract materials at the time of the sale.

In its Final Determination, the Department upheld the decision to assess additional tax to Lowe’s because, rather than remitting sales tax based upon the retail sales price of the installation contract materials, Lowe’s improperly remitted tax based upon its cost for the materials. While the Department ultimately argues the taxable retail sale is the withdrawal, use, or consumption of the installation contract materials by Lowe’s, the resulting monetary assessment first put forth by the Department remains correct – Lowe’s should have remitted sales tax based upon the retail selling price of the materials. Accordingly, despite relying on an alternative and improper theory in arguing its case, the court finds the amount of additional tax assessed by the Department for the Audit Period to be proper. Moreover, the court finds the initial identification of the triggering event as the sale of the installation contract materials by Lowe’s to the customer, as originally put forth by Ms. Crawford in her assessment, to be the taxable retail sale.

³⁵ Because the court finds the taxable retail sale to be the sale of the installation contract materials to the customer and the gross proceeds of sales is the selling price of the materials to the customer, this court does not need to determine the fair market value of the installation contract materials. Consequently, the court finds the issue of whether the Department erred in calculating the fair market value of the installation contract materials is moot.

Equal Protection Claim

Concluding that Lowe's acted as a retailer during the taxable sale portion of the installation contract transactions at issue, the court need not consider the Petitioner's equal protection claim asserting that the Department's assessment treats Lowe's differently than other contractors in South Carolina. During the pertinent part of these transactions, Lowe's was not acting as a contractor and, thus, any argument that it received disparate treatment than other similarly situated contractors is moot.³⁶ Moreover, if the court were to follow the Petitioner's logic and treat Lowe's like a contractor for the purpose of assessing sales tax in installation contract transactions, an equal protection violation would, in fact, arise. Lowe's would be able to acquire materials from its vendors at wholesale using its resale certificate and that beneficial – and disparate – advantage, not available to other contractors in South Carolina who must pay tax on the retail price of the materials they purchase at the time of that purchase, would result in an equal protection violation in favoring the Petitioner.

Interest and Penalties

Upon finding the Department properly assessed Lowe's for additional tax based on the retail sales price of the installation contract materials, the court also finds the Department properly assessed interest on the Petitioner's outstanding tax liability in this case. Section 12-54-25(A) of the South Carolina Code provides that if a tax is not paid when due, interest must be paid on the unpaid portion from the due date until paid in its entirety. S.C. Code Ann. § 12-54-25(A) (2014). The statute allows the Department to waive up to thirty days' interest for administrative convenience. *Id.* In this case, the Department did not indicate an intention to waive thirty days' interest for administrative purposes and no statute provides that the Department may otherwise waive interest when it is properly assessed based on underpayment. *See id.* Because Lowe's had use of monies owed and due for its outstanding sales tax liability, interest is applicable in this matter and it continues to accrue until the sales tax liability is paid in its entirety. *See id.*

³⁶ For an equal protection claim to stand, it is necessary for the party to show "that similarly situated persons received disparate treatment." *Bodman*, 403 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)). Equal protection does not require that all taxpayers be treated the same, rather, only similarly situated taxpayers be treated the same. *See id.*

Unless otherwise provided, civil penalties are applied to every South Carolina tax law which requires a return. S.C. Code Ann. § 12-54-43 (2014). Such penalties are considered a tax owed this State. *Id.* Further, “[i]f any tax is not paid when due, interest is due on the unpaid portion from the time the tax was due until paid in its entirety.” S.C. Code Ann. § 12-54-25(A). Section 12-54-43(F)(1) imposes a penalty for negligence or disregard of a regulation providing “[i]f part of an underpayment of tax or part of a claim for refund of tax paid is due to negligence or disregard of regulations, there must be added to the tax an amount equal to the sum of five percent of the underpayment or claimed refund and an amount equal to fifty percent of the interest payable under Section 12-54-25.”

In this instance, the Department applied a negligence penalty reasoning that the identical issue had been addressed in the prior audit of Lowe’s for the period of March 1, 2002 through February 28, 2005. At the completion of the prior audit in January of 2007, the Department informed Lowe’s that the withdrawal for use would trigger sales tax in installation contracts and that tax should be based upon the retail shelf price of the materials withdrawn for use in the installations. While the Petitioner asserts that it made a business decision in the prior audit by opting to pay the monies owed without disputing the Department’s theories or assessment, the Department argues the facts presented in this matter reflect that Lowe’s continued the practice of inaccurately basing its tax liability for installation contracts upon its wholesale cost to acquire the materials and continued to remit the lesser use tax rather than the sales tax due. Furthermore, the Department asserts that Regulation 117-309.17 clearly informs Lowe’s of the appropriate tax treatment in installation contract sales and Lowe’s clearly did not follow the regulation. Based upon the Petitioner’s disregard of Regulation 117-309.17 and the Department’s instructions following the prior audit as to the appropriate tax procedures, the Department deemed it proper to impose negligence penalties in this instance.

When determining whether to assess a penalty, the court, as the finder of fact, should look to “the major purpose of a civil penalty – deterrence.” *Anonymous Co. v. S.C. Dep’t of Rev.*, 03-ALJ-17-0435-CC, 2004 WL 3154667 (Aug. 10, 2004) (citing *Midlands Util., Inc. v. S.C. Dep’t of Health & Envtl. Control*, 313 S.C. 210, 437 S.E.2d 120 (1993)). While Respondent argues that Lowe’s was made fully aware of the proper tax treatment of installation contracts after the prior audit, the court is not convinced that such a level of clarity was reached by Lowe’s or, for that matter, the Department itself. From the evidence presented in this case, it is clear to the court that

various representatives who testified for the Department had and continue to have differing opinions as to the proper theory supporting Petitioner's tax liability in these transactions. In fact, the withdrawal theory ultimately argued by the Department during the proceedings before the court differs from the retail sale theory upon which Ms. Crawford based her initial assessment and continued to stand behind during her testimony. The court acknowledges the complexity of the issues presented and is further cognizant that, under either theory, Lowe's should have been aware that its tax liability for these transactions was not properly based upon its own wholesale acquisition cost for the materials. However, the court would be strained to justify a negligence penalty as a deterrent in this instance when the Department seeking to impose the penalty is, heretofore, seemingly split as to the exact practices the taxpayer in this situation should be deterred from. Therefore, strongly urging the Petitioner to properly remit future sales tax based upon the retail selling price of installation contract materials at the time those materials are sold to the customer, the court declines to assess negligence penalties in this matter.

CONCLUSION

Although this court disagrees with the theory ultimately relied upon by the Department in this case and declines to assess negligence penalties in this instance, the court agrees with the Department that Lowe's underpaid sales tax on installation contracts during the Audit Period and, therefore, the Department Determination is upheld as to the amount of tax and interest assessed, therein.

ORDER

Based upon the foregoing Findings of Fact and Conclusions of Law,

IT IS HEREBY ORDERED that the Department's assessment of \$2,206,054.28 in sales tax and \$360,580.69 of interest with regard to the Audit Period is upheld.

IT IS FURTHER ORDERED that interest is calculated through October 31, 2014 and will continue to accrue until this matter is resolved.

AND IT IS SO ORDERED.



S. Phillip Lenski
Administrative Law Judge

December 11, 2020
Columbia, South Carolina

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SC ADMIN. LAW COURT

CERTIFICATE OF SERVICE

I, Emily B. Howard, hereby certify that I have this date served this Order upon all parties to this case by depositing a copy hercof, in the United States mail, postage paid or by electronic mail to the address provided by the party(ies) and/or their attorney(s).

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