

THE STATE OF SOUTH CAROLINA
In The Court of Appeals

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SC Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

S. Phillip Lenski, Administrative Law Judge

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

Appellate Case No. 2021-000031

Lowe's Home Centers, LLC

Appellant,

v.

South Carolina Department of Revenue

Respondent.

RECORD ON APPEAL
Volume 1 of 12

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**FINAL ORDER of
DECEMBER 11, 2020**

**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.

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 ever 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 (e) 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 Env'tl. 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 Env'tl. 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 contact 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.

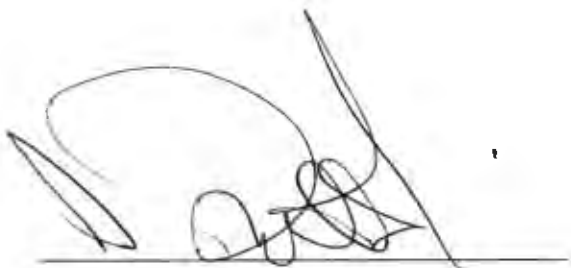
ORDER

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

FILED

DEC 11 2020

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 hereof, 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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Emily B. Howard
SCALC Staff Attorney

December 11, 2020
Columbia, South Carolina

FILED

DEC 11 2020

SC ADMIN. LAW COURT

**TRANSCRIPT OF PROCEEDINGS
DATED APRIL 20, 2016**

Transcript of the Testimony of **LOWE'S V. SC DOR**

Date: April 20, 2016



CREEL COURT REPORTING, INC.
Condensed Transcript and Word Index

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Lowe's Homes Centers, LLC,)
 Petitioner,)

v.)

South Carolina Department of)
Revenue,)

 Respondent.)

* * * * *

The hearing before the Honorable S. Phillip Lenski was taken at the Edgar A. Brown Building, 1205 Pendleton Street, Suite 224, Columbia, South Carolina, on the 20th day of April, 2016 before Carla S. Dominick, Court Reporter and Notary Public in and for the State of South Carolina.

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APPEARANCES

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ALSO PRESENT:
Edye Moran,
Judge Lenski's Judicial Law Clerk

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STIPULATIONS

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It is stipulated and agreed that this hearing is being taken pursuant to the rules of the Administrative Law Court and the South Carolina Rules of Civil Procedure.

1 (Joint Exhibits Number 1 through 63 were marked for
2 identification purposes prior to the hearing.)

3 THE COURT: Good morning, everyone.

4 MR. ALLAN: Good morning.

5 MR. SMITH: Good morning.

6 MR. CONDON: Good morning.

7 MS. WOOTEN: Good morning.

8 THE COURT: I am Phil Lenski, the Administrative Law
9 Judge assigned to this matter. And this is
10 Lowe's Home Centers, LLC, Petitioner, versus
11 South Carolina Department of Revenue,
12 Respondent. Docket Number 14-ALJ-17-0552-CC.
13 It is the 20th of April, 2016. Representing
14 the petitioner today, we have Mr. Smith, is
15 that right?

16 MR. SMITH: That's correct.

17 THE COURT: Good morning, sir. How are you?

18 MR. SMITH: Good morning, Your Honor.

19 THE COURT: Good. And Mr. Allan?

20 MR. ALLAN: Yes. Good morning, Your Honor.

21 THE COURT: How are you, sir?

22 MR. ALLAN: I'm good.

23 THE COURT: And for the respondent, we have Ms.
24 Wooten. How are you?

25 MS. WOOTEN: Good. Thank you, Your Honor.

1 THE COURT: Good. And Mr. Condon?

2 MR. CONDON: Yes, sir.

3 THE COURT: How are you, sir?

4 MR. CONDON: I'm fine, Your Honor.

5 THE COURT: Good. Wonderful. All right. Do we
6 need to take up anything before we get started?
7 Any preliminary matters or anything like that?
8 Motions?

9 MS. WOOTEN: Yes, Your Honor. We believe we have a
10 few preliminary matters for you. We have
11 submitted a joint exhibit notebook to the
12 court. It's Exhibits 1 through 63.

13 THE COURT: Yes.

14 MS. WOOTEN: We would like to offer all of those,
15 with the exception of 11 and 12, at this time.

16 THE COURT: With the exceptions of Exhibits 11 and
17 12, okay.

18 MS. WOOTEN: That's correct.

19 MR. SMITH: That's correct, Your Honor.

20 THE COURT: Okay.

21 MR. SMITH: We've worked hard to stipulate as much
22 as we can.

23 THE COURT: Okay. So, with the exceptions of
24 Exhibits 11 and 12 in the joint exhibits, the
25 joint exhibits are admitted.

1 (Joint Exhibit Numbers 1 through 10 and 13 through 63
2 were admitted into evidence.)

3 MS. WOOTEN: Thank you, Your Honor.

4 THE COURT: All right.

5 MS. WOOTEN: Also, we've prepared a list of
6 authorities that the parties believe -- well,
7 one or both of the parties believe is relevant.
8 We do not intend to admit this as an exhibit.
9 We just wanted to give this to you for your
10 consideration.

11 THE COURT: Okay. Yes. All right. So, there'll be
12 no objection. Thank you. Proceed. Anything
13 else?

14 MS. WOOTEN: Nothing further from the Department.

15 THE COURT: Okay.

16 MR. SMITH: Nothing further, Your Honor.

17 THE COURT: All right. Opening statements, then?

18 MR. SMITH: Yes, sir.

19 THE COURT: All right.

20 OPENING STATEMENT BY MR. SMITH: I'm going a little
21 old school here so I have blowups and it's a
22 tight room so I'll do the best I can to not
23 knock anyone over here.

24 THE COURT: All right.

25 MR. SMITH: But I'm Kendrick Smith with Jones Day.

1 My law partner, John Allan. Fresh off the
2 trail is Craig Price. We cleaned him up for
3 today so.

4 THE COURT: He's looking good.

5 MR. PRICE: Thank you for that.

6 MR. SMITH: We have an array of people from Lowe's
7 who are not going to be testifying but this is
8 a very important case for them. And I'll let
9 everyone introduce themselves. This is Chuck
10 Crider, who is our expert on fair market value.

11 THE COURT: All right. Good morning, sir.

12 MR. ALTMAN: I'm Chuck Altman. I'm taking Craig's
13 role at Lowe's.

14 THE COURT: All right. Good morning, sir.

15 MR. REED: Andy Reed, accounting.

16 THE COURT: All right. Good morning, sir.

17 MR. LOWE: Will Lowe for sales tax with Lowe's.

18 THE COURT: All right. Good morning, sir.

19 MR. SMITH: And that's it.

20 THE COURT: All right.

21 MR. SMITH: We're protesting a sales tax assessment.

22 It is about \$2.9 million dollars. It is
23 including about \$290,000.00 in penalties. And
24 it is over a three-year audit period, which
25 actually goes back a few years to '08 to the

1 end of July of 2011. The controversy deals
2 with installed sales or home improvement
3 contracts. It is a recurring issue. It is an
4 issue that we have been squabbling with states
5 throughout the country. We've litigated this
6 matter in Oklahoma, Iowa, Indiana, Kansas, we
7 have decisions from everyone except Iowa, and
8 we'll talk about that later on. But the
9 primary issue that's driving this is, is
10 Lowe's, which looks like a retail home
11 improvement store, can it also be a contractor.
12 We've stipulated most of the facts that were
13 not really in dispute. But as you know, I
14 assume you've been in a Lowe's, they currently
15 have 49 stores in South Carolina. They're big,
16 they're big boxes, and they sell home
17 improvement items that you can buy at retail.
18 Beginning in about the mid-90s, they started
19 going into actually installing home
20 improvements for customers. It was a new
21 business. They would be licensed contractors
22 operating through third-party installers but
23 they would be the prime contractor. They would
24 enter into contracts with the customers to put
25 on a new roof, to install kitchen cabinets or

1 whatever. So, there are two lines of business
2 that Lowe's engages in; retail sales of
3 tangible personal property and home improvement
4 contracts, real property improvements. And for
5 sales tax purposes, South Carolina, and most
6 states, treat those two types of transactions
7 differently. If it's a retail sale, if I'm
8 going into a Lowe's and I'm picking out a
9 hammer, and I take it up to the counter and
10 they'll scan it and they'll charge me the price
11 and I'll pay it and there'll be a tax on it,
12 which I'll tender and they'll collect and remit
13 to the taxing authorities. And I take with me
14 tangible personal property, a hammer. If I
15 want a home improvement, there's a process that
16 I got through where an installer will go out
17 and they'll measure and come up with the proper
18 space and what they think it's going to cost
19 and we'll pick out the materials and we enter
20 into a contract, which I will then tender up or
21 bring it up to the counter, as I would do my
22 hammer, tender it to the cashier and they'll
23 charge me the full amount, lump sum, and I'll
24 leave with no tangible personal property. I
25 have a contract and an expectation that three

1 weeks down the road, I'll have a new roof or
2 new custom windows installed. So, there are
3 two different types of transactions. South
4 Carolina does not assess sales tax on real
5 property goods. A customer who enters into a
6 contract with a contractor to have new cabinets
7 installed owes no sales tax on it because he's
8 not buying tangible personal property. Someone
9 is and so how South Carolina treats it is the
10 contractor. The contractor who procures the
11 building materials is the user and consumer of
12 the tangible personal property and he's to pay
13 sales tax on the costs, the gross proceeds of
14 sale, that he tenders when he buys the building
15 materials. No problem there. There's no
16 dispute. Our contention, Lowe's, as the
17 contractor is the final user and consumer of
18 the tangible personal property that it utilizes
19 when it makes this home improvement for its
20 customer. It owes sales tax or use tax on its
21 cost of materials when it purchased them. And
22 as far as what the law is, there's not a
23 controversy. It's just how it's interpreted.
24 This is a regulation, 117-314.2, which deals
25 generally with contractors and sales tax, and

1 this talks about building materials. And it
2 says, "Building materials, when purchase by
3 builders, contractors or land owners,"
4 contractors being Lowe's when it's doing this,
5 "for use in adding to, repairing or altering
6 real property, are subject to either sales or
7 use tax at the time of purchase by such
8 builder, contractor or land owner." And then
9 it has this extraordinarily broad definition of
10 what building materials are, which includes,
11 "All other tangible personal property which
12 becomes part of real property." Lowe's did
13 that. Lowe's, as the contractor, remitted
14 sales tax or use tax on its cost of materials
15 to the state, deeming it's a contractor. And
16 also, there's a question as to what is a
17 contractor in South Carolina. And mercifully,
18 we have a statute that defines it. It's not in
19 the sales tax code. The sales tax code doesn't
20 define it. But a contractor, these are four of
21 the definitions from it, there's this concept
22 of general construction which is improvement of
23 any kind to real property, a general contractor
24 is an entity which performs or supervises or
25 offers to perform or supervise general

1 construction and then a prime contractor,
2 which is what Lowe's would be, is the entity
3 which contracts directly with the owner to
4 perform general or mechanical construction.
5 And it doesn't matter what the cost is that's
6 incurred to procure materials under the rules,
7 the regulation, the statute, whatever those
8 are, the gross proceeds of the sale, that's
9 what the tax is on. Our challenge here is the
10 Department takes the position that Lowe's,
11 because it holds itself out as a retailer,
12 because it looks like a retailer, because it
13 engages in substantial retail sales, can't be
14 a contractor. And so what the state is
15 imposing on Lowe's, when it's acting as a
16 contractor, is a burden substantially greater
17 than any other home improvement contractor in
18 the state. They have decided that you're not
19 going to pay sales tax on your costs, what
20 we're going to do is we're going to deem that
21 had you sold all those individual pieces of
22 items over-the-counter to retail customers, you
23 would have enjoyed an average deemed markup of
24 40 percent. And so what we're fighting about
25 is sales tax not on the cost that was incurred

1 for the materials but an additional deemed
2 markup, which of course puts Lowe's at a
3 distinct competitive disadvantage to other home
4 improvement contractors in the state. And,
5 again, the facts are not in dispute. Let me go
6 over just generally the applicable law and then
7 we'll go into what the case is. Item number
8 one is what is defined as a retail sale in the
9 state of South Carolina, this is 12-36-110, and
10 it lists a bunch of things. I've picked out
11 three because these are what we're fighting
12 over in this case. A, a retail sale triggers
13 sales tax. Until you have a retail sale, no
14 tax is due. So, these things trigger sales
15 tax. (a) is sales of building materials to
16 construction contractors. And it goes on,
17 "Builders or land owners for resale or use in
18 the form of real estate." That would seem to
19 apply to every one of these transactions. (e)
20 would clearly apply to every one of these
21 transactions. Sales to contractors for use in
22 the performance of construction contracts. So,
23 that trigger would tick when the contractor
24 buys the materials. What the state is saying
25 is well, you can't be a contractor because you

1 look like a retailer. So, we're ignoring (a)
2 and (e) and we're saying that you're buying it
3 not as a contractor but as a retailer. And so
4 we're going to go to (c) and we're saying that
5 the tax kicks in on the withdrawal or use or
6 consumption of tangible personal property by
7 anyone who purchases at wholesale. Couple of
8 things. First of all, (c) can't kick in unless
9 it's not (a) or (e) because (a) or (e) would
10 occur before (c). So, (c) only kicks in if
11 it's not a sale to a construction contractor.
12 Number two, (c) only kicks in if it's purchased
13 at wholesale. And what we will show in the
14 course of this case here is that nearly 60
15 percent of the installation contracts, the home
16 improvement contracts that were performed
17 during the audit period, involve special order
18 items. Special order items are items which are
19 not at the store. And typically, if you go in
20 and you want new tile or you want new flooring,
21 they don't have it in the store, you have to
22 order it. And when Lowe's orders special order
23 items, it is for that contract. It is a custom
24 window for that customer. And it is not for
25 resale and it doesn't go into the inventory and

1 it is solely for the purpose of performing that
2 contract. And under the code, the definition
3 of wholesale, if I can get these right, it's
4 tangible personal property to licensed retail
5 merchants, jobbers, dealers or wholesalers for
6 resale and do not include sales to users or
7 consumers not for resale. So, with respect to
8 at least 60 percent, or thereabouts, of the
9 installation contracts performed during the
10 audit period, (c) can't possibly apply to it.
11 And moreover, (c), if you read the revenue
12 rulings that discuss (c) and what it's supposed
13 to apply to, it's supposed to apply to tangible
14 personal property used by the business and to
15 employees for the personal use given to
16 employees to give away to customers or
17 potential customers as a promotion or for
18 purposes of goodwill. It's when the store
19 gives away its inventory, which of course is a
20 trigger that would happen after any sale to the
21 contractor. Now, the question that may be
22 running in your mind is who cares? I mean,
23 what difference does it make if it's (a) or (c)
24 (d) or (e), wouldn't the tax liability be the
25 same? And that's, again, where the Department

1 kind of goes off the rails because there's
2 another provision that measures what the taxes
3 are when you have a retail sale. And I'm
4 almost through with the law. It's actually not
5 that many of them. 12-36-90; "Gross proceeds
6 of sale," which is what the tax is on, in
7 almost all situations it would be on the
8 proceeds from the sale of tangible personal
9 property. But if it's tangible personal
10 property previously purchased at wholesale,
11 which is withdrawn from the business or stock
12 and used and consumed in connection with the
13 business or used and consumed by any person
14 withdrawing it, then it's on the fair market
15 value. And that's where the Department says,
16 got you, because yeah, we know what you paid
17 for it, we know what the cost was, we know
18 what you incurred for it but for fair market
19 value, we're going to deem that to be what
20 customers would have paid at the shelf price at
21 the specific time over a period of time if
22 you'd sold it over the counter at retail.
23 That's a position of law that we disagree with.
24 That distinction is made solely because Lowe's,
25 unlike contractors, professional contractors,

1 which could be a huge one, Pulte Homes, also
2 sells materials at retail. They're making that
3 distinction. The position of the state is
4 flawed, we contend, for four reasons. One, the
5 state does not have discretion to deem Lowe's
6 not to be a contractor when it's performing
7 construction contracts. It's a defined term,
8 the legislature has told you what a contractor
9 is, we clearly fit in the definition, there is
10 no authorization for the Department of Revenue
11 to, on its own, arbitrarily say, I don't think
12 you're a contractor, even though you fit under
13 the statutory definition. That's the easy
14 answer. If they're contractors, they have to
15 be treated like one. The second problem is the
16 equal protection provision. The Department
17 will concede, because we asked them this, that
18 absent express statutory authority to the
19 contrary, similarly situated taxpayers must be
20 treated similarly. There is no authorization
21 to treat Lowe's, when it is performing
22 construction contracts, differently from other
23 contractors. And what the testimony will show
24 you is that by imposing a 40 percent higher tax
25 burden on Lowe's, when it's performing the

1 exact same services as another home improvement
2 contractor, makes it impossible for Lowe's to
3 compete in the state. The third point is that
4 the facts don't fit their conclusion. Their
5 conclusion is that 100 percent of these items
6 that were consumed in these home improvement
7 contracts were items that were previously
8 purchased at wholesale and withdrawn from the
9 stock. And the facts will show that even if
10 you accept their interpretation of the law,
11 which we contend is wrong, it can't apply to
12 the vast majority of the contracts that are at
13 issue here. And the fourth point is let's
14 assume they're right on everything. Let's
15 assume that every single contract is not a
16 construction contract and falls under this (c)
17 provision of fair market value. We will
18 present testimony as to what is the generally
19 accepted meaning of the term fair market value
20 when it deals with retail inventory. It is not
21 defined in the sales tax code. And you will
22 hear that under income tax, property tax,,
23 transfer questions, estate tax, condemnation
24 laws, accounting methodology, you measure the
25 fair market value of inventories by the lower

1 of cost or market or the cost minus
2 depreciation. The cost is, in fact, the
3 highest value that you can assess the fair
4 market value in inventory because it tends to
5 lose value once you buy it. There is no
6 accepted use nor methodology of the term fair
7 market value as applied to retail inventories
8 under any discipline or any law, other than a
9 regulation, that contemplates using the price
10 at which these goods are offered for sale by
11 the person withdrawing them. What the
12 Department is entirely relying on, outside this
13 misinterpretation of the law and the facts, is
14 a regulation. Is addressing gross proceeds of
15 sales, money value of property purchased at
16 wholesale for resale purposes and subsequently
17 withdrawn from stock for use or consumption by
18 the purchaser. And in this case, according to
19 the Department, the value to be placed upon
20 such goods is the price at which these goods
21 are offered for sale by the person withdrawing
22 them. We believe that as applied to Lowe's,
23 that is unauthorized by law, it is
24 unreasonable, it is contrary to the undisputed
25 facts of the case. And the final point, and

1 then I will sit down, is there has been a
2 negligence penalty assessed on Lowe's, the
3 burden's on the Department to show that Lowe's
4 position is unjustified. I believe we will
5 show that our position is entirely justified
6 and consistent with the law and we believe it
7 is completely inappropriate to impose a
8 negligence penalty on it. So, what we're going
9 to ask for is to uphold protest, set aside the
10 assessment and vacate the penalties. Thank
11 you, Your Honor.

12 THE COURT: Thank you, sir. Ms. Wooten?

13 OPENING STATEMENT BY MS. WOOTEN: Thank you, Your
14 Honor. My name is Nikki Wooten and I'm here
15 today representing the South Carolina
16 Department of Revenue. This case is really
17 about the taxpayer's attempt to characterize
18 itself as a contractor rather than a national
19 big box retailer to significantly reduce its
20 sales tax liability. And just for the record,
21 the Department does assert that there are facts
22 in dispute, primarily the fact of whether or
23 not the taxpayer is operating as a contractor
24 in the transactions in dispute. The taxpayer
25 is a large, big box retailer. A retailer with

1 stores across the United States and Canada, 48
2 of which were in South Carolina during the
3 audit period. In just a short time, the
4 court's going to hear from the taxpayer all
5 about its operations and its installation
6 services. But importantly, you will hear that
7 a Lowe's customer who wants to come in and
8 purchase tangible personal property to be
9 installed in an installed sales contract who
10 comes to the retail store to purchase it, to
11 select it, signs a contract for the
12 installation services to be performed by a
13 third-party installer and that they receive
14 value from Lowe's retail operations. The
15 ultimate goal of Lowe's retail operations,
16 including their installation services, is to
17 facilitate the retail sale of tangible personal
18 property to a customer at retail. The
19 Department believes that the primary issues in
20 this case are does Lowe's make a retail sale
21 when, as part of the installed sales contract,
22 it withdraws, uses or consumes that item that
23 was purchased for resale. And secondly, what
24 are the gross proceeds of sales related to the
25 install contracts on which Lowe's must remit

1 sales tax to South Carolina. And looking at
2 the retail, the court will see that Section 12-
3 36-110, Subsection 1(c), defines retail sale as
4 the withdrawal, use or consumption of tangible
5 personal property by anyone who purchases it at
6 wholesale. And we believe the court will hear
7 that the taxpayer, as a retailer, purchases its
8 inventory, including items to be installed, at
9 wholesale. This court will also hear that the
10 taxpayer withdraws, uses or consume that
11 property to be installed pursuant to the
12 installed sales contract. And then turning to
13 the gross proceeds of sale, which is under 12-
14 36-90.1(c), it provides that gross proceeds of
15 sales includes the fair market value of that
16 tangible personal property previously purchased
17 at wholesale or used or consumed by any person
18 withdrawing it. And then if you'll turn to
19 Regulation 309.17, it provides that the gross
20 proceeds of sale are the installed items and
21 the price to put on those are the price at
22 which the goods are offered for sale by the
23 retailer. The Department will present four
24 witnesses in its case and they will support the
25 Department's position in this matter. Paulette

1 Crawford is a senior auditor who conducted the
2 audit examination of the taxpayer and she will
3 describe the audit, the documentation received
4 by the taxpayer and the method agreed upon and
5 used by the Department in this proposed
6 assessment. And specifically, she will
7 describe how, from that sample of information
8 provided from the taxpayer, that she determined
9 Lowe's sale price of its installed items are
10 approximately 40 percent above its costs. And
11 she will also explain how she verified that
12 information from the actual sales prices of the
13 items from Lowe's documentation. Secondly,
14 Cynthia Krull, an audit supervisor, will
15 testify about the audit in general, the
16 Department's longstanding audit policies and
17 practices regarding contractors and retailers
18 and her experience as an auditor for the past
19 32 years at the Department. Third, John
20 McCormack, a long time Department employee and
21 the general manager of the policy section, will
22 testify that Ms. Crawford's determination, as
23 well as the Department's determination, is
24 supported by Department policy, South Carolina
25 case law, statutes and regulations. And I

1 think it's important to point out opposing
2 counsel mentioned some litigation in other
3 states. We don't need to look to other states
4 for their interpretation of their own laws. We
5 have the laws in South Carolina and we have a
6 case law that we believe supports our position.
7 So, it's unnecessary to look at other states'
8 decisions based on those states' laws. And
9 finally, our fourth witness is Dr. Hennie van
10 Bulck who will testify from a general valuation
11 perspective that the fair market to be placed
12 on the tangible personal property in these
13 installed sales should be valued at the retail
14 level of trade or the shelf price that the
15 customer pays at the register when it checks
16 out. And the Department submits that this is
17 consistent with the Regulation 117-309.17. He
18 will also testify why Lowe's expert's cost
19 approach is not applicable to installed sales
20 but rather applies to a value of inventory as
21 a whole. Here we're not valuing inventory as
22 a whole. We're looking at individual
23 transactions with a known sales price. So,
24 just to conclude, the court will see or hear
25 why Lowe's is not acting as a contractor but is

1 acting as a retailer in these issues. South
2 Carolina case law, statutes and regulations
3 support the Department's decision that the
4 taxpayer, acting as a retailer, withdraws, uses
5 or consumes the inventory from its stock or
6 business for use in a retail sales transaction.
7 And accordingly, the Department asks that you
8 uphold its Department determination in this
9 matter.

10 THE COURT: Thank you.

11 MS. WOOTEN: Thank you, Your Honor. The Department
12 is ready to begin.

13 THE COURT: All right.

14 MR. SMITH: I'd call Craig Price.

15 THE COURT: All right. Mr. Price?

16 CRAIG J. PRICE, having been duly sworn, testifies as
17 follows:

18 MR. PRICE - DIRECT EXAMINATION BY MR. SMITH:

19 THE COURT: Please be seated and make yourself
20 comfortable, Mr. Price.

21 Q: Mr. Price, thank you for being here today.

22 A: Thank you. It's good to be here.

23 Q: What was your title when you worked at Lowe's?

24 A: My title was Director of Sales and Use Tax.

25 Q: And how long did you hold that position?

1 A: I held the director position for approximately
2 14 or 15 years.

3 Q: Okay. What does a Director of Sales and Use
4 Tax do?

5 A: The three primary responsibilities that I had,
6 first and foremost, was to make sure that our
7 sales at point of sale, whether they were
8 retail sales or contractor sales, and when I
9 say sales, I'll say transactions, were taxed
10 properly across the United States and Canada.
11 If there were environmental fees and such,
12 those fees had to be passed onto the consumer.
13 Proper rounding on the tax calculation. So,
14 any customer facing transaction was properly
15 taxed. The second primary duty that my team
16 performed was the filing of the sales tax
17 returns. We collect a certain amount of tax,
18 we need to remit that tax in a timely fashion
19 on returns that are accurate. And then the
20 third primary responsibility is dealing with
21 the audit of the those filed returns by a
22 variety of jurisdictions, South Carolina being
23 one. But potentially, any jurisdiction that we
24 file tax returns with.

25 Q: And how many states charge a sales tax?

1 A: State sales taxes are 45. Alaska doesn't have
2 state sales tax but it has some local taxes.

3 Q: And you have to comply with all of them?

4 A: Yes, sir. If I speak in current tense, I'm
5 retired, so just be -- and only recently. So,
6 I'll do my best to -- I used to deal with
7 them.

8 Q: Okay. When did you retire from the company?

9 A: March 18th of this year.

10 Q: Okay. Can you summarize briefly both your
11 education and your professional background?
12 And I'm going to give you some of this, too.

13 A: Sure. Thank you. I graduated high school in
14 1978. I was accepted to Appalachian State
15 University. I pursued a degree and received a
16 degree in Chemistry, a B.S. in chemistry. I
17 worked for one year. I got accepted to East
18 Carolina University in their MBA program. I
19 graduated from there. The head of the finance
20 department then asked me if I wanted to teach
21 in his area. I'd never thought about that as
22 a career but I was playing rugby at the time
23 and wanted to coach the rugby team so I gave
24 teaching a try. I enjoyed it. While I was
25 teaching, there was opportunity to work for

1 Yale Materials Handling on a project that they
2 had, which was a local company. I worked for
3 them in a part-time fashion, part-time at the
4 University. I then went full-time at Yale and
5 part-time at the University. Then I left Yale.
6 I just didn't know what I wanted to do, whether
7 pursue a Ph.D. in academics or stay in
8 business, and I just went down the path of
9 business. I was then employed by a company
10 called BGB Management as their assistant
11 controller. That was a multi-unit car
12 dealership. We handled the books and records.
13 I got laid off from that job in probably 1991,
14 December 1991, November. I then resought
15 employment. I was then hired by Lowe's at that
16 time in Wilkesboro, North Carolina in March of
17 '92 as a tax accountant in sales tax. And
18 basically, I've been in sales tax ever since.
19 I got promoted to manager, senior manager and
20 then director.

21 Q: Okay. And as part of your job, are you
22 required to become familiar with the sales tax
23 statutes and regulations in the various states?

24 A: Yes, sir, that is my job duty.

25 Q: And are you generally familiar with the South

1 Carolina statutes and regulations?

2 A: Generally familiar, yes, sir.

3 Q: Okay. During the audit period, how many stores
4 did Lowe's have in the state?

5 A: I believe we had 42.

6 Q: Okay.

7 A: We have 49 now or 49 at the date of my
8 deposition. But I believe during the audit
9 period, we started out with 40 stores in 2008,
10 and I believe we added two during the audit
11 period.

12 Q: Okay.

13 A: I could be wrong.

14 Q: Now, when we're dealing with sales tax, why is
15 it important for retailers to collect and remit
16 the correct amount of sales tax?

17 A: Well, for a variety of reasons. You don't want
18 to add a tax to a transaction that's not
19 legally due. It's obviously a bad customer
20 experience, charging tax on a transaction
21 that's not subject to tax. It's bad in the
22 sense of the customer experience but the
23 downside of that is there's potential class
24 action lawsuits as a result. If you've made a
25 mistake in this type of transactional tax

1 environment, if you've taxed one customer
2 incorrectly, the chances are you've taxed
3 thousands of them incorrectly. So, the
4 potential for a class action lawsuit is ever
5 present and something I do lose sleep about.

6 Q: Okay. So, if you're having a disagreement with
7 a Department of Revenue who says that it thinks
8 that transactions are subject to sales tax and
9 your reading of the law is that it's not
10 subject to sales tax, why not just simply
11 collect the tax to be safe?

12 A: I don't think that's the right answer. The
13 thread of the class action lawsuit is there.
14 That's happened in the past. There's been
15 bulletins that states have issued that imply
16 tax should be collected. I try to focus on
17 what the law says. I just think it's a safer
18 answer for the brand of the company and the
19 company's -- the opinion of people of the
20 company or customers, it's treating them
21 correctly.

22 Q: Okay. So, what types of customer transactions
23 does Lowe's engage in?

24 A: Well, as you said in your opening remarks, I
25 feel we run two businesses. We are a

1 retailer, that's clear, but we are also a
2 contractor. So, we are the retailer of
3 tangible personal property. We sell some
4 ancillary services in that line of business.
5 If you buy a grill, we will offer that grill
6 fully assembled or -- let me go back. You can
7 buy it but we also offer assembly services.
8 Some people try to assemble that grill and have
9 trouble so we will assemble it for you. And we
10 also deliver tangible personal property on a
11 retail sale.

12 Q: Now, do you consider delivery as part of the
13 installation contract business?

14 A: No. No. It's just -- we have trucks and the
15 products that we sell are large and a lot of
16 people don't have pickup trucks or trailers to
17 haul that amount of concrete or wood. So, we
18 offer delivery services.

19 Q: When did Lowe's first start getting into home
20 improvement business?

21 A: I want to say we started out small, as you can
22 imagine. When I first came to Lowe's, we did
23 not -- did you say delivery or contracting?

24 Q: Home improvement contracting.

25 A: Okay. So, home improvement. When I started in

1 1992, we were not in that business. We were
2 strictly a retailer and our systems were
3 designed for retailing. I think it was 1995,
4 1996, somewhere in that time frame, the
5 business started pursuing what they deemed or
6 titled installed sales. And, of course, I had
7 to figure out -- my responsibility was to
8 figure out how to tax these items. And I had
9 limited system capability. And quite honestly,
10 I was ignorant on what we were doing. The
11 significance of the terms of the contracts, I
12 was relatively -- I'd been at Lowe's three or
13 four years but in sales tax, this was a new
14 area and I learned over time. But we started
15 out in, I think, North Carolina. We did our
16 market research and we learned that most people
17 that buy carpet from us immediately go to
18 someone else and say install it. So, we
19 realize that we can sell a lot more or we can
20 get more revenue if we provide installation
21 services along with, you know, carpet. And
22 then it transitioned from, well let's try
23 vinyl, let's try hardwood floors, and it just
24 -- there's various categories that just
25 expanded the offering that we have. So, we do

1 just about every home improvement there is now.

2 Q: Okay. Can you describe, briefly, how home
3 improvement transactions, the installation
4 contract transactions, are different from the
5 retail transactions?

6 A: Well, it's like you described, once again in
7 your opening, a retail transaction is a
8 customer walks through the store, puts items in
9 their shopping cart or their buggy, they walk
10 to the checkout counter, they -- we scan the
11 items, the point of sale system, which is
12 referred to as Genesis at Lowe's, knows the --
13 when you scan the item, the computer system
14 pulls the price back, we then calculate tax at
15 the line item level. And I'm speaking
16 currently now but back then it was very
17 similar. We then have logic that makes sure
18 that the final tax calculation rounding is
19 correct. We render a tax calculation on the
20 bottom of the receipt and the customer takes
21 title and possession of those items and leaves
22 the store.

23 Q: Okay.

24 A: Now, on a contract for real property
25 improvement to the customer's home, it's

1 substantially different.

2 Q: How is it different?

3 A: They -- they -- they quite often come in and
4 understand or they'll talk to an associate and
5 the associate is there, "What do you really
6 want?" "Well, you know, I need a new kitchen
7 floor. I need a new tile floor in my kitchen
8 and I don't have the ability to put those tiles
9 in." And a Lowe's associate, "Well, we can do
10 that for you. We can offer and install tile
11 floor for you." And if the customer has
12 interest in that process, what will happen is
13 they will -- we used to charge them a -- what's
14 called a detail fee. And the detail fee was we
15 would send an installer to their home and the
16 installer would take very detailed measurements
17 of that area. And it varied by the category of
18 the item that was being installed. So, for
19 example, if it's tile, you don't typically tile
20 a staircase but carpeting, you would. So, the
21 installer has to know what the job entails
22 because he's doing, one, a labor calculation,
23 what's his labor cost going to be, but he's
24 also doing a material calculation in terms of
25 quantity. He then conveys that information

1 back to the Lowe's associate, says, "I've been
2 to the home, I know how much it's going to cost
3 to do this job for my labor and I know how much
4 material it's going to take." At that point,
5 the Lowe's store contacts the customer and
6 says, "We've got some quotes and an idea of
7 what this is going to be. You just need to
8 tell us what type of carpet you want, what
9 color of carpet you want, what type of
10 underlayment. Do you want it stain mast, you
11 know, the protectant on it? All questions like
12 that. So, really, what the customer is doing
13 is determining the quality of the items to be
14 installed. What items do they want, what
15 color? We then calculate the actual cost now
16 because we know the quantity of the materials,
17 they've told us what they want, we can do a
18 calculation of the material. We know the quote
19 from the installer. We add those two together,
20 it's combined, put into a contract that both
21 the customer signs and the store associate
22 signs. The customer then takes that contract
23 to the checkout counter. We then have to
24 tender the sale. And the customer pays up
25 front, everything, for that transaction. So,

1 it's a -- it's a much more involved process.

2 There is a contract and there's terms and
3 conditions on that contract and I think the
4 customer knows clearly what they're buying.

5 Q: And when a customer leaves, does he take any
6 tangible personal property with him?

7 A: No. The only thing the customer takes with him
8 is the contractual right to receive the home
9 improvement that he's negotiated for.

10 Q: Okay. Let's look at what a contract looks
11 like. I think this is it. I'll hand you both
12 of these. And we'll start with Exhibit 34,
13 Joint Exhibit 34.

14 A: This one or this one?

15 Q: It's one of them. It'll be this one. What are
16 we looking at there?

17 A: This is a contract that was used during the
18 audit period. As you can see, there's a lot of
19 information. I'll try to help everybody, if
20 they're looking at this, as well as me. At
21 the top of the contract it says, "Installation
22 Services Customer Contract" ---

23 Q: Let's pause for just a second.

24 MR. SMITH: Your Honor, have you found it yet?

25 THE COURT: I'm getting there.

1 MR. SMITH: Okay.

2 A: I'll wait.

3 Q: Yeah.

4 THE COURT: Got it. I'm there. Okay.

5 Q: So, at the top of the contract, what do we
6 have?

7 A: I'd mentioned earlier that Lowe's installs a
8 variety of category of items. And this
9 contract is, you can see, it's got the heading
10 at the top, "Flooring" and a subcategory of
11 flooring would be hardwood. So, that's what
12 this is telling you. This is a contract that's
13 related to either a hardwood installation or a
14 laminate installation. You can see the date on
15 the contract, you can see who the customer is,
16 the address and so forth. And then we show,
17 for the benefit of the customer, at the bottom
18 in the merchandise summary area, the actual
19 item numbers of the material that he's
20 purchased.

21 Q: Now, there's some initials that appear
22 throughout the merchandise summary, STK. What
23 does that mean?

24 A: That's an abbreviation that Lowe's uses to
25 indicate it's a stock item.

1 Q: Okay. So, this is a contract dealing with
2 items that came from stock?

3 A: Yes, sir.

4 Q: Is this a form contract, by the way?

5 A: What do you mean form?

6 Q: Is this a contract form that you use throughout
7 the country?

8 A: Yes. There's minor, minor changes. It's a, I
9 guess the term you might use, it's a
10 boilerplate contract.

11 Q: Better still. Okay.

12 A: There are slight differences state by state but
13 they're slight. Some states require that you
14 print your contractor license on the front of
15 the contract and additional terms specific to
16 the state. But for the most part, yes, this is
17 a boilerplate that's used across the country.

18 Q: Okay. Well, let's talk about this one for a
19 second. Let's assume the contractor goes out
20 and the flooring that they select is flawed or
21 it's put in wrong or something that the
22 customer's not happy with. Who bears the risk
23 of making that right?

24 A: Lowe's, 100 percent, bears the risk.

25 Q: Okay.

1 A: So -- so ---

2 Q: And how do you make it right? What do you do?

3 A: We just make it right is what we do. The
4 customer expected a tile floor and if the
5 installer is walking into the customer's house
6 and drops a box of tile and breaks every one,
7 he's got to come back to the Lowe's store and
8 get more tile. The customer bought a tile
9 floor, not tangible personal property. It's
10 clear it's a lump sum -- it's a lump sum
11 contract.

12 Q: Okay. Now, is Lowe's licensed to act as a
13 contractor in South Carolina?

14 A: Yes, sir.

15 Q: Okay. Let's look at Exhibit 33 real quickly.
16 What are we looking at there?

17 A: Throughout all the pages, these are qualified
18 -- these are our contractor license. In North
19 Carolina, which I'm more familiar with on
20 contractor license, legal entities, in other
21 words, non-individuals, cannot be assigned a
22 contractor license. A contractor license is
23 given to an individual. But those individuals
24 can do what's called qualify a business and
25 that's what happened here is these names that

1 you see are people that qualified Lowe's Home
2 Centers to do business as a contractor.

3 Q: And was Lowe's qualified as a contractor
4 throughout the audit period?

5 A: Yes, it was.

6 Q: Okay. By the way, are you a licensed
7 contractor?

8 A: In North Carolina, I am.

9 Q: Okay. I forgot to mention that. All right.
10 Let's go back to the contract on 34 and let's
11 go to the terms and conditions, which appear on
12 pages four and five. First, let's just look at
13 some of the definitions. Goods, how is that
14 defined?

15 A: Should I read it?

16 Q: Yeah, go ahead and read it.

17 A: "Lowe's will arrange for delivery of goods to
18 the premises. Any surplus materials, upon
19 completion of the installation services, shall
20 remain the property of Lowe's and shall be
21 returned to Lowe's by the installer."

22 Q: Okay. When you're doing a real property permit
23 for a customer, when does the customer actually
24 get title to the improvement?

25 A: There's a document. What we want are satisfied

1 customers. The process is the installer gets
2 done and the installer actually has a document
3 called a Certificate of Completion and he's
4 going to ask that customer, "Are you happy with
5 this job? Is there anything that you need us
6 to do before we leave here?" And the goal is
7 to make sure the customer is satisfied and when
8 they are satisfied, they need to sign this
9 little document that says Certificate of
10 Completion. They just sign it and date it.
11 And that means, at that point, they have
12 received title to the goods.

13 Q: Okay.

14 A: Because it's not really done until they sign
15 that.

16 Q: And at that point ---

17 A: There could be more work to be done.

18 Q: --- is there tangible personal property at that
19 point?

20 A: No, it's converted to real property. No.

21 Q: Okay.

22 A: And just to add, and that is the triggering
23 event that pays the installer. So, the
24 installer then takes that Certificate of
25 Completion and remits it to Lowe's accounts

1 payable to say, "I've done my job, the customer
2 agrees that I've done my job, I'm due payment
3 now."

4 Q: Now, that whole process you've described, is
5 that done for normal retail sales?

6 A: No.

7 Q: Okay.

8 A: A retail sale is a sale of tangible personal
9 property and out the door.

10 Q: All right. There's a provision dealing with
11 licenses down at the bottom of page four.

12 A: Okay.

13 Q: It says, "Lowe's shall be responsible to
14 customer for obtaining any and all licenses and
15 building permits which are legally required to
16 perform the contract." Is that something that
17 Lowe's has to do when it's doing a retail
18 transaction?

19 A: Not -- not contractor license. We have other
20 business license to sell other items but this
21 is specific to a -- being properly licensed as
22 a contractor and pulling building permits and
23 such.

24 Q: Okay. So, with respect to South Carolina sales
25 and use tax, how does Lowe's treat a home

1 improvement transaction?

2 A: My interpretation of the law, which is what I'm
3 required to do, is I feel we're acting as a
4 contractor. We have a contract for the -- for
5 a real property improvement. So, there's a
6 contract, it's for real property improvement,
7 it's a lump sum contract. My interpretation of
8 the law says we're -- it's a contractor
9 performing a real property improvement. These
10 transactions are not subject to sales tax that
11 the customer has to pay. So, going back to my
12 primary responsibility, I'm going to turn that
13 tax calculation off at point of sale. The
14 customer will not be charged tax.

15 Q: Okay. And does Lowe's pay tax?

16 A: We pay tax.

17 Q: Okay. Now, just as an aside, I know some of
18 the contracts dealt with installing stoves and
19 appliances. Does Lowe's ever sell appliances
20 over-the-counter without installing them?

21 A: Absolutely.

22 Q: Okay. And what are some examples?

23 A: You name it. Washers, dryers, ovens,
24 microwaves. Think of your kitchen.

25 Q: Okay.

1 A: We sell it.

2 Q: For sales and use tax purposes, how do you
3 treat those transactions?

4 A: Like a sale of a hammer. We simply -- if all
5 you want to do is buy an appliance or any item
6 of tangible personal property in our store, you
7 take it to the checkout counter and we tax it.
8 We might deliver some appliances because
9 they're large items. South Carolina has what's
10 called destination sales tax. So, when the
11 truck delivers it to South Carolina, anywhere
12 in South Carolina, we're going to charge the
13 destination rate of tax. If we deliver outside
14 of South Carolina, we're going to charge the
15 other state's tax. It would be a use tax at
16 that point but we'll be charging it.

17 Q: Okay. Let's go to Exhibit 36. What is this?

18 A: This is a contract. At the top of the
19 contract, once again, it gives you insight into
20 the type of item being installed. You'll see
21 Mwork, that stands for millwork, it's
22 abbreviated, and specifically, windows.

23 Q: Okay. And down on merchandise summary, there's
24 some initials, SOS. What does that mean?

25 A: That's a Lowe's internal term that stands for

1 Special Order Sale.

2 Q: Okay. So, tell us, what is a special order
3 sale.

4 A: The special order sale has been around. When
5 I first got to Lowe's, we did special order
6 sales. So, it's somewhat of a retail term that
7 we have. To give an example, windows is
8 probably the best example, no two windows in
9 houses are ever alike it seems. You can have
10 windows that are made of wood, fiberglass,
11 aluminum, plastic, vinyl. You can get those,
12 whatever the source material is for the frame,
13 you can have it painted, unpainted, colored.
14 You can get double hung, single hung, you can
15 have different panes of glass, triple pane,
16 double pane, single pane. The gas in between
17 the panes can be changed. You can put
18 reflective material on it. What I'm trying to
19 give you an example of is there's a lot of
20 decisions to make on a window. The size, the
21 height of the window, the width of the window,
22 does it have an arch type. They're all
23 different. So, Lowe's doesn't carry an
24 inventory of every window possibility out
25 there. It would be foolish to do so. So,

1 that's where special order comes in, is we --
2 we have items where we have manufacturers or
3 vendors that can build windows relatively
4 quickly based on the customer needs. So, in
5 this particular case, the installer went to the
6 customer's home, the customer -- he made the
7 measurements and if Lowe's doesn't have windows
8 that fit those measurements in their stock, the
9 customer is going to have to buy a special
10 order window.

11 Q: And how is that done? How is that different
12 from a stock transaction?

13 A: It's not radically different. What's really
14 different, the customer really doesn't know,
15 the customer just has the ability to -- we give
16 them a catalog, it could be an electronic
17 catalog or a paper catalog, and they go through
18 and make decisions what they want. We actually
19 have a computer system that the sales associate
20 has and it's called M20 and it's an
21 abbreviation for Made to Order. And it's
22 basically a decision tree. So, the first
23 thing, we would type in the height of the
24 window, the width of the window and then the
25 type of material and who the vendor is, is it

1 Jeld-Wen, Pella, is it a Lowe's private label
2 brand. But the goal is to ultimately determine
3 exactly what type of window that customer
4 wants. And what's happening behind the scenes
5 is that information is going to be
6 electronically conveyed to the vendor so they
7 can build that window. That's specific. So,
8 that's where the term Special Order Sale comes
9 in.

10 Q: Okay. Let me show you a code definition. The
11 definition of wholesale sale or sale at
12 wholesale. Defined as "Tangible personal
13 property to a licensed retail merchants,
14 jobbers, dealers or wholesalers for resale and
15 do not include sales to users or consumers not
16 for resale." The description you just gave of
17 a special order sale, in this case, a custom
18 built window, is Lowe's purchasing that window
19 at wholesale, like in that definition?

20 A: Not when it's part of a contract. Not at all.

21 Q: Why not?

22 A: Well, for one thing, it's not even treated in
23 our books and records as inventory. It never
24 enters inventory because there is no inventory
25 that has come in. It's not sitting on the

1 shelf, it's not in inventory, and furthermore,
2 the customer's already paid for it. So, it's
3 a direct from vendor to job site typically.
4 It's not inventory.

5 Q: So, there's no intent ---

6 A: So, we're not ---

7 Q: --- to resale that to some unknown customer?

8 A: No. It's specifically assigned to that
9 customer for that job and it's put aside. Now,
10 if I can elaborate.

11 Q: Sure.

12 A: The vendor that makes that window could ship it
13 to the store, could ship it to the installer or
14 could ship it directly to the job site. If
15 it's shipped to the store, the PO or purchase
16 order number that's associated with that
17 delivery is looked up in Genesis and the
18 unloader at the store or the receiver is going
19 to say, "Oh, this is for an installed sale."
20 And they will take that item and put it in a
21 specific place in the back of the store so it
22 does not get commingled with actual retail sale
23 inventory up front.

24 Q: And does Lowe's have a preference as to whether
25 it go to the store or the installer or to the

1 customer?

2 A: We do. Somewhat commonsense, once again.
3 Every time you unload a truck or load a truck,
4 you have a possibility of damaging that
5 material. So, if you -- if the vendor ships it
6 to the store, we have to unload that truck.
7 We're then going to put it somewhere where it
8 could get damaged with forklifts running
9 around. The installer would then come by and
10 we would load it on the installer's truck. The
11 installer then has to carry it to the job site
12 where he's going to unload it. All those
13 points of handling are a potential for damage.
14 So, ideally, what we're starting to do now,
15 we're starting to get a little smarter, is
16 let's just ship it directly to the job site.

17 Q: Okay. Let me show you another definition
18 that's in the code. These are the definitions
19 in the code section that deals with
20 contractors. Are you generally familiar with
21 those?

22 A: Yes, sir.

23 Q: Okay. In the opening, I talked about general
24 construction which, among other things, is
25 defined as improvement of any kind of real

1 property. Does Lowe's doing home improvement
2 contracts, from your reading of that statute,
3 fit within general construction?

4 A: Absolutely.

5 Q: Okay. And does Lowe's performance of home
6 improvement contracts seem to fit under the
7 definition of general contractor?

8 A: Yes, sir.

9 Q: And between prime and subcontractor, which one
10 is Lowe's, based on those definitions?

11 A: We're a prime contract because the contract
12 that's entered into with the customer is
13 between Lowe's and the customer. If the
14 customer has a problem, they come to us. We'll
15 then go to the installer. If the installer
16 made the mistake installing material, he's our
17 sub effectively, and we're just -- the
18 customer, once he pays his lump sum, that's it.

19 Q: Okay. In the business of performing home
20 improvement contracts, does Lowe's have any
21 competition in the state?

22 A: It's got a lot of competition in the state.

23 Q: What are some examples of your competitors?

24 A: It's anybody that's in that business that
25 offers home improvements. Obviously, Home

1 Depot's in the same boat. They're a
2 competitor. They're a retailer, contractor
3 like we are. But anybody, any, you know, Joe
4 the Plumber.

5 Q: Okay.

6 A: Joe the Plumber is a competitive -- or is
7 competition.

8 Q: How about the big ones like Pulte Homes and all
9 those, are those competitors, too?

10 A: They are. I think in a less of a sense. Pulte
11 Homes typically is a tract builder that's
12 building an entire home but they could sub out
13 some of their work to Lowe's to say, "Hey, we
14 like your appliances, would you put the
15 appliances in here?" So, a tract builder, I
16 might not perceive as a competitor. I would
17 look at a specialist, a roofing company, one
18 that puts in carpet and tile work. So, more of
19 the smaller individual specialized contractors.

20 Q: Okay. When you're competing for business, do
21 you ever compete on basis of price?

22 A: Absolutely.

23 Q: So, if Lowe's, when it's performing home
24 improvement contracts, has to pay substantially
25 more in sales tax than it's competitors doing

1 the same work, is that additional cost factored
2 into your price?

3 A: Well, it's kind of like break-even analysis.
4 You have the option of passing your cost on to
5 the customer but competitively priced, your
6 price could now be higher. So, if your prices
7 are higher, you're not going to get as much
8 revenue from that contracting side of business.
9 So, if you drop your price down to make it
10 competitive with others, you're going to erode
11 your profit margins because your costs are
12 higher. So, it's a tradeoff, you can keep the
13 revenue coming in but the profit margin on each
14 sale is less.

15 Q: Okay.

16 A: You've got more expense. You're paying more
17 tax.

18 Q: Well, does the additional tax burden that's
19 being imposed by the Department here impact
20 your ability to compete for home improvement
21 installation work in South Carolina?

22 A: Once again, it depends on whether we increase
23 our prices to cover the additional costs. If
24 we do, then we're not cost-competitive anymore.
25 From a pure profitability standpoint, if we

1 keep our selling prices competitive to others,
2 we're eroding our profit margins.

3 Q: Okay. All right. Here's a regulation, 117-
4 314.2, that talks about building materials.
5 Are you generally familiar with that
6 regulation?

7 A: I am.

8 Q: And the definition of building materials?

9 A: Yes, sir.

10 Q: From your reading of that, does the tangible
11 personal property that's used by Lowe's in
12 performing home improvement contracts fall
13 within that definition of building materials?

14 A: Yes. As I've stated in those other cases, at
15 one time, all tangible personal property or,
16 excuse me, all structures built on real
17 property were at one time a combination of TPP.

18 Q: What is your understanding of what this
19 regulation requires?

20 A: Well, the best thing to do is just read it.

21 Q: Okay.

22 A: "Building materials, when purchased by
23 builders, contractors or landowners for use in
24 adding to, repairing or altering real property
25 are subject to either sales or use tax at time

1 of purchase."

2 Q: Okay.

3 A: And I think the key word is time of purchase.

4 Q: So, does Lowe's pay sales use tax at the time
5 it purchases the materials for its contracts?

6 A: It does not.

7 Q: Why not?

8 A: Well, I believe there's a reg, I don't think
9 it's the law, I think it's a regulation that
10 says that if you operate in the capacity of a
11 dual operator, you must purchase your materials
12 at wholesale. Now, they're not for resale but
13 we're still deemed, because of the reg, to
14 purchase at wholesale.

15 Q: Would it be practical or equitable to parse out
16 in advance the sales tax that you would owe on
17 materials that you might use in construction
18 contracts as opposed to what will be sold at
19 retail?

20 A: In a company the size of Lowe's, we rely
21 heavily on computer systems. Could it be done?
22 It could. Is it practical? Absolutely not.
23 It's -- no.

24 Q: Okay. Let's try another code section. 12-36-
25 110, which identifies the various triggers of

1 what they call sales of retail. From your
2 understanding of the law as applied to the
3 facts, which of those subcategories best
4 applies to Lowe's when it's performing home
5 improvement contracts?

6 A: (e) does. It says, "Sales to contractors for
7 use in the performance of construction
8 contracts." What I looked at is we've got a
9 contract, it's related to construction and
10 Lowe's is a contractor performing real property
11 improvements.

12 Q: And has Lowe's complied with its obligations
13 under the law if (e) applies?

14 A: Yes.

15 Q: Let's go to Exhibit 37. What is that?

16 A: This is a summary of a -- we have a report
17 called the TAX 765-D, which shows every item
18 that was installed that we deem is subject to
19 use tax. So, we didn't charge sales tax on it.
20 I think Paulette has seen this report before.
21 And that information -- that report provides
22 information of the item number that was
23 installed and whether that item number was an
24 SOS item or a stock item.

25 Q: Okay.

1 A: So, what I did here is I looked at -- what I
2 was -- kind of inverse, if you will, I looked
3 at the total. Their weekly reports, this is
4 the summary of all those weeks. So, William
5 Lowe, who introduced himself here, he and I
6 basically downloaded each of those weekly
7 reports, 150 or 200 of them, stripped the data
8 out and then analyzed it to determine of the
9 material that's installed, how much is stock
10 material, how much is SOS items.

11 Q: And this is during the audit period?

12 A: Yes, this is -- this data is from the audit
13 period, yes, sir.

14 Q: Okay. And so from this, you were able to
15 conclude the percentage, overall percentage, of
16 items consumed in performing home improvement
17 contracts during the audit period that were
18 stock versus special order?

19 A: That's correct.

20 Q: Okay. And what is the conclusion?

21 A: Well, the very bottom row is showing that that
22 report provides the shelf price of the item.
23 I shouldn't say the shelf price. It's the
24 price that was used to calculate the amount of
25 the installed sale.

1 Q: Okay.

2 A: So, the selling price. But we also had the
3 cost information. I didn't know what might be
4 of value. I had the information so I did two
5 calculations. But I think you can see that 40
6 to 42 percent, whichever number you choose or
7 average the two, is the amount of items that
8 were stocked that were installed, which means
9 100 percent minus 42 percent tells you how much
10 was SOS items that were installed.

11 Q: Okay. So, throughout the audit period, between
12 58 and 60 percent of all of the items that were
13 consumed in performing home improvement
14 contracts by Lowe's involved special order
15 items?

16 A: Yes, sir.

17 Q: Which ---

18 A: Never go in inventory.

19 Q: And are not bought for resale?

20 A: And they're not bought for resale.

21 Q: Okay. Okay. Let's go to Exhibit 32. And
22 we're going to have to flip in a little bit on
23 this. What I'm trying to get to is the
24 Department's determination, which would be the
25 first document after the green page.

1 A: Okay. I'm there.

2 Q: And it's dated October 24, 2014?

3 A: Yes.

4 MR. SMITH: I will wait for Your Honor to find that.

5 THE COURT: Could you repeat the number again?

6 MR. SMITH: It's Exhibit 32 and go to the first
7 green separator in it. It's actually Exhibit
8 1 to Exhibit 32.

9 THE COURT: Got it.

10 Q: Okay. And this is what we're protesting today.
11 This is the Department's determination back on
12 October 24. And it lists some relevant facts
13 that begin on page one of the determination.
14 So, let's go to fact number two, which this is
15 the basis of the assessment, "The taxpayer
16 purchases tangible personal property at
17 wholesale for resale to its customers. The
18 tangible personal property is stored in
19 inventory at warehouses and at each retail
20 facility." Is that statement accurate as to
21 the special order sale items?

22 A: Not with regards to the special order items.
23 And it's a little misleading. It's the truth
24 but it's not the whole truth and nothing but
25 the truth. So, "The taxpayer purchases

1 tangible personal property at wholesale for
2 resale." So, clearly the SOS items are not
3 purchased for resale. So, that's a little
4 misleading. "The tangible personal property is
5 stored in inventory." If you're referring to
6 the special order items, they're not in
7 inventory. So, that's a little misleading.
8 It's true that the other items are stored at
9 warehouses and at each retail facility. So,
10 it's somewhat true.

11 Q: Okay. Are there any distribution centers in
12 South Carolina, by the way?

13 A: No.

14 Q: Okay. So, what distribution center feeds the
15 stores in South Carolina?

16 A: I don't know with certainty. We have a
17 distribution center in just -- just south of
18 Statesville. No, north of Statesville. Near
19 Statesville. I'll be safe here. We have a
20 distribution center on I-77 near Statesville,
21 North Carolina. That, most likely, feeds the
22 stores in South Carolina. And I believe we
23 have a distribution center in Georgia, as well,
24 and I wouldn't be surprised if that's supplying
25 several of the stores in South Carolina.

1 Q: Okay. Now, the third factor or finding is that
2 "The taxpayer also withdraws items from its
3 inventory to perform contract sales and
4 installations." Is that statement true?

5 A: Well, with regards to the special order items,
6 they're not in inventory so that's not true.
7 I don't consider they're contract sales and
8 installations. I think better wording is to
9 perform real property improvements.

10 Q: Okay. Let's look then at the regulation that
11 the Department is looking at. It says that
12 "The value be placed on the goods at the price
13 at which the goods are offered for sale by the
14 person withdrawing them." That's to apply to
15 property purchased at wholesale for resale
16 purposes and subsequently withdrawn from stock
17 for use or consumption by the purchaser. Would
18 that apply to any of the special order sale
19 items?

20 A: No. No, it's never in inventory and it wasn't
21 purchased for resale. I might go back. It was
22 purchased at wholesale but understand, I think
23 there's a regulation that says we must purchase
24 it at wholesale.

25 Q: Wholesale meaning it was pursuant to a resale

1 certificate that you didn't collect the tax at
2 the time?

3 A: Correct.

4 Q: But it was not for resale?

5 A: It was not for resale but we had to purchase it
6 at wholesale.

7 Q: Okay.

8 A: But that doesn't imply it's for resale.

9 Q: Okay. Let's stick with the determination here.
10 And there's a discussion on page four that
11 talks about contractor versus retailer making
12 installed sales. And the conclusion of the
13 Department is that Lowe's is not a true
14 contractor. I think that's the phrase it uses.
15 It says, "A retailer truly serves as a
16 contractor or subcontractor in the traditional
17 sense for some transactions (bids on projects
18 against others, entrance into a contract upon
19 winning the bid process, etc.) then the
20 building materials purchased for those
21 contracts may be purchased as a contractor with
22 sales tax being paid at the time of the
23 purchase of the raw materials." And down at
24 the paragraph below that, it says, "Taxpayer is
25 not a contractor based on the facts and

1 circumstances in this matter." Other than that
2 definition of contractor that we saw, the
3 statutory definition, are you aware of any
4 other caveat or condition or exclusion or
5 exemption that says you can't be a contractor
6 if you also make sales at retail?

7 A: No. And, actually, I think South Carolina
8 addresses that in a reg that they have that
9 says you can.

10 Q: This dispute then about whether Lowe's is a
11 contractor, or should it be treated as a
12 contractor when it makes installed sales, is
13 this the same issue that you have been fighting
14 in other states?

15 A: It's very similar. The issue in the other
16 states is that whether Lowe's should charge its
17 customers sales tax on these transactions.
18 That's the issue in the other states. If you
19 go to the prior South Carolina audit, and there
20 was actually a news piece done on Lowe's where
21 somebody said Lowe's isn't charging sales tax,
22 the Department of Revenue said, "Well" ---

23 MS. WOOTEN: Objection, Your Honor. Hearsay.

24 MR. SMITH: Well, we have that exhibit here. We
25 would like to tender that exhibit. That's one

1 that's objected to. But, of course, that's an
2 admission by the Department to Lowe's as to why
3 they were assessing tax on them in the prior
4 audit, which is a justification for the
5 penalty. So, we would like to address what
6 they were told at the time.

7 MS. WOOTEN: Your Honor, the spokesperson was Danny
8 Roselle. He's no longer employed with the
9 Department. He's not here to testify. And we
10 would just submit that that is hearsay. It was
11 something said outside of the courtroom and
12 it's not relevant in this particular matter.

13 MR. SMITH: I disagree. It is relevant and they
14 said it.

15 THE COURT: I mean, isn't this going to at least one
16 of the justifications that the Department has
17 for its position?

18 MR. SMITH: Correct.

19 MS. WOOTEN: Yes, Your Honor, it is part of the
20 justification from the prior audit.

21 THE COURT: I'm going to allow it then.

22 Q: So, we're jumping out of order but we're here,
23 there so we'll do it at this time. So, what
24 were you told by the Department in the prior
25 audit?

1 A: It was a long time ago. I -- I can't recall
2 everything. The -- my thinking of it is the
3 state of South Carolina has not assessed Lowe's
4 that it should have charged sales tax on -- let
5 me rephrase. If the South Carolina Department
6 of Revenue thought Lowe's was acting as a
7 retailer with these transactions, they could
8 have easily said, "You should have charged
9 sales tax on these transactions" and that's the
10 end of it. But they're not assessing us under
11 the theory that you should have charged your
12 customers sales tax. They're assessing a sales
13 tax under the theory of withdrawal.

14 Q: That's this time around?

15 A: This time around.

16 Q: Yes.

17 A: And I think that's different than last time.
18 I don't know but by deeming -- by assessing
19 Lowe's under a withdrawal concept, they've
20 pretty much admitted, in my opinion, that they
21 know that these transactions are real property
22 improvements and aren't subject to sales tax
23 that the customer has to pay. And that's why
24 it's critical, in my job, to know whether the
25 customer needs to pay that tax or not. I

1 turned that tax calculation off. South
2 Carolina doesn't seem to have a problem, this
3 time around, with that calculation.

4 Q: All right. Well, let's back up. I was about
5 to go into the other states but let's talk
6 about the prior audit for a moment. Were you
7 involved in the prior audit?

8 A: In -- I was involved, yes. Not as -- Victor
9 Brown is a manager that reported to me. The
10 audit process with South Carolina has worked
11 well over the years. They look at our books
12 and records, they're entitled to do that.
13 They're looking for situations where tax wasn't
14 paid, wasn't charged, with regards to fixed
15 assets, expenses and our sales transactions.
16 And we provide the data, they find the errors,
17 we want to classify the type of errors that
18 they're finding in hopes that we can improve
19 that going forward. So, we want to know where
20 the errors are. And these are the errors that
21 we agree with. We also want to classify errors
22 that we disagree with. The state thinks we're
23 -- we owe tax on this. We need to identify
24 each issue so we can develop an argument. We
25 want to categorize them so we know what the

1 issues are. You know, do we appeal it, are we
2 going to -- are we right, are we wrong, on the
3 items that we disagree with. And the items
4 that we agree with, all we want to do is
5 improve our processes going forward. So, if
6 there's one vendor that's not charging tax that
7 made up 80 percent of the audit, maybe a phone
8 call to that vendor might help, such that
9 they're charging tax. Or we can build a
10 process to accrue for that one vendor, accrue
11 use tax.

12 Q: Okay. You had testified earlier that the
13 company started doing installed sales,
14 transactions, in the mid-90s?

15 A: Yes.

16 Q: And you were heading up sales and use tax and
17 you were trying to wrestle with how to deal
18 with this new line of business?

19 A: Yes.

20 Q: Carry it forward. Tell me the process of
21 addressing that issue?

22 A: It's a long story.

23 Q: I know but it's important for the prior audit
24 purposes here. So, I know it's a long story
25 and if we need to take a break at some point,

1 that's fine.

2 A: Okay.

3 Q: But I think that's important.

4 A: As I said, I started Lowe's in 1992. I had
5 done some sales tax work with my previous
6 employer but I was -- I was a novice. Through
7 '92 and '95, Lowe's engaged in retail sales.
8 We had retail systems, you charged tax on the
9 tangible personal property, remit it, things
10 like that. When Lowe's started in installed
11 sales, I treated it as a retail. I didn't know
12 any better, so. But I did know that there was
13 a service element and I knew that there was
14 materials as part of the transaction. I wasn't
15 even looking at the contracts, I wasn't looking
16 at the terms and conditions, I just looked at
17 it very elementary to say there's a service
18 element, there's a material element, how do I
19 tax them.

20 Q: At the time, was retailers engaging in
21 contracting work kind of a new concept?

22 A: For me. Well, for me, it was.

23 Q: Okay.

24 A: Maybe -- Sears did it for years.

25 Q: Okay.

1 A: But I knew very little about it. Nothing.

2 Q: Okay.

3 A: So, I -- my goal was, okay, well, there's
4 materials being transferred. I don't know that
5 it -- I didn't even -- the concept of
6 construction really didn't enter my mind. It's
7 just a sale of materials and it was a sale of
8 labor.

9 Q: Okay.

10 A: A bifurcated transaction. And that's the way
11 I set the tax flags on those items.

12 Q: What does that mean, set the tax flags?

13 A: To calculate tax on the materials and to not
14 calculate tax on the labor. Some states tax
15 labor so I would set the tax flag to do a tax
16 calculation on that.

17 Q: And you're the guy who does that, who decides
18 how the states ---

19 A: Well, Victor Brown and I.

20 Q: Okay.

21 A: Back in the -- there's 13 or 14 people in the
22 group now. Back in 1995, there was three of
23 us.

24 Q: Okay.

25 A: Three or four. It was a small group. So,

1 Lowe's, because I was a CPA, Lowe's would send
2 me to get my CPE credit and they would always
3 send me to focused sales tax schools. And
4 that's where I started learning there was a lot
5 of sales tax issues related to construction.
6 And the more I listened to these seminars and
7 started reading these papers, I started
8 scratching my head, asking myself the question,
9 what is Lowe's really doing? Have we entered
10 a business and I might be taxing it wrong? So,
11 I went -- I went to David Green, who was my --
12 or Larry Stanley, at the time, and shared my
13 concern that "I think we're in a different line
14 of business than standard retail. We might --
15 we might need to think about this." And began
16 with resources, went to the business and it
17 kind of went up the chain and they said, "Well,
18 you know, this is not a big percentage of" ---

19 MS. WOOTEN: Objection. Hearsay.

20 MR. SMITH: I'm sorry, which part is hearsay?

21 MS. WOOTEN: "They said."

22 MR. SMITH: Okay.

23 MS. WOOTEN: "It went up the chain and they said."

24 Q: Okay. Just talk about your thoughts here.

25 THE COURT: Yeah.

1 A: Okay. Let me regroup.

2 Q: Okay.

3 A: The decision, at the time, was installed sales
4 was a small portion of our business. As I
5 said, we -- we were adding these categories to
6 the business model over time. So, the
7 installed sales became larger over time but
8 back years ago, in '95, '96, '97, it was not a
9 large percentage of our business. So, the
10 decision was made, "Craig, keep monitoring,
11 keep thinking about this." We had a few
12 customer questions that would come up, here and
13 there, kind of across the country where "I
14 don't think you're supposed to be charging
15 sales tax, this seems like a real property
16 improvement," which started adding, for lack of
17 a better term, fuel to my fire, if you will,
18 where I was thinking about this more thoroughly
19 and more deeply. In December 2002, we received
20 a formal letter from the state of Maryland. We
21 were under audit by the state of Maryland and
22 Maryland, it's just a little one-page letter
23 and it said, "You are put on notice that in the
24 state of Maryland these transactions, you're
25 serving as a contractor, and you need to cease

1 and desist charging sales tax. And, of course,
2 I took that up the chain and said, "This is
3 what I've been talking about, this right here."
4 The next state, and it was within a month or
5 two, was the state of Ohio, same exact issue,
6 and this was in 2002. 2003, I think the state
7 of Utah raised the issue. Somewhere in 2004,
8 Sarbanes-Oxley and I don't remember when
9 Sarbanes-Oxley requirements actually kicked in
10 but at Lowe's we took that very seriously and
11 all managers in finance had to sign a statement
12 saying that they are not aware of any material
13 misstatement of the financial records. And
14 David and I got together because he was
15 starting to come to the same conclusion that I
16 did, is we're charging sales tax on
17 transactions that we don't think are subject to
18 sales tax. We're potentially putting Lowe's in
19 a class action lawsuit situation in a number of
20 states. We've not remitted any use tax. And
21 it's actually a double-edged sword with regards
22 to sales tax and use tax. And I know South
23 Carolina doesn't -- use tax is a little
24 different in South Carolina. But when you
25 collect a sales tax that's not legally allowed

1 to be collected, that money is held in trust by
2 the state. So, we've remitted that money and
3 the state is going to hold that money, not
4 Lowe's. But then the state can actually come
5 to Lowe's and say, "You owe use tax on these
6 transactions based on the cost." So, it was a
7 very bad situation in the multi-millions of
8 dollars.

9 Q: Okay.

10 A: So, David Green and I decided that it was our
11 fiduciary responsibility to qualify those
12 Sarbanes-Oxley statements and that's exactly
13 what we did. And it was reacted on very
14 quickly, so.

15 Q: It got people's attention?

16 A: It got people's attention. It got the board of
17 directors' attention, it got internal audit's
18 attention. And there was a meeting with the
19 executive vice president of operations, chief
20 counsel of Lowe's, Robert Niblock was in that
21 meeting. Robert Niblock, at the time, I think,
22 was chief accounting officer.

23 Q: And let's not talk about what was said during
24 that because that's a ---

25 A: Okay.

1 Q: --- that's a privileged communication. But, in
2 essence, this came to an issue in late 2004,
3 early 2005, is that about right?

4 A: Yes, 2004, I believe.

5 Q: Now, what was the period during which the prior
6 audit in South Carolina took place?

7 A: I think it was 2004 through 2007.

8 Q: Okay. So, this kicked in right in the middle
9 of the audit period?

10 A: Yes, sir.

11 Q: Okay. During that audit period, did Lowe's
12 change how it handled sales and use tax on home
13 improvement contracts in South Carolina?

14 A: It did. So, the -- the -- what we decided was
15 if we're doing something wrong, we need to do
16 it right. And I was given the authority to fix
17 it. So, the way I approached it was I knew
18 that each state was different and I knew that
19 each category of installed sales were
20 different. So, I had to build a system that
21 allowed me to turn those tax flags on and off
22 by state, by category. I also had to, if I
23 turned the tax calculation off to not calculate
24 tax that the customer would pay us, then I had
25 a use tax responsibility on the material cost.

1 And I had to design that system, think it
2 through and then work with the information
3 technology group to build that system. That
4 system was built in approximately 2004, tested
5 and rolled out 2005 time frame, 2004. I don't
6 remember the rollout date. But what I do know
7 is on the prior South Carolina audit, the
8 changes were rolled out in the middle of the
9 audit towards the back one-third of the audit.
10 So, essentially, what happened is based on my
11 reading of the law, I felt, one, we were
12 operating as a contractor and, two, we should
13 not be charging our customers sales tax on
14 those transactions. So, once I had the system
15 built, I was able to turn the tax calculation
16 off on installed sales.

17 Q: Okay.

18 A: And then subsequently perform a use tax
19 calculation on the materials that were utilized
20 in those contracts.

21 Q: So, for two-thirds of the audit period, you
22 were collecting sales tax from customers, the
23 final third, you were not collecting sales tax,
24 you were getting use tax on the cost of the
25 material?

1 A: On the cost, yes, sir.

2 MS. WOOTEN: Objection. Leading.

3 THE COURT: I'm going to allow it.

4 MS. WOOTEN: Okay. Thank you.

5 Q: So, you had two different operations throughout
6 this audit period. What did the auditors say
7 about that?

8 A: They liked the first two-thirds of the audit.
9 In other words, where we were charging sales
10 tax, they didn't have a problem with that side.
11 They didn't like the fact on the second half,
12 or the second -- the final third of the audit,
13 that we weren't charging it.

14 Q: Okay. And so they ---

15 A: So, they assessed us.

16 Q: They assessed you?

17 A: They assessed us.

18 Q: Why didn't you protest that?

19 A: It was a business decision. We -- the
20 statement I made earlier, if you've collected
21 sales tax that legally you're not allowed to
22 collect -- Lowe's can't get the money back.
23 That's the customer's money. So, when we
24 looked at the data, there was more risk
25 associated with the first two-thirds of the

1 audit, when I say risk, I mean a potential
2 assessment, than there was in the last one-
3 third of the audit. It was purely a business
4 decision.

5 Q: Okay. Did you agree with the Department's
6 position?

7 A: We didn't agree with it. We -- they assessed
8 us on the back one-third under the way it was
9 -- the way I remember it is the first one --
10 first two-thirds, we were charging sales tax,
11 that was perfectly okay. There was no
12 overcharging done. I disagree. And the back
13 one-third, "Well, you weren't charging your
14 customers tax and you should have been."

15 Q: Okay. This is the news story that we talked
16 about that came out in 2004 where the
17 Department's representative's complaining that
18 Lowe's stores don't charge sales tax on
19 installed sales. Are you familiar with that?

20 A: Oh, yeah.

21 Q: Okay.

22 A: Yes.

23 Q: Did I accurately describe what that document
24 was?

25 A: Yes.

1 Q: Okay.

2 A: Yes. I mean, there's a video of it, as well.

3 Q: Okay.

4 MR. SMITH: Your Honor, I understand there's an
5 objection on it. I will tender this at this
6 time.

7 THE COURT: All right. This is Exhibit 11 or 12?

8 MR. SMITH: No, this is a ---

9 MS. WOOTEN: No.

10 MR. SMITH: --- this is a ---

11 MS. WOOTEN: This is a new exhibit.

12 THE COURT: Oh, this is a different exhibit?

13 MR. SMITH: It's a new exhibit.

14 MS. WOOTEN: I mean, our objection would be the
15 hearsay, which I think that you ruled on
16 earlier. So, if you would like to admit it, we
17 can put it in as 64, I believe, to make it
18 consistent.

19 THE COURT: All right. Right, I did overrule your
20 objection on that and allowed that so I'm going
21 to go ahead and let that in. And it would be
22 Exhibit?

23 MR. SMITH: Sixty-Four, I think.

24 THE COURT: Sixty-Four.

25 MS. WOOTEN: Sixty-Four.

1 THE COURT: All right.

2 (Joint Exhibit Number 64 was admitted into evidence.)

3 MR. SMITH: I've got that one and this one. We'll
4 make more copies. I'll hand this to yours.

5 THE COURT: Thank you.

6 MR. SMITH: That's Exhibit 64.

7 Q: All right. Let's briefly talk about some other
8 states just because this is a recurring theme.
9 Oklahoma, did you have this issue come up in
10 Oklahoma?

11 A: Not the withdrawal issue but whether we should
12 ---

13 Q: No, the contractor/retailer thing?

14 A: Yes, whether we should be charging sales tax to
15 our customer, that issue came up in Oklahoma.

16 Q: Okay. And was their contention that you're a
17 retailer so you can't be a contractor?

18 A: That is correct.

19 Q: Okay. Was that matter litigated and presented
20 to a hearing officer who rendered a ruling?

21 A: That is correct.

22 Q: And what was that ruling?

23 A: The ruling was in favor of Lowe's. Lowe's was,
24 indeed, a contractor and should not be charging
25 sales tax to its customers.

1 Q: And that went up the chain and adopted by the
2 Oklahoma Tax Commission as their official
3 position?

4 A: They appealed that decision, I think, two or
5 three times. There was an En Banc hearing. It
6 went through the chain, which you're more
7 familiar with than I am. But the state of
8 Oklahoma Department of Revenue exhausted their
9 appeal rights, I believe, short of going to the
10 Supreme Court in that state, and it was ruled
11 in Lowe's favor. We were a contractor.

12 MR. SMITH: Okay. And, Your Honor, that's in one of
13 the authorities that we've submitted to you.

14 Q: Do you recall if an equal protection claim was
15 made in Oklahoma about you can't treat this
16 contractor different from all the other
17 contractors?

18 A: You did make that, yes, sir.

19 Q: Okay. This is just a final page from the
20 ruling of the Administrative Law Judge. I've
21 highlighted a portion. What was the finding by
22 the Administrative Law Judge?

23 A: I will read it. "The Division's distinction
24 between protestant and contractor as defined by
25 the Sales Tax Code would be a violation of the

1 equal protection clause if upheld. But based
2 upon the conclusions reached herein, it is a
3 moot point."

4 Q: Okay.

5 A: So, they saw they were placing an extra undue
6 burden on Lowe's.

7 Q: How about Indiana? What was the issue in
8 Indiana?

9 A: Similar. Once again, they -- they felt we
10 should be charging sales tax. It had a slight
11 twist. They felt our contracts were time and
12 material contracts. The outcome was the same.
13 Knock on wood. The court determined, the tax
14 court determined, that Lowe's was, indeed,
15 acting as a contractor. They also looked very
16 thoroughly at our contracts and determined,
17 yes, they are lump sum contracts. And,
18 actually, the Indiana Department of Revenue
19 appealed to the Indiana Supreme Court, the
20 Supreme Court said, "No, tax court got it
21 right." And the actual judge, I believe,
22 invalidated the regulation that the Department
23 of Revenue had that -- that spoke on different
24 treatment as to whether something was a time
25 and material contract versus a lump sum.

1 Q: Okay. And that, too, is in our table of
2 authorities. And I think it was this week last
3 year that we had a trial in Kansas, did we not?

4 A: We did.

5 Q: Okay. And what was the issue there?

6 A: The same issue. It was more limited in scope.
7 It was literally limited to installed kitchen
8 appliances or, I should say, appliances but the
9 appliances that we installed are kitchen
10 appliances. It was different in the sense that
11 they -- it was related to the labor side of the
12 transaction, that if you're providing setup
13 services then the labor is taxable. And that
14 was different. All the -- really, all the
15 research I'd ever done was on material taxation
16 and use tax accruals of that and that one was
17 related to taxation of labor.

18 Q: Sure. And that ruling is there, as well. But
19 in all three rulings, was there a conclusion as
20 to whether or not Lowe's, when performing home
21 improvement contracts, was a contractor?

22 A: Well, that was the issue obviously. When we
23 install appliances, are those appliances, do
24 they represent real property improvements? And
25 the conclusion was yes. Therefore, Lowe's is

1 a contractor.

2 MR. SMITH: I will tender the witness, Your Honor.

3 THE COURT: Thank you.

4 MS. WOOTEN: You ready, Your Honor?

5 THE COURT: Ready if you're ready.

6 MS. WOOTEN: I am. Thank you for joining us from
7 jail this morning.

8 A: Thank you, very much.

9 MS. WOOTEN: We appreciate that. A few questions
10 for you.

11 MR. PRICE - CROSS EXAMINATION BY MS. WOOTEN:

12 Q: Lowe's is a licensed retail merchant, correct?

13 A: Yes, ma'am.

14 Q: And as a retailer, when Lowe's buys items for
15 resale, it does not pay sales tax on that
16 purchase?

17 A: That is correct.

18 Q: And to purchase inventory tax free from a
19 vendor, Lowe's provides a resale certificate to
20 the vendor, is that correct?

21 A: Yes, ma'am.

22 Q: And on a regular sale of inventory from the
23 retail location, Lowe's requires the customer
24 to remit sales tax on the store's retail price
25 of the item, is that correct?

1 A: We -- we -- we calculate sales tax on the sale
2 of that item and the amount the customer pays
3 us is inclusive of that tax.

4 Q: You pass along the sales tax to the customer,
5 is that correct?

6 A: Yes, ma'am.

7 Q: All right. We're going to turn to the
8 installed sales contracts and we're going to
9 look first just at the regular type install
10 contracts.

11 A: The stock one?

12 Q: Yes, stock. Also known as stock.

13 A: Thirty-Four?

14 Q: If you'll refer to Exhibit 34, please.

15 A: Uh-huh (affirmative response).

16 Q: When a Lowe's customer purchases the materials
17 as part of the regular or stock installed
18 contract, Lowe's charges the customer the
19 store's retail price of the item, is that
20 correct?

21 A: We charge a price for the item. It doesn't
22 have to be the retail price. It can be any
23 price that we deem. So, if they're cross-
24 shopping us against Home Depot and Home Depot
25 has come in lower, we might drop the price on

1 those items. So, I wouldn't refer to it the
2 retail price but there is a price there.

3 Q: But it's more than what Lowe's cost of the item
4 is, is that correct?

5 A: Not necessarily. I hope it is, that's the way
6 we make money, but it doesn't necessarily have
7 to be. It's what we sell it for.

8 Q: And on this contract, I believe it's for
9 hardwood floors, the price of the floors is
10 \$1,445.07, is that correct?

11 A: The total materials quoted here is \$1,445.07.

12 Q: And, again, that's the price that Lowe's sells
13 the items to the customer, is that correct?

14 A: This is the material price portion of that
15 contract, yes.

16 Q: And this is what the customer pays, ---

17 A: Yes.

18 Q: --- is that correct?

19 A: Yes. In addition to -- yes, ma'am.

20 Q: Okay. All right. If you'll flip to the second
21 page. Lowe's does not charge any tax to the
22 customer as part of the installation contract,
23 is that true?

24 A: That is correct.

25 Q: Okay. And in South Carolina, the customer is

1 responsible for remitting the sales tax?

2 A: Say that again. I want to be sure.

3 Q: Is the customer responsible for remitting the
4 sales tax?

5 A: Remitting the tax? Hopefully, they remit it to
6 us so we can remit it to the state.

7 Q: Okay. So, Lowe's is responsible for remitting
8 it to the state, not the customer?

9 A: Yes. If there was tax collected, that is our
10 responsibility. Whether that tax was collected
11 legally or illegally, we must remit it to the
12 state.

13 Q: So, whether or not Lowe's collects sales tax
14 from its customers, Lowe's is responsible for
15 paying the tax over to South Carolina, is that
16 correct?

17 A: If tax was collected from the customer, we
18 would remit it. And if there's an additional
19 tax liability related to our construction
20 process, use tax or sales tax, if there is,
21 we'll remit that.

22 Q: Okay. Thank you. When materials are purchased
23 under the regular or stock -- I'll sometimes
24 refer to it as regular ---

25 A: That's fine. That's fine.

1 Q: --- that is also known as stock ---

2 A: That's fine.

3 Q: --- regular install contract, those materials
4 can be withdrawn from the stock of the retail
5 store where the customer signs the contract, is
6 that correct?

7 A: That is typically what happens, yes, ma'am.

8 Q: Okay. And it can also come from stock
9 inventory of another retail location, is that
10 correct?

11 A: It could. If we have -- if the store is out of
12 inventory and the customer really wants this
13 job done quickly and there's a sister store
14 that has the inventory, it could be moved from
15 that other store, yes, ma'am.

16 Q: Okay. And the sister store could be a store in
17 South Carolina or another state, is that
18 correct?

19 A: Yes.

20 Q: Okay. And when the materials are withdrawn
21 from a sister store's stock of inventory, the
22 material is sent to the retail store where the
23 customer signed the contract, is that correct?

24 A: Yes. I'm pretty sure that's the case, yes,
25 ma'am.

1 Q: Okay. And in those situations, who picks up
2 the materials, does the customer or the
3 installer or can both?

4 A: Both could. It's very, very rare that the
5 customer ever takes possession of the actual
6 materials. Could they? Sure. I mean, if they
7 asked us to, I mean, we're not going to say no
8 to a customer. But, typically, they don't.
9 They're bulky items. And the installer is the
10 one that comes by the store to get the items.
11 Unless it's a special order transaction. And
12 I know you said regular.

13 Q: Right, we're just talking about regular right
14 now.

15 A: Right. So, regular, the installer would come
16 by the store and get the items.

17 Q: And then materials can also be shipped to the
18 customer's location, correct?

19 A: Yes.

20 Q: Could the materials used in a stock install
21 contract also come from a distribution center?

22 A: They -- they would probably flow through a
23 store. I don't think, during the time of the
24 audit, the materials would be shipped directly
25 from the distribution center to the job site.

1 The distribution centers are set up to deliver
2 to stores. Very rarely -- there have been some
3 situations where a distribution center might
4 ship directly to a huge job site but it'd be a
5 -- it'd be an apartment complex that's got 150
6 units in it. That's extremely rare.

7 Q: So, in all of these examples where materials
8 come from a regular install contract,
9 ultimately the stock is withdrawn from Lowe's
10 inventory to be used in the install contract,
11 correct?

12 A: On regular stock items.

13 Q: On regular stock items?

14 A: Yes.

15 Q: All right. Again, we're still talking about
16 regular stock items. Lowe's purchases the
17 regular inventory from a manufacturer or
18 vendor, let's say Maytag, is that correct?

19 A: That would be an example.

20 Q: Okay. And when the inventory item is purchased
21 from Maytag or any other vendor, Lowe's does
22 not remit tax on that purchase, is that
23 correct?

24 A: We're buying it under a resale certificate.

25 Q: Okay. So, the purchase from Maytag is a

1 wholesale sale, correct?

2 A: If we're buying it under a resale certificate,
3 yes.

4 Q: Once Lowe's purchases ---

5 A: Let me go back on that. There's -- what we're
6 buying from Maytag is made up of -- the demand
7 for a Maytag item is made up of two elements.
8 There is a certain amount that we know are
9 going to be retail sales and a certain amount
10 that's going to be related to real property
11 improvements. And it's -- when you're dealing
12 with stock items, there is a defined amount of
13 on-hand that each Lowe's store wants based on
14 prior sales history. And sales history is a
15 component, understand that, it's made up of two
16 components. You might sell five dishwashers
17 outright as tangible personal property but you
18 might sell three that were part of an installed
19 sale. So, the demand last year was seven
20 units. So, the on-hand that that Lowe's store
21 wants to carry is seven. And when it goes
22 below that, it's going to automatically trigger
23 a PO to the distribution center to say we want
24 seven on-hand because we know that we're likely
25 going to sell four as retail sales and we're

1 probably going to utilize three as contractor
2 real property improvements.

3 Q: So, taking your seven dishwashers as an
4 example, when Lowe's purchases those seven
5 dishwashers, do they know at that time which
6 specific ones will be used for stock and which
7 will be used in an installed sales contract?

8 A: No, we do not.

9 Q: Okay. When those seven dishwashers comes into
10 Lowe's, are those, the ones to be used in
11 regular inventory and the ones to be used in
12 the installed sales, are they separated at all
13 in the inventory of the retail store?

14 A: They are not.

15 Q: They're in the same location?

16 A: Same location.

17 Q: Can a customer purchase a regular inventory
18 item used in the installed sales contract, and
19 we'll go with the dishwasher again, without
20 purchasing the installation services?

21 A: Yes. We do that all the time.

22 Q: And when that happens, when the customer goes
23 to their checkout, is the customer charged any
24 sales tax?

25 A: It depends. So, if there's a sales tax holiday

1 going on, sometimes a variety of states have E-
2 Star sales tax holidays. If there's a -- if
3 there's a tax holiday going on that says
4 dishwashers are temporarily exempt for this
5 weekend, we're not going to calculate tax. If
6 the item is shipped out of state, we're not
7 going to charge South Carolina tax. The
8 customer that's buying from us could be the
9 federal government, could be a local Army base.
10 So, it depends -- it depends is the answer.
11 But I think the question you're asking is, in
12 the general sense, if an individual comes in
13 the store and buys a dishwasher as a retail
14 sale, do we charge sales tax and the answer is
15 yes. And it's based on the destination of
16 where that dishwasher is delivered. So, if you
17 leave the store with the dishwasher, we will
18 charge the sales tax where that store is
19 located because you ---

20 Q: And what -- I'm sorry.

21 A: --- you took -- I'm sorry.

22 Q: Go ahead.

23 A: You took possession of that good in that store
24 in that tax jurisdiction. If we deliver it to
25 another county, we would charge that other

1 county's local tax.

2 Q: And what is the sales tax based on that you
3 charge the customer if they purchase it and do
4 not buy installation services?

5 A: It is based on the price that we sell the item
6 to the customer.

7 Q: All right. Same situation, we have a customer
8 that comes in, wants to buy the same exact
9 dishwasher from the same Lowe's store but uses
10 Lowe's installation services and a Lowe's
11 third-party installer installs it. Does Lowe's
12 charge any tax to the customer on the purchase
13 of that dishwasher?

14 A: We should not be. If my flags are set
15 correctly, we would deem that a real property
16 improvement. The system, Genesis, the Point of
17 Sale system, knows whether that transaction was
18 an installed sale or not. It also knows what
19 category it is. And there's just a smart table
20 behind the scenes and Genesis looks at that
21 table and says South Carolina appliance, don't
22 calculate -- don't charge customer sales tax
23 and it just cuts the tax calculation off. Is
24 that the question you asked?

25 Q: Yes, it is.

1 A: Okay, good.

2 Q: All right. Now, we're going to switch over to
3 special order sales. So, if you'll refer to
4 Exhibit 36, I believe. When a Lowe's customer
5 purchases materials as part of a special order
6 installation contract, Lowe's charges the
7 customer the store's retail price of the item,
8 correct?

9 A: Once again, it's the price that we sell it to
10 the customer for. There's -- it's -- we're
11 going to be -- we're going to compete with
12 other contractors out there.

13 Q: And on this particular contract for windows,
14 the price of the windows is \$764.79, correct?

15 A: Based on what I'm reading here, there were a
16 total of five windows sold, they were Pella
17 windows, they were SOS windows and the total
18 price of those windows, the total material
19 portion of the contract, was \$764.79.

20 Q: And that's the price the customer paid for the
21 materials, is that correct?

22 A: That's the material portion of this contract.

23 Q: Is the material portion of the contract that's
24 listed on here, is that Lowe's cost of the
25 materials?

1 A: I don't know. In this particular case, I don't
2 know.

3 Q: Generally, is it Lowe's cost of the materials?

4 A: I would hope not.

5 Q: Okay. All right. And if you'll flip to the
6 second page.

7 A: And I'll elaborate on that.

8 Q: Sure.

9 A: I hope our cost is lower than this number right
10 here.

11 Q: Did Lowe's charge any tax to the customer as
12 part of this special order sales contract?

13 A: On this particular transaction, no, ma'am.

14 Q: In South Carolina, is the customer responsible
15 for remitting sales tax on the purchase of
16 tangible personal property in special order
17 sales?

18 A: I don't believe so.

19 Q: Okay. Is Lowe's responsible?

20 A: Let me go back. Special order sale is a part
21 of an installed sales contract.

22 Q: Yes.

23 A: And the answer would be no.

24 Q: And do you believe Lowe's is responsible?

25 A: I believe Lowe's is responsible to pay a

1 certain amount of tax on the materials.

2 Q: Whether or not it collects that tax from the
3 customer, correct?

4 A: That's correct.

5 Q: All right. Again, we're still looking at the
6 special order sales. We're looking at the
7 location like we did in the regular installed
8 sales contract we talked about earlier.

9 A: Okay.

10 Q: When materials are purchased under the special
11 order contract, those items are not in stock at
12 the retail location, correct?

13 A: That is correct.

14 Q: And they must be ordered by Lowe's?

15 A: Yes, ma'am.

16 Q: How do the items -- let me rephrase that. The
17 vendor of the materials ships to a Lowe's
18 retail location for pickup, is that correct?

19 A: It varies.

20 Q: Okay. Will you please describe all of the
21 instances in how a product gets from the vendor
22 to the customer, please?

23 A: Sure. There's three situations that I can
24 think of. I don't think there's any more.

25 I'll start with what we prefer. We prefer the

1 least amount of handling of product possible
2 and we find that to be -- we would like the
3 vendor to ship directly to the job site.
4 That's number one. Number two, we do have some
5 installers that have warehouses and some of
6 them will say, "Just ship it directly to me and
7 I'll store it in my warehouse and then when I'm
8 ready to do the job, I'll take it to the job
9 site." The benefit to Lowe's is we're not
10 paying our employees to unload the truck, we're
11 paying the installer to do the work. So, it's
12 cheaper, either way. So, the first two
13 examples are less expensive for Lowe's. The
14 first example has the least amount of handling.
15 The second example that I just went over has a
16 certain amount of handling but Lowe's employees
17 aren't doing the handling so it's less
18 expensive for us. And the third situation is
19 vendor directs a store where the Lowe's
20 employees would unload the vendor's truck,
21 there is a PO or a piece of paper on that item
22 in the truck and it'll have a PO number, the
23 original purchase order number. The receiver
24 in the store is going to look that PO up on the
25 Genesis system and say, "Oh, this is earmarked

1 for a specific customer related to a contract."

2 And it's just going to take that material and
3 it's not -- it's not even -- you'll -- you, as
4 a customer, walk in a Lowe's store, will never
5 see that item. It's in back stock is what we
6 call it. It's in the very back of the store
7 because we know eventually the installer is
8 going to come by and we want to be able to get
9 it on his truck quickly. So, it's on the
10 loading dock is where it sits. Inside loading
11 dock, I should say, not on the outside.

12 Q: When you're talking about the loading dock or
13 the other area, are there regular inventory
14 items waiting to be picked up by an installer
15 also stored in this area?

16 A: It could be quite often. A store that's
17 running its -- or a store manager that's
18 running its store well will, if they know that
19 an installer is coming by, they're going to
20 pull that stock and put it, you know, put it
21 off the shelf. Because what you don't want to
22 do is have a customer come in and buy the
23 materials that are deemed for a job that's
24 going to happen tomorrow. So, you want to make
25 sure when the installer says, "Hey, I want to

1 do this job tomorrow, that's when we're
2 scheduled," the Lowe's person is going to go to
3 the shelf, pull the inventory and stage it for
4 that installer to come by. We don't want to
5 take a chance of not having enough materials to
6 finish that job.

7 Q: Lowe's purchases the special order items
8 directly from the manufacturer or vendor,
9 correct?

10 A: Yes, ma'am.

11 Q: And when the item is purchased, Lowe's does not
12 pay any tax to the vendor, is that correct?

13 A: Yes, ma'am.

14 Q: And Lowe's is able to do this because they
15 extend their resale certificate, is that
16 correct?

17 A: Yes, ma'am. Because we're required to.

18 Q: So, the purchase is a wholesale sale, correct?

19 A: It's deemed as a wholesale sale by South
20 Carolina because we have to do it that way per
21 South Carolina regulation.

22 Q: And then so Lowe's purchases the special order
23 sales items and then uses or consumes those
24 materials in the connection of its business, is
25 that correct?

1 A: That's a fair statement, yes, ma'am.

2 Q: All right. Looking at a special order sales
3 item, and we'll use windows, I believe that's
4 the example in the contract, can a customer
5 come in and purchase a special order sale item
6 without also purchasing the installation
7 services?

8 A: Yes, ma'am.

9 Q: Okay. When a customer does that, purchases it
10 without purchasing the installation services,
11 is there sales tax charged on that transaction?

12 A: Yes, ma'am.

13 Q: And what is the sales tax based on?

14 A: Once again, yes, ma'am, depending on the
15 situation, but in the general sense, yes,
16 ma'am.

17 Q: And what is that sales tax based on?

18 A: It's based on the price that we sell that item
19 to the customer for.

20 Q: Okay. Another customer walks in, purchases the
21 same exact special order window from the same
22 store but uses Lowe's third-party installers,
23 is any tax charged to the customer in that
24 transaction?

25 A: State that one more time for me.

1 Q: Okay. You're going to test me. A customer
2 walks into the store, purchases the same window
3 as we just described in the previous
4 hypothetical ---
5 A: Okay.
6 Q: --- same special order window ---
7 A: Okay.
8 Q: --- also uses a third-party installer from
9 Lowe's ---
10 A: Their own? They negotiate with the installer?
11 Q: No, Lowe's third-party installer.
12 A: So, it's a ---
13 Q: So ---
14 A: --- it's a ---
15 Q: --- part of an installation contract.
16 A: Okay.
17 Q: Does Lowe's require the customer to remit any
18 tax on that purchase ---
19 A: No.
20 Q: --- of the windows?
21 A: That transaction would be classified as a
22 window install and that's a real property
23 improvement, in my mind, and we would turn the
24 tax calculation off. We would not charge the
25 customer tax.

1 Q: Okay. Thank you. All right. You have both
2 notebooks.

3 MS. WOOTEN: May I approach, Your Honor?

4 THE COURT: You may.

5 MS. WOOTEN: Thank you.

6 Q: All right. If you'll flip to Exhibit Number
7 13, please.

8 THE COURT: Fourteen?

9 MS. WOOTEN: Thirteen.

10 THE COURT: Thirteen.

11 MS. WOOTEN: I apologize, 33. I can't read my
12 handwriting.

13 THE COURT: Thirty-Three?

14 MS. WOOTEN: Thirty-Three, yes.

15 Q: And do you recognize this first document in
16 Exhibit 33?

17 A: I've seen it before.

18 Q: And what is the date of issuance, first
19 issuance, on this document?

20 A: It looks like June 23, 2011.

21 Q: And do you recall the audit, the audit period,
22 in this matter?

23 A: It was August 1, 2008 through July 31, 2011.

24 Q: So, Lowe's only held this contractor's license
25 for approximately two months of the entire

1 audit period, is that correct?

2 A: It would have to be that -- that way. This
3 particular, what I'm looking at, I would say,
4 yes.

5 Q: So, Lowe's contractor's license wasn't required
6 for all of the transactions in the audit
7 period?

8 A: My understanding is, in South Carolina,
9 contractor license are required when the
10 transaction exceeds a certain dollar limit.
11 So, there's a lot of installed sales, even
12 though we have a license, there's a lot of the
13 installed sales that we do don't even require
14 a license.

15 Q: Lowe's does not provide installation services
16 to a customer without the customer first
17 purchasing the tangible personal property from
18 Lowe's, correct?

19 A: No. They -- they purchase a right to receive
20 a real property improvement is what they're
21 purchasing. Unless I misunderstood your
22 question, which I'm getting good at evidently.

23 Q: Can a customer purchase Lowe's installation
24 services without purchasing anything else in
25 the store?

1 A: Once again, could they? We're here to make our
2 customers happy. I'm not aware of that ever
3 happening but in the interest of making
4 customers happy, possibly. But I feel very
5 confident, at least the policy is that Lowe's
6 will only install material that the customer
7 has purchased from Lowe's.

8 Q: So, the primary reason a customer comes to
9 Lowe's is to purchase the tangible personal
10 property?

11 A: No. They're -- they have a need and the Lowe's
12 associate is empowered to determine what that
13 need is and we're going to satisfy the
14 customer. It could be that all they need is a
15 purchase of tangible personal property, it
16 could be they want a new roof on their house.

17 Q: The third-party installers are not employees of
18 Lowe's, correct?

19 A: They are not employees of Lowe's.

20 Q: All right. And if you'll flip back to one of
21 the contracts. Thirty-Four. We'll use 34.

22 A: Exhibit 34?

23 Q: Exhibit 34, yes. The second page.

24 A: Okay.

25 Q: There is a charge for labor. Does the third-

1 party installer receive all of the labor charge
2 on the contract?

3 A: Typically, not.

4 Q: And how does Lowe's reimburse or pay the Lowe's
5 installer?

6 A: So, going back to my testimony with regards to
7 Mr. Smith, the installer goes to -- as a matter
8 of fact, if you look underneath that labor
9 charge, you'll see detail deduction. That
10 means -- that tells you that the installer
11 visited the customer's job site and did
12 detailed calculations of what his estimate for
13 labor was and the amount of quantity. And what
14 -- what we have done here is hopefully taken
15 his labor estimate and increased it to make our
16 profit margin. It's not -- there's no
17 guarantee that -- that happened on this
18 particular contract. I don't know what his
19 quote was. I'm only looking at a contract.
20 His quote could have been more and the store
21 manager might have said, "Go ahead and let's
22 lose money on this transaction. Let's make the
23 customer happy." I don't have those facts
24 here.

25 Q: But Lowe's does keep some of the labor charge,

1 is that correct?

2 A: I -- I hope so.

3 Q: And as a national retailer, Lowe's receives
4 discounts from vendors based on the volume of
5 items that it purchases?

6 A: I hope so.

7 Q: And the retail stores carry a large inventory
8 of items, is that correct?

9 A: Define large.

10 Q: Has a lot of different retail items, an
11 assortment of retail items, in its store?

12 A: We have -- a typical store will carry between
13 40 and 60 thousand stock -- different stock
14 items.

15 Q: And if the item is not stocked, Lowe's can get
16 the customer that item by a special order sale?

17 A: We -- we can get them a lot of different items.
18 So, I believe our special order catalogs, in
19 total, I think we can offer probably an
20 additional three to six million items. I could
21 be wrong on that number. That's today's world.
22 But we offer for sale special order item that
23 substantially outnumbers stock items.

24 Q: You talked earlier about the Oklahoma, Indiana
25 and Kansas decisions. Are the laws of those

1 states exactly the same as the laws in South
2 Carolina?

3 A: No, ma'am.

4 Q: Okay. And are all those states members that
5 participate under the Streamlined Sales Tax
6 Agreement?

7 A: Let me think. Oklahoma is streamlined. Kansas
8 is streamlined. I don't know about Indiana.

9 Q: Indiana is, as well, correct?

10 A: I've been retired too long, I don't know.

11 Q: And South Carolina is not a member that
12 participates in the Streamlined Sales Tax
13 Agreement, correct?

14 A: I think you're right. Yes, it's not
15 streamlined.

16 Q: And you stated earlier that regulations are not
17 law, is that correct?

18 A: Regulations are not law.

19 Q: But are you aware, in South Carolina, that
20 regulations have the force and effect of law?

21 MR. SMITH: Object. It calls for a legal
22 conclusion.

23 A: Do I answer the question?

24 MR. SMITH: If you know it.

25 THE COURT: I'm going to go ahead and allow him to

1 answer the question, if he knows the answer to
2 that question.

3 A: What if I think I know the answer?

4 THE COURT: You can testify to what you think, sir.

5 A: I feel if the regulation is in keeping with the
6 intent of the law, then it has the full force
7 and effect. But as Indiana, the court case in
8 Indiana clearly pointed out that regulation was
9 not in keeping with the law and, therefore,
10 that's the reason it was invalidated.

11 MS. WOOTEN: Can I have just a moment, Your Honor?

12 THE COURT: Certainly.

13 Q: If a carpet installer buys carpet from Lowe's,
14 he will pay sales tax on Lowe's retail price,
15 correct?

16 A: Once again, he will pay -- we will charge him
17 sales tax on the price that we sell him that
18 carpet.

19 Q: And that's the same retail price that the
20 Department believes Lowe's should pay sales tax
21 on in these installation sales contracts,
22 correct?

23 A: Not necessarily. Like I said, we -- we, as a
24 retailer, can sell our product for whatever
25 amount we want to. When we have obsolete

1 product, we might sell it at less than cost.
2 The calculation that you have, you're referring
3 to shelf price. Shelf price is a price on the
4 shelf. It does not mean that the product sold
5 for that price. It can always sell for less.
6 It could be marked down, it could be on
7 special. It could have a ten percent off
8 coupon. There's a lot of situations that we
9 have. We have credit instruments that if you
10 buy using your Lowe's private label credit
11 card, you'll get five percent off. So, there's
12 -- you can't just say shelf price, you've got
13 to say the price that you sold it for, in my
14 opinion. So, we will -- we will calculate
15 sales tax. And you also say, "Will the
16 customer pay it?" There's a lot of times
17 customers write checks and those checks bounce.
18 So, what we're going to do, we're going to
19 calculate tax on the selling price of the item,
20 the customer is going to tender a payment, but
21 whether he ultimately pays us or not, that's a
22 whole -- so, I just want to be thorough and
23 focused in my answer there. You asked the
24 question does the customer pay the tax? Not
25 necessarily.

1 Q: Okay. On a non-installed sale, the customer
2 does not always take the purchased item with
3 him, correct?

4 A: That is correct.

5 Q: Such as delivery? Lowe's provides a delivery
6 service. Lowe's delivers the item to the
7 customer's home in that situation?

8 A: Well, no, there's actually more than that. We
9 have a load indicator. We have several load
10 indicators, which is basically establishing did
11 the customer take the product. So, one load
12 indicator that we have is CW. CW is an
13 abbreviation for Carry With. So, items that go
14 out the front door are always Carry With items.
15 The customer is carrying those items. And we
16 tax all Carry With items based on the store's
17 location, the tax that's due at that location.
18 You then have a load indicator called DD. DD
19 stands for Direct Delivery. In Direct
20 Delivery, that means the vendor is shipping
21 directly to the job site. We have another load
22 indicator called LD and that's a Lowe's
23 Delivery. So, to your point, the customer
24 could buy something and say, "I need you to
25 deliver this to me." And if it's a stock item,

1 Lowe's will flag that as LD, it'll generate a
2 loading ticket in the back of the store and
3 then it'll eventually be loaded on a truck, a
4 Lowe's truck, and delivered to you. The final
5 one is a PL. PL stands for Pickup Later. So,
6 the customer is in the store, has identified,
7 "I really" -- "Oh, this thing is marked down,
8 this refrigerator, I'm going to buy it today.
9 It's the last one left." They buy it and say,
10 "I'll be back tomorrow with my pickup truck to
11 get it." So, what we're going to do, we're
12 going to flag that item as PL, Pickup Later,
13 and we're going to move it off the sales floor
14 and then when the customer comes in with their
15 receipt, that item is flagged as PL and we'll
16 be able to load it in the customer's pickup.
17 So, I just wanted to give a thorough answer to
18 your question.

19 Q: So, in the situation where it's coded DD,
20 that's similar to a special order sales
21 contract where the vendor is shipping it
22 directly to the customer's home, correct?

23 A: Yes. Yes, that's a great example.

24 Q: If a sales transaction is subject to sales tax
25 but Lowe's did not collect it from the

1 customer, under South Carolina law, Lowe's
2 would still be liable to remit the sales tax to
3 South Carolina, right?

4 A: That's my understanding of your law, yes,
5 ma'am.

6 Q: Okay.

7 MS. WOOTEN: Thank you, Your Honor. That's all from
8 the Department.

9 THE COURT: No further questions? All right.

10 MS. WOOTEN: No further questions.

11 THE COURT: Any redirect?

12 MR. SMITH: Just two.

13 MR. PRICE - RE-DIRECT EXAMINATION BY MR. SMITH:

14 Q: Ms. Wooten in her questioning addressed special
15 order sales and you testified that, based on
16 her questioning, that because, by regulation,
17 you purchase special order items pursuant to
18 resale certificates. She said, "Did you buy
19 them at wholesale?" And you said, "Well, I had
20 to." Let's look at the definition of wholesale
21 again. As defined under the code, putting
22 aside you were required to buy using a resale
23 certificate, special order products, were they
24 sales to users or consumers not for resale and,
25 therefore, excluded from the definition of

1 wholesale?

2 A: I think so.

3 Q: Okay.

4 A: I think so.

5 Q: One final question. On Exhibit 33, with the

6 business licenses, Ms. Wooten referred to the

7 first page. There's a bunch of other licenses

8 behind the first page, all dated during and

9 before the audit period. What are those?

10 A: Those are contractor license extended to

11 individuals that qualified Lowe's.

12 Q: Okay. And is that the manner in which during

13 the audit period that Lowe's was able to

14 operate as a licensed contractor?

15 A: Yes. I mean, I believe they cover the entire

16 audit period. Once again, my understanding of

17 -- I know in North Carolina, you don't even

18 have to have a contractor's license if the size

19 of the job is \$30,000.00 or less. I think it's

20 a lower limit in South Carolina. But clearly,

21 a lot of our real property improvements don't

22 even require a license.

23 Q: But do these ---

24 A: But I still think we have one or had one during

25 the whole audit period.

1 Q: Okay. That's all. Thank you.
2 THE COURT: No further questions?
3 MR. SMITH: No further questions.
4 THE COURT: Anything from that?
5 MS. WOOTEN: Nothing further, Your Honor.
6 THE COURT: All right. So, may Mr. Price be
7 excused?
8 MS. WOOTEN: Yes, Your Honor.
9 THE COURT: All right.
10 MS. WOOTEN: From the Department's standpoint.
11 THE COURT: Mr. Price, thank you very much ---
12 A: Thank you.
13 THE COURT: --- for participating. You may be
14 excused.
15 A: Leave these here?
16 MR. SMITH: Yes. Yes.
17 A: Okay.
18 MR. SMITH: What's your wish, Your Honor.
19 THE COURT: Well, I was just going to ask you what
20 you felt. Would this be an appropriate time to
21 take a lunch break?
22 MR. SMITH: Probably. I'm going to go a little out
23 of order. Mr. Crider needs to get back today
24 so I was going to put him on next. But I don't
25 think it's going to take more than 30 minutes.

1 I don't know how thorough and sifting you will
2 be in your cross but we could muscle through
3 now or I can just put him on right after lunch,
4 depending on -- what are your thoughts?

5 MS. WOOTEN: I couldn't tell Your Honor what cross
6 is going to be without him testifying.

7 MR. SMITH: Okay.

8 MS. WOOTEN: So, I don't know a time on that. We
9 would probably prefer just to break for lunch
10 and then come back and have it all at one time.

11 MR. SMITH: That's fine.

12 MS. WOOTEN: If that's okay with the court and
13 opposing counsel.

14 THE COURT: That would be fine. Let's take a recess
15 till 1:30.

16 MS. WOOTEN: 1:30? Thank you, Your Honor.

17 THE COURT: Is that going to be enough time for
18 everybody?

19 MR. SMITH: Yeah.

20 THE COURT: All right. We're at recess till 1:30.

21 (Lunch was taken from 12:22 p.m. to 1:51 p.m.)

22 THE COURT: Okay. We're back on the record. Let's
23 see. We finished with Mr. Price so who is
24 next?

25 MR. SMITH: The next one is Charles Crider, Your

1 Honor.

2 THE COURT: All right. Okay. Mr. Crider, sir,
3 please step forward and be sworn in.

4 CHARLES CRIDER, having been duly sworn, testifies as
5 follows:

6 MR. CRIDER - DIRECT EXAMINATION BY MR. SMITH:

7 Q: Mr. Crider, what is your occupation?

8 A: I am a real estate appraiser. I am a
9 consultant. I'm an educator of real estate.
10 And when I say real estate, I encompass real
11 property, personal property, as well as
12 business valuations.

13 Q: Okay. And can you give a brief synopsis of
14 your educational and professional background?

15 A: I graduated from The Citadel in Charleston,
16 South Carolina with a Bachelor of Science in
17 Business Administration in 1991. I received a
18 Master's Degree in Real Estate and Urban
19 Analysis from the University of Florida.

20 Q: And do you have professional designations?

21 A: I do.

22 Q: And they are what?

23 A: I am a Certified General Appraiser, which is
24 the highest designation that the state of South
25 Carolina can offer. It includes educational

1 courses, testing and peer review. I also hold
2 the MAI designation from the Appraisal
3 Institute, which is a more rigorous set of
4 criteria educationally; comprehensive exam as
5 well as a demonstration report, in addition to
6 peer review. I'm also a real estate broker.

7 Q: Now, you said you're a teacher. What do you
8 teach?

9 A: I've been an adjunct professor at Clemson
10 University. I have my own proprietary school.
11 I teach for the Appraisal Institute. I teach
12 for the Appraisal Standards Board. Those
13 courses include everything from the beginning
14 appraisal courses, day one, you want to become
15 an appraiser, to the advanced appraisal
16 courses, including income, sales comparison and
17 cost approaches, also involving business
18 valuation, personal property, as well as real
19 estate.

20 Q: Okay. And you work at a company?

21 A: Yes, sir. It is Crider, Bouye and Goodwin.

22 Q: And the Crider is you ---

23 A: Yes, sir.

24 Q: --- I take it?

25 A: Yes, sir.

1 Q: Okay. And how many people work there?

2 A: At one time, 17. I think we've got about 14
3 now.

4 Q: Okay. And what does that do?

5 A: We are appraisers. And, again, we appraise the
6 three disciplines.

7 Q: Okay. What does it mean to be an instructor
8 for the Uniform Standards of Professional
9 Appraisal Procedures or ---

10 A: Practice.

11 Q: --- USPAP?

12 A: Yes, sir. The Uniform Standards of
13 Professional Appraisal Practice are the
14 guidelines that all appraisers have to adhere
15 to. It is a national and, in fact,
16 international set of requirements that they
17 have to meet. They include everything from
18 competency to ethics to all the standard rules
19 that we have to adhere to. At one time, there
20 were about 3,000 USPAP instructors across this
21 country and someone got the idea that maybe we
22 should test the instructors to see what they
23 know before they teach. And we went from about
24 3,000 to less than 500. And I am one of those
25 instructors and do teach those classes

1 regularly to other appraisers.

2 Q: Okay. And you mentioned that you are a
3 Certified Appraiser. What does that mean and
4 in what states?

5 A: I am a Certified Appraiser in South Carolina,
6 North Carolina and Virginia and it gives me the
7 ability, given competency, to appraise all
8 property types and all types of property within
9 those states.

10 Q: Okay. Before you are some of the joint
11 exhibits. Could you go to Joint Exhibit 46,
12 please?

13 A: Yes, sir.

14 Q: What is that?

15 A: That is my Curriculum Vitae. My certification,
16 if you will, of my qualifications as an
17 appraiser.

18 Q: Okay. Is it up to date?

19 A: Yes, sir.

20 Q: And Exhibit 47, what is that?

21 A: It's a list of court cases where I have been
22 retained as an expert for deposition within the
23 preceding five years.

24 Q: Okay. Now, in the course of your appraisal
25 practice, have you had experience and expertise

1 in determining the fair market values of retail
2 inventories?

3 A: Yes, I have.

4 Q: Okay. Could you describe some of that?

5 A: Personal property takes a lot of different
6 forms. Furniture fixtures and equipment could
7 include personal property. And we've been
8 involved in the appraisals of things like
9 McDonald's, fast-food restaurants, hotels, but
10 specifically dealing with retail inventories.
11 Convenience stores are probably the most
12 dominant of the appraisal types that we do. I
13 used to work with Pilot Oil and was involved in
14 the acquisition as well as sale and disposition
15 of convenience stores. So, I'm familiar with
16 that business entity. As part of the appraisal
17 process, we're charged with valuing the real
18 estate, the personal property, the retail
19 inventory, if you will, and the business value.

20 Q: Okay. From your education, as you've
21 described, and your certifications and your
22 experience as an educator and professional
23 appraiser, do you hold yourself out as an
24 expert in the generally accepted term, or
25 meaning of the term, fair market value as it

1 relates to retail inventories?

2 A: Yes, sir.

3 MOVE TO QUALIFY WITNESS

4 MR. SMITH: Your Honor, I'd like to tender Mr.

5 Crider as an expert in that area.

6 THE COURT: Fair market value?

7 MR. SMITH: The meaning of fair market value.

8 THE COURT: The meaning of fair market value. Any
9 objection?

10 MS. WOOTEN: Yes, Your Honor. One, we believe the
11 South Carolina statute and regulations would
12 speak to the definition of a fair market value.
13 And secondly, we don't believe Mr. Crider's
14 opinion will assist the court in this matter.
15 Mr. Crider will provide -- it seems like he's
16 going to be providing information about
17 property appraisals and we don't believe that
18 that's relevant in a sales tax matter. There's
19 only two possible values in this matter, cost
20 or the retail sales price, and Lowe's has
21 provided that information already. So, we
22 don't believe any kind of appraisal methodology
23 opinion would be relevant in this matter.

24 MR. SMITH: Your Honor, fair market value is a word,
25 a key word, in this case and this sales tax

1 statute that is undefined in the sales tax
2 code. And so, therefore, one has to turn to
3 what is the generally accepted meaning. Mr.
4 Crider can give a generally accepted meaning in
5 the appraisal technique and areas that he knows
6 about. I understand they are calling their own
7 expert to talk about what fair market value
8 means in accounting and that area, as well.
9 That's the only way you can determine the
10 meaning of an undefined word is how is it
11 generally understood. So, that is what we're
12 presenting.

13 MS. WOOTEN: Your Honor, we would just, you know,
14 again, submit that the fair market value, the
15 information that is needed for this court to
16 make the decision, is in the statute and that
17 it would be improper for an expert or someone
18 else to tell the court what that is. That goes
19 to the ultimate issues.

20 THE COURT: So, you're not going to offer anybody
21 that testifies to the meaning of fair market
22 value?

23 MS. WOOTEN: If Mr. ---

24 THE COURT: You're just going to tell this court it
25 is what it is and ---

1 MS. WOOTEN: No, Your Honor. If Mr. Crider is
2 allowed to testify then, of course, we would
3 like to present a rebuttal witness. If Mr.
4 Crider is not allowed to testify then the
5 Department would not present its own valuation
6 witness.

7 THE COURT: But fair market value, there is nowhere
8 in the code where, or at least in Title 12,
9 where it's defined, is it?

10 MS. WOOTEN: Not specifically defined "in the
11 statute" but we believe it's defined in
12 Regulation 309.17.

13 MR. SMITH: What they can do when they promulgate a
14 regulation is they can promulgate a regulation
15 that is reasonable and consistent with the
16 statute. They cannot make up a definition of
17 fair market value that is inconsistent with the
18 generally accepted meaning of the term, unless
19 the legislature says that's what it means.

20 THE COURT: I'm going to go ahead and let him
21 testify. I'm going to recognize him as an
22 expert and let him testify in this area because
23 I do think that we're going to have -- I think
24 there's just a dispute over the meaning of the
25 term fair market value. While I understand

1 there's a regulation that the Department
2 asserts defines this, I think that there's more
3 to it than that. So, I am going to allow them
4 to use Mr. Crider's testimony.

5 WITNESS QUALIFIED

6 MS. WOOTEN: Thank you, Your Honor.

7 THE COURT: So, the court recognizes Mr. Crider as
8 an expert in the meaning of fair market value.

9 MR. SMITH: The generally accepted meaning.

10 THE COURT: The generally accepted meaning of fair
11 market value.

12 MR. SMITH: That is correct, Your Honor.

13 THE COURT: Yes.

14 MR. SMITH: And you may note, we're a little out of
15 order here, as I said, because we're going to
16 try to get Mr. Crider out.

17 THE COURT: I understand.

18 MR. SMITH: We don't think we ever get to fair
19 market value unless we lose every other trunch
20 but we wanted to put that in while we had him.

21 THE COURT: I understand. I can do that. We can
22 work that.

23 MR. SMITH: Okay.

24 Q: What was your task undertaken in this case, Mr.
25 Crider?

1 A: My responsibility as part of my assignment was
2 to opine on the meaning of fair market value
3 and the methodologies recognized as general
4 appraisal practicing in valuing personal
5 property as it relates to retail inventories.

6 Q: Okay. And tell me what you did.

7 A: That is exactly what I've done.

8 Q: Okay. And what conclusions did you come to?

9 A: Conclusions? I came to the determination that
10 fair market value is a -- it's an accounting
11 term and it's a legal term. Appraisers
12 generally refer to it as market value. So,
13 they've lost the fair part. So, in that sense,
14 I'm using those two terms synonymously. That
15 fair market value relates to what, number one,
16 a willing buyer and willing seller would pay on
17 the open market for a product. In this case,
18 retail inventory. It recognizes that there is
19 a specific date of sale. Market value assumes
20 the consummation of a sale on a specific date.
21 Not a series of dates but one date. Market
22 value recognizes cash or its equivalent as what
23 someone would pay for that property without
24 duress in a competitive market and it
25 identifies the market that it must adhere to.

1 In other words, different property types will
2 have different markets, not all are the same.
3 A home will sell to a specific market, a
4 commercial building, another market. Retail
5 inventories would have their own level of
6 trade, the area that they deal with buyers and
7 sellers in.

8 Q: Okay. What are the levels of trade and how do
9 they come into play when you're determining
10 fair market value?

11 A: Levels of trade, first of all, deal the buyers
12 and the sellers. Where are they? Who are
13 they? This inventory, this retail inventory,
14 who is a purchaser of that inventory as it sits
15 on a -- on a given date of value? That means
16 somebody's going to purchase the bulk. And so
17 we're looking at a competitor of Lowe's, say a
18 Home Depot, say a Chuck's Wholesale distributor
19 that's going to look at that inventory and say,
20 "I'll give you X for that entire inventory."
21 And, again, it's as of a specific date that we
22 have to consummate that sale. And the question
23 becomes would they pay retail value for that
24 merchandise? And the answer's obviously got to
25 be no because they can't take that, pay retail,

1 and then be able to sell it competitively on
2 the market to a make a generally accepted
3 profit. So, they have to pay something less
4 than retail. And if they're buying bulk and
5 paying something less than retail, the other
6 thing they're going to consider is could I buy
7 it myself cheaper than I could purchase it from
8 a retail inventory that exists. And if the
9 answer to that is yes, it's supply and demand,
10 it recognizes substitution, that I would buy
11 myself cheaper from my own distributor rather
12 than buying this retail inventory. So, cost
13 has to be the max. And from there, you look at
14 things like obsolescence to determine whether
15 it's something less than cost.

16 Q: Okay. Now, are you familiar with a term lower
17 of cost or market?

18 A: I am.

19 Q: And what does that mean?

20 A: It's an accounting term. It actually applies
21 -- I think it's Accounting Bulletin 43,
22 specifically. And it deals with cost, first of
23 all, as a bases of this is the most that we can
24 charge on the books for a given item, the cost
25 of that item. And it compares that to the

1 market. When you're looking at market, they're
2 now using the term market as it relates to
3 value, what is the net realizable value that
4 exists after price minus cost, what's left.

5 And it's the lower of those two that will go as
6 the assignment to that retail inventory. But
7 it is a general accepted term. For example, if
8 a -- I buy something for \$100.00 with the
9 intent of selling it for \$125.00 and then right
10 before Christmas that distributor puts that
11 product on sale for \$75.00 to other retailers,
12 now they're going to sell it for \$99.00. Well,
13 I can't sell it for \$125.00 if they're selling
14 it for \$99.00. So, actually, I have to lower
15 my price to compete. So, that's what Bulletin
16 43 recognizes. It's possible that it's below
17 cost as the book inventory.

18 Q: Okay. And book inventory is to show the value
19 of the inventory on the books and records?

20 A: Correct.

21 Q: Okay. Now, what I have up here is a statute.
22 It's 12-36-90. And I'm going to have you
23 assume something. I'm going to go to (c).
24 Let's assume that 100 percent of the items that
25 are consumed, used by Lowe's in performing real

1 property contracts, contrary to what you heard
2 this morning, were previously purchased at
3 wholesale, withdrawn from the business or stock
4 and user consumed in connection with the
5 business or user consumed by any person
6 withdrawing it. Let's also assume they're not
7 contractors so that those other provisions
8 don't apply. So, if this applies to everything
9 we're talking about, applying the generally
10 understood meaning of fair market value, what
11 does that mean?

12 A: As far as value goes, we're still looking at
13 cost because that can be the -- that has to be
14 the maximum that someone would be willing to
15 pay. If I had an alternative, why would I pay
16 more than cost?

17 Q: Is there any generally understood application
18 of the term fair market value that would
19 require a value higher than cost that you're
20 aware of?

21 A: There are unusual situations that exist after
22 Katrina. The demand for drywall was extremely
23 high but that's a very short-term issue. There
24 was a lot of homes that needed rebuilt.
25 Generally, that will go away very quickly.

1 Cost being the standard or the bases, very
2 often it'll be below cost. And once it goes
3 below cost, once that obsolescence sets in,
4 it's never coming back. Drywall. Chinese
5 drywall is never going to come back into vogue.
6 It's gone. And it's value, if it was still in
7 stock in a retail inventory, would be virtually
8 nothing, way below cost, just to give an
9 example.

10 Q: Okay. I'm going to read just a brief quote
11 from a case that is one of the ones that we've
12 submitted as authority. It's JCPenney Company
13 versus Richmond County Board of Tax Assessors
14 from the Georgia Court of Appeals, so.

15 A: Yes, sir.

16 Q: We're not citing it as South Carolina authority
17 but I just wanted to cite a quote. "For ad
18 valorem tax purposes, fair market value is not
19 the retail value to the taxpayer but the
20 current wholesale value adjusted for the fair
21 market. Thus, the taxpayer's costs may be
22 adjusted upward, downward or remain the same to
23 reflect the wholesale market as it determines
24 the fair market value of the tangible
25 personalties and the taxpayer's possession at

1 that economic moment in time." Is that
2 definition consistent with your conclusion?

3 A: It's exactly what we were just discussing.
4 That's exactly right, yes.

5 Q: Okay. Thank you.

6 THE COURT: Thank you.

7 MS. WOOTEN: Thank you, Your Honor.

8 MR. CRIDER - CROSS EXAMINATION BY MS. WOOTEN:

9 Q: You mentioned earlier, or you testified
10 earlier, that you teach classes at your real
11 estate school?

12 A: Yes.

13 Q: You don't teach any classes on sales tax,
14 correct?

15 A: Sales tax only as a portion of a business
16 valuation, not on specific South Carolina code,
17 no.

18 Q: And you also do not teach a class on use tax,
19 correct?

20 A: Again, just as a function of real estate, not
21 specific to that tax.

22 Q: Okay. And you prepare appraisals for property
23 tax purposes?

24 A: I have, yes.

25 Q: Okay. And for property tax purposes, the

1 subject property is property that's held by the
2 owner, correct?

3 A: Ask me that again, please.

4 Q: Sure. For property tax purposes, the subject
5 property is property that is held by the owner?

6 A: Not always. It could be leased property.

7 Q: Any other examples besides leased property?

8 A: We've appraised -- done tax valuations for
9 various property types. I'm not sure what else
10 would exist. We've got owner-occupied and
11 leased property. I don't know what else you
12 would refer to.

13 Q: You've never provided an appraisal for sales
14 tax purposes, correct?

15 A: For sales tax purposes? No.

16 Q: And you're not a CPA, correct?

17 A: Correct.

18 Q: If you'll briefly look at Exhibit 47. I
19 believe those are your testifying experiences,
20 is that correct?

21 A: Yes.

22 Q: Okay. And none of these relate to a sales tax
23 issue, correct?

24 A: That is correct.

25 Q: You mentioned earlier there are three general

1 appraisal methodologies, correct?

2 A: That's correct.

3 Q: Income, sales and costs?

4 A: Correct.

5 Q: Okay. Regarding the income valuation approach,
6 you don't consider that to be applicable in the
7 valuation of personal property, is that
8 correct?

9 A: That's correct.

10 Q: In this case?

11 A: That's correct.

12 Q: Okay. Why is that?

13 A: Because, generally speaking, you would not
14 lease personal property as it relates to retail
15 inventories. You might lease furniture,
16 fixtures and equipment and there could be a
17 valuation assigned to that. But as it relates
18 to retail inventories, you generally don't
19 lease those items.

20 Q: And when you're looking at the income approach,
21 you're looking at the income that's coming in
22 from that particular property, is that correct?

23 A: No, that's not correct.

24 Q: Then what is the income valuation approach?

25 A: The income valuation is looking at what a

1 rental rate would be for a specific component.
2 It has nothing to do with gross sales. So,
3 those are completely different concepts. One
4 deals with business valuation, gross sales.
5 The income approach that I'm referring to deals
6 with leased or rented property like you would
7 lease that duplex.

8 Q: But if you're looking at the rental income that
9 can come in from that property, isn't that
10 similar to the retail sales price that a
11 retailer offers, personal property?

12 A: Completely different.

13 Q: How?

14 A: Totally different concepts.

15 Q: How is that different?

16 A: What would rental income have to do with sales
17 price? There's no correlation there. The
18 income being rented for a property using a
19 capitalization rate can be, you know, it can
20 help derive value but there's no correlation
21 between those two components absent that.
22 They're completely different things.

23 Q: All right. And turning to the sales comparison
24 approach, you don't believe that that is
25 applicable in this matter either, correct?

1 A: That is correct.

2 Q: And why is that?

3 A: Again, you would have to have sales of this
4 universe of properties to a -- to another level
5 of trade entity. So, I can look at restaurant
6 equipment, for example, and say that if it
7 closes, you're going to get ten cent on the
8 dollar to sell that equipment. I know that,
9 that's pretty much an industry standard. But
10 to take entire retail inventories and say the
11 discount is going to be 50 percent or 75
12 percent, those kinds of numbers or percentages
13 don't really exist. They are somewhat
14 conjecture, if you will. I have an idea, I
15 have an opinion, that that discount is going to
16 be very deep because anything that would have,
17 in this case, Lowe's emblem, Home Depot's not
18 buying it. So, you've got to have a different
19 person that's going to buy it, a different
20 entity. But, you know, as far as the amount of
21 that discount, I don't have that. That's why
22 I don't think sales comparison ---

23 Q: So, that ---

24 A: --- is appropriate.

25 Q: I'm sorry. So, in that finished particular

1 instance, you're looking at valuing the
2 inventory as a whole, correct?

3 A: Well, you would have to because, again, we deal
4 with a specific date. We don't deal with a
5 series of dates. To not value it as a whole
6 violates the entire premise of fair market
7 value. Fair market value specifically says, as
8 of a given date, it says that if you're going
9 to look at property, USPAP says the sum of the
10 parts don't equal the value of the whole.
11 That's right in USPAP. To not discount the sum
12 of those parts that someone would pay less than
13 the whole value or the retail value, is not
14 performing proper analysis; against appraisal
15 methodologies completely.

16 Q: But here we're not selling Lowe's entire
17 inventory, correct? We're looking at
18 individual installed sales transactions?

19 A: Again, you're looking at slicing the pie and
20 when we value a component as of a given date,
21 we have to take the entire personal property
22 that we're talking about, that entire retail
23 inventory, what's it worth today as a whole,
24 because that's the only way to divide it up.
25 It doesn't make sense to do it any other way.

1 You would have to use some type of discounted
2 cash flow or net realizable value in order to
3 come up with that -- that estimation. That's
4 the only way to do it.

5 Q: So, it's your opinion that the cost approach is
6 the only applicable valuation method in this
7 matter?

8 A: Yeah. And it's not only just my opinion, it is
9 the opinion of others, as well. Again, the
10 Appraisal Institute provides course work and
11 material on how these things should be done and
12 that is the methodology that should be used.
13 I've done this type of work for banks and that
14 is a requirement of the banking regulatory
15 commissions. They require that cost be a basis
16 for personal property because they're going to
17 loan on that and they need to know if I have to
18 foreclose, what happens to my -- my investment
19 and what can I expect to realize from that and
20 that's what cost does for them.

21 Q: Your method for determining fair market value
22 of Lowe's inventory for sales tax purposes
23 would also be the method used for property tax
24 purposes, is that correct?

25 A: Yeah, for the valuation of the retail

1 inventory. It would be the same method I'd use
2 for any valuation. That's the only way to do
3 it.

4 Q: Your method of determining fair market value
5 assumes that the inventory is still sitting on
6 the shelves, correct?

7 A: It's whatever inventory exists as of a given
8 moment in time, today's date, yes. So, I guess
9 on the shelves, in the building, yes.

10 Q: And you referenced levels of trade earlier.
11 When determining or looking at the level of
12 trade, you must identify appropriate buyers and
13 sellers first, correct?

14 A: Correct. Well, that's a component. It doesn't
15 have to be first but yes.

16 Q: It is a part of evaluating the level of trade?

17 A: I would absolutely agree, yes.

18 Q: Okay. And the appraiser must also determine
19 the appropriate market when doing an appraisal,
20 is that correct?

21 A: The appropriate market and the market trends
22 that exist, yes.

23 Q: Explain market trends.

24 A: We kind of just talked about it a little bit.
25 It's the obsolescence or even depreciation that

1 may exist. As time goes on, an item that may
2 have been purchased at X, a cost, a better --
3 a better mousetrap comes out and that item
4 becomes either obsolete or depreciated, however
5 you want to phrase that, and becomes worth less
6 price-wise than it would otherwise have been.
7 It may have been bought for \$100.00 and offered
8 at \$125.00 but it sat on the shelf for two
9 years and now something else better has come
10 along. It's no longer worth \$125.00, it's no
11 longer worth \$100.00. In fact, it may not be
12 worth hardly anything because something else
13 has come along to take it's place. That's the
14 market trends.

15 Q: You briefly referenced the JCPenney case ---

16 A: Correct.

17 Q: --- we talked about. That's a property tax
18 case, correct?

19 A: Yes, I believe it is.

20 Q: And that's also in Georgia, correct?

21 A: That is correct.

22 Q: Just a few more questions. You believe that
23 Lowe's inventory held for resale should be
24 valued at Lowe's cost, correct?

25 A: At -- that is the maximum I believe it should

1 be valued at. It could be less.

2 Q: But the items sold through Lowe's installed
3 contracts are not held for resale anymore, are
4 they?

5 A: I'm charged with valuing the inventory, not an
6 individual contract. It's the inventory that,
7 as an appraiser, you have to look at and what
8 is its value.

9 MS. WOOTEN: Can I have a moment, Your Honor,
10 please?

11 THE COURT: (Nods head affirmatively.)

12 Q: Just one final question. The buyer in these
13 installed sales contracts, they're a retail
14 customer to Lowe's, correct? They are not
15 another retailer?

16 A: The buyer is -- I guess so. I mean, I've been
17 one of them so I guess I'm a buyer, in that
18 sense. I'm not sure of the point because,
19 again, we go back to we have to identify what
20 the inventory is worth on a given date, not a
21 series of dates. So, today, what's it worth?
22 You can't assume that all these buyers are
23 going to come in the same day and pay exactly
24 the same amount. There has to be a discount
25 for somebody to buy all of that today because

1 that's our requirement for fair market value.

2 Q: What is the item worth to you as a buyer going
3 into Lowe's?

4 A: I think that's a great question. It was worth
5 me getting my daughter's doors fixed on the
6 back of her house. When she purchased her
7 home, we had to replace the patio doors. I am
8 not a contractor kind of guy. I looked for
9 someone that I could go to and purchase a
10 turnkey product and that's what I did. I
11 purchased that contract from Lowe's to come and
12 fix that problem for me and I was willing to
13 pay for that. So, what's it worth to me? I
14 can't even begin to tell you because it
15 wouldn't have gotten fixed otherwise. But
16 there's no way that a market is going to pay
17 more than the retail of that. They're just not
18 going to do it because they could do it
19 themselves better or differently at a cheaper
20 price. They're not going to pay retail. It's
21 cost, at best.

22 Q: But it was worth what you paid for the sales
23 price, correct?

24 A: No. No, no, no. It was worth what I paid to
25 fix a problem. It had nothing to do with the

1 retail price. I had to fix a problem. That's
2 not valuation.

3 MS. WOOTEN: That's all from the Department, Your
4 Honor.

5 THE COURT: Okay. Anything?

6 MR. SMITH: I don't have any further questions, Your
7 Honor. I'm going to ask if Mr. Crider can be
8 released. I do know typically when we have
9 experts, sometimes the court has questions.
10 So, I'll offer him to you before he's released
11 if you have any questions.

12 THE COURT: I appreciate that but I do not have any
13 questions for Mr. Crider. Any objection to him
14 being released?

15 MS. WOOTEN: No, Your Honor.

16 THE COURT: All right. Mr. Crider, thank you very
17 much. You're released.

18 A: Thank you.

19 MR. SMITH: Your Honor, our next witness would be
20 Ms. Paulette Crawford.

21 THE COURT: Okay. All right. Ms. Crawford, please
22 step forward to be sworn in.

23 PAULETTE CRAWFORD, having been duly sworn, testifies
24 as follows:

25 MS. CRAWFORD - DIRECT EXAMINATION BY MR. SMITH:

1 Q: Hello, Ms. Crawford.

2 A: Hi, how are you doing?

3 Q: We've met before. As you recall, last summer
4 we had a deposition ---

5 A: Yes, we did.

6 Q: --- when you were here. I'm just going to go
7 over a couple of the questions I asked last
8 summer ---

9 A: Okay.

10 Q: --- for purposes of making our case in general.
11 You've been a field auditor for the last 28
12 years?

13 A: That's correct.

14 Q: And you handled the audit and the assessment
15 that's the subject of this appeal?

16 A: I did.

17 Q: You were designated by the Department as one of
18 its representatives to testify on its behalf in
19 this case?

20 A: That's right.

21 Q: And you gave a deposition last June. At the
22 beginning of our deposition, I asked you some
23 tax principle questions, which you were kind
24 enough to answer, and I'm just going to go over
25 them one more time. The first one was "The

1 Department of Revenue itself has no authority
2 to create its own tax laws or repeal or alter
3 tax laws enacted by the legislature." Do you
4 agree?

5 A: That's true.

6 Q: Okay.

7 A: True.

8 Q: The second was "The Department of Revenue
9 cannot impose interpretations of tax laws that
10 are inconsistent or in conflict with statutes
11 passed by the legislature." Also true?

12 A: True.

13 Q: Thank you.

14 A: True.

15 Q: The third was "The Department of Revenue cannot
16 impose different tax burdens on similarly
17 situated taxpayers unless the legislature
18 expressly authorizes it to do so." You agree?

19 A: That's true.

20 MS. WOOTEN: Your Honor, I'm going to object to the
21 line of questioning. Ms. Paulette, in this
22 deposition, was designated to speak about the
23 prior audit and the current audit. She was not
24 asked to speak about any kind of policy tax
25 considerations. Mr. McCormack was designated

1 as that witness. So, we would ask that Ms.
2 Paulette, that she would not be allowed to be
3 asked questions about policy considerations
4 when Mr. McCormack was designated as that
5 witness.

6 THE COURT: So, specifically, you're objecting to
7 any questioned of Ms. Crawford regarding the
8 Department policies?

9 MS. WOOTEN: Tax, yeah.

10 THE COURT: Got it.

11 MS. WOOTEN: Policy-type decisions. She was
12 designated as the auditor who, you know,
13 performed the actual method and calculations.

14 THE COURT: All right.

15 MS. WOOTEN: Those types of issues.

16 MR. SMITH: Your Honor, she's been an auditor for 28
17 years with the Department. These are general
18 tax principles that any auditor would know and
19 agree with, which she did. And so I'm simply
20 confirming that she agrees with these
21 principles.

22 THE COURT: And if we're talking just about tax
23 principles but if we're talking about specific
24 South Carolina Department of Revenue policies,
25 that's what you're objecting to?

1 MS. WOOTEN: Yeah. In general, yes, sir.

2 MS. SMITH: And I will not ask her policy questions.

3 These are tax principles, universal tax
4 principles, that she's acknowledging exists and
5 she abides by them.

6 THE COURT: And that's kind of what I was hearing,
7 too. I wasn't -- perhaps, I didn't hear the
8 question correctly but I didn't hear that these
9 were specifically related to South Carolina
10 Department of Revenue ---

11 MS. WOOTEN: Okay.

12 THE COURT: --- specific tax policies. I thought
13 that he was just asking her some basic
14 principles.

15 MS. WOOTEN: So, for the record, she's being asked
16 these in her own individual capacity, not as a
17 representative of the Department's position on
18 a certain issue on tax policy considerations?

19 THE COURT: Right. And, again, I think -- I see a
20 distinction between the term principle and
21 policy.

22 MS. WOOTEN: Okay. I understand.

23 THE COURT: Right. And so I'm going to let the
24 questions go as to the principles of taxation
25 but she's not speaking for the Department as to

1 the Department's policies.

2 MS. WOOTEN: That's correct, Your Honor.

3 THE COURT: Okay. Thank you.

4 MS. WOOTEN: Thank you.

5 MR. SMITH: And I don't believe you'll hear

6 different answers from Mr. McCormack either but
7 nevertheless.

8 Q: Fourth principle and then we'll move on here.

9 "When deciding a sales tax applies to a
10 transaction or service, the tax statute should
11 be strictly construed and applied in favor of
12 the taxpayer and against the Department."

13 A: True.

14 Q: Okay. Okay. We're going to talk about your
15 thoughts and actions as the auditor here. It
16 is your or the Department's position that
17 Lowe's should have remitted tax on the retail
18 price, shelf price, of the tangible personal
19 property, is that correct?

20 A: That's correct.

21 Q: And so you came up, you calculated, an overall
22 retail markup of 40 percent across the board?

23 A: Forty percent with the information that I was
24 given, yes.

25 Q: Okay. And you applied that to every single

1 item that was consumed in the performance of
2 these home improvement contracts?

3 A: As far as I know.

4 Q: Okay. That was what you tried to do?

5 A: Right.

6 Q: Okay.

7 A: If I was -- never mind.

8 Q: And so the dispute, the squabble that we're
9 having today, is simply does the sales tax
10 apply to this markup or not? Is that ---

11 A: That's correct.

12 Q: --- the sum of it? Okay. And as I understand,
13 you had some assumptions when you made this
14 assessment. You assumed that Lowe's withdrew
15 all of the tangible personal property consumed
16 in the home improvements from its store
17 inventories in South Carolina, is that correct?

18 A: I did say that in the deposition. I answered
19 yes.

20 Q: Okay.

21 A: But after other information, I -- that is not
22 true.

23 Q: Okay. When you made the assessment, was that
24 your assumption?

25 A: Yes.

1 Q: Okay. That's all I'm asking. I understand you
2 may want to change that answer. But when the
3 assessment was made, that was your assumption?

4 A: Yes.

5 Q: And the assessment presumed that every item
6 that had been assessed was withdrawn from an
7 inventory in South Carolina?

8 A: I don't think it would have mattered either way
9 but I guess you could say I did assume that.

10 Q: Okay. And from the deposition, I understand it
11 was the withdrawing of the items from inventory
12 that you deemed to be the retail sale?

13 A: At the time -- repeat the question, please.

14 Q: Okay.

15 A: I'm sorry.

16 Q: I don't think you are changing this now.

17 A: Okay.

18 Q: I don't think so anyway.

19 A: Uh-huh (affirmative response).

20 Q: But it's the withdrawing of the items from
21 inventory that you deem to be the retail sale?

22 A: Yes.

23 Q: Okay. It wasn't Lowe's purchase of the
24 materials from the vendors?

25 A: No.

1 Q: And it wasn't the customer signing of the
2 installation contract?

3 A: At the time, no.

4 Q: Okay. Have you changed your opinion?

5 A: I've changed my opinion.

6 Q: Okay. We'll get to that in a minute.

7 A: Okay.

8 Q: I'll stick with what your prior testimony was.

9 Is it your position on these transactions that
10 the customer did or did not owe sales tax?

11 A: I'm sorry, repeat again.

12 Q: Okay. Was it your position, at the time you
13 made the assessment, that the customer did or
14 did not owe sales tax on these transactions?

15 A: The customer -- if the customer was not charged
16 the tax, then Lowe's owed the tax.

17 Q: Okay. Now, you personally consider all of
18 these installation transactions to be retail
19 sales, don't you?

20 A: Yes, I do.

21 Q: Okay. And you believe, in fact, the customer
22 owes sales tax on these transactions?

23 A: It doesn't matter to me if the customer, like
24 I said, if it pays or not, but it is due.

25 Q: Okay. And then do you recall our talking about

1 the fact that some 60 percent of the installed
2 sales transactions were special order sales, do
3 you remember that?

4 A: I think I remember that, yes.

5 Q: Okay. Items shipped by a vendor for specific
6 transactions from out of state, do you remember
7 that?

8 A: Yes, I remember you saying that.

9 Q: And you testified at the time that even with
10 special order sales, and I'm going to quote
11 here, "You would treat it as being withdrawn
12 from inventory even if it wasn't withdrawn from
13 inventory." Is that still your belief?

14 A: Yes, withdrawn from the business, even if it
15 was not withdrawn from inventory.

16 Q: Okay. And your belief, your position, is that
17 Lowe's was not a construction contractor?

18 A: That's correct.

19 Q: Okay. And I believe, am I correct, you never
20 assessed any other retailer for sales tax
21 arising out of home improvement transactions?

22 A: That's true because they pay the retail price
23 at the time of purchase for the items that they
24 use.

25 Q: At the time ---

1 A: I'm sorry.

2 Q: --- that they purchase? I'm sorry.

3 A: I'm sorry. You repeat the question, please.

4 I'm sorry.

5 Q: Okay. My understanding, Lowe's is the only

6 retailer you've ever assessed sales tax on

7 arising out of home improvement transactions?

8 A: It is. It's the only one that I've audited

9 with this problem.

10 Q: Okay.

11 A: Of this situation, yes.

12 Q: Okay.

13 A: I thought you said contractor. I'm sorry.

14 Q: And under your understanding of South Carolina

15 sales and use tax, a contractor, a construction

16 contractor, is the user and consumer of

17 tangible personal property consumed in

18 performing an installation contract, is that --

19 -

20 A: Construction contract, yes.

21 Q: Okay. I'm not talking about Lowe's. I'm now

22 saying construction contractor.

23 A: Contractor.

24 Q: Okay. And so in that case, the contractor owes

25 the tax, the customer receiving the home

1 improvement does not owe tax?
2 A: That's true.
3 Q: And the installation labor is tax exempt?
4 A: That's exactly right.
5 Q: Okay. And the contractor would owe tax on what
6 he paid for the materials, correct?
7 A: Paid at retail, yes.
8 Q: Well, whatever he paid?
9 A: Paid at retail.
10 Q: Okay.
11 A: Is what our law says. Paid at retail.
12 Q: Well, contractors are all different sizes,
13 aren't they?
14 A: Yes, sir.
15 Q: Some buy at discount, do they not?
16 A: They do buy at discount.
17 Q: Okay. Some buy in bulk and actually store some
18 of it, don't they?
19 A: I would assume they would.
20 Q: Okay. So, they might even have an inventory of
21 building materials and they don't know where or
22 what project it's going to go on, is that
23 correct?
24 A: That's correct.
25 Q: But you deem them to be construction

1 contractors and they would be taxed on what
2 they paid for the materials?

3 A: That's right.

4 Q: No matter what they paid?

5 A: According to our policy, yes.

6 Q: Okay. And you've never taxed markup on a
7 construction contractor?

8 A: I have not.

9 Q: Okay. And the reason why you are treating
10 Lowe's not as a construction contractor is
11 because it has big box retail stores, is that
12 right?

13 A: Because they represent themselves as a
14 retailer.

15 Q: Okay. Now, and I didn't ask you this before
16 but I'm curious, if a big contractor who buys
17 in bulk and stores it in inventory opens up one
18 store where he sells some of that stuff, nails,
19 hammers, shingles, whatever, would he then be
20 taxed on his markup for all of the materials he
21 bought? Would he still be a contractor or
22 would he now be a retailer?

23 A: I'm sorry, repeat the question again.

24 Q: Okay. We've got a construction contract.

25 A: Okay.

1 Q: So, you acknowledge the construction contract?

2 A: Right. Construction contract.

3 Q: They're big.

4 A: They are.

5 Q: They can buy stuff at bulk and they have

6 warehouses, they store it there. But then they

7 decide, aha, let's open up a store in Beaufort

8 and we're going to sell some of our stuff at

9 retail. Are they still a construction

10 contractor?

11 A: They could be both, yes.

12 Q: Okay. How would they be taxed?

13 A: They would be taxed at the time -- how would

14 they be taxed when they purchased the goods, is

15 that the question?

16 Q: Well, okay, would they be taxed when they

17 purchased the goods?

18 A: Not if they extended their -- yes, they would

19 be taxed when they purchased the goods.

20 Q: And they'd be taxed on what they paid for it?

21 A: They would be, unless they extended their

22 resale certificate to their vendors telling

23 them that they're going to resale at that

24 store. We're talking about two different

25 things here, I think.

1 Q: Well, I don't think so.

2 A: Well, if it's a construction contractor, they
3 have to pay tax up front. They don't have
4 anything to extend, no resale certificate.

5 Q: Okay.

6 A: So, the tax would be paid at that time.

7 Q: Okay. Now, there is a regulation, is there
8 not, that deals with dual businesses?

9 A: It is. There is.

10 Q: And it requires, if you do both, and if you do
11 what I think is called substantial amount or
12 significant amount of retail sales, that you
13 have to buy it using a resale certificate, is
14 that correct?

15 A: As far as I know.

16 Q: Okay. So, if this construction contractor
17 opened up a store, he would have a resale
18 certificate, would he not?

19 A: He would have that for that store, yes, sir.

20 Q: Okay. So, would you segregate it? Would you
21 just tax the stuff that went to the store at 40
22 percent markup or would you tax everything they
23 buy at 40 percent markup?

24 A: Well, it's according to if he charged the
25 customer the tax. In the retail store, he

1 would have to charge the customer the tax. He
2 wouldn't have to but he's going to pay on the
3 markup.

4 Q: Okay.

5 A: For anything that's sold in the store, he would
6 have to pay on the markup.

7 Q: But all the other stuff he's buying for his
8 construction contracts, he's taxed at his cost?

9 A: As long as he doesn't sell it in the store.

10 Q: Okay. Okay. So, if goods are not sold in the
11 store, then they don't have to be taxed at the
12 markup?

13 A: In that case, no.

14 Q: Okay. And I believe you said you came up with
15 the 40 percent markup by reviewing the accrual
16 information provided you by Victor Brown, who
17 worked with Mr. Price at the time?

18 A: Yes, sir.

19 Q: Okay. And the question I asked you at the time
20 was if Victor Brown worked for Pulte Homes and
21 no Lowe's and showed you the exact same
22 numbers, you would have not marked up the
23 accrued tax, or accrued cost numbers, is that
24 correct?

25 A: If they're a true -- if they're a contractor

1 using that to -- to -- on the -- on the
2 contracts, no.

3 Q: Okay. And there's that term.

4 A: I know. I didn't mean to say it.

5 Q: Let's talk about that term.

6 A: Contracts.

7 Q: No, that's okay. I mean, it's in the
8 determination. It's from the Department's
9 determination that a true contractor -- what is
10 a true contractor?

11 A: I think a true contractor is one that does
12 construction work. It makes, you know -- my
13 mind just went blank. Give me just a minute,
14 please.

15 Q: Okay.

16 A: Is one that holds their self out as a
17 contractor, does additions and construction,
18 repairs to real property. They buy their --
19 usually buy their -- all the materials at
20 retail. They usually will do work for other
21 people. If you come in and ask them, you may
22 have something that you've bought at Lowe's and
23 you ask them to install it for you, they
24 probably would do that. They -- I think
25 that's enough.

1 Q: Okay. And as you recall I, I hope politely,
2 questioned you on this concept of true
3 contractor and asked you is there any statute,
4 is there any law, is there any regulation, is
5 there anything anywhere that talks about it and
6 I believe you said, "No."

7 A: Not that word. Not true contractor, no.

8 Q: This is your personal opinion, is it not?

9 A: It is.

10 Q: Okay. We've been talking about this today and
11 I'm sure you're familiar with it, this is the
12 statutory definition of contractor. And I
13 asked you before if, from your understanding of
14 these home improvement contracts, if they were
15 in fact involving improvements of any kind of
16 real property and fell under general
17 construction and I believe you said, "Yes," is
18 that correct?

19 A: At that time, I did, yes. But if I -- if I'm
20 answering for the Department, I think that we
21 just can't take out one definition and we have
22 to look at the whole picture.

23 Q: Okay. Well, at least as far as the one statute
24 that deals with contractors ---

25 A: Okay.

1 Q: --- Lowe's is clearly a prime contractor, is it
2 not?

3 A: It would depend on the circumstances.

4 Q: Well, on this definition, is Lowe's an entity
5 which contracts directly with an owner to
6 perform general or mechanical construction?

7 A: I guess you could say it would be.

8 Q: Okay. And you're not aware of any other
9 definition of what a contractor is in the code
10 anywhere, is that right?

11 A: That's right. And I'm not familiar with that
12 code.

13 Q: Okay. But you do, and you did then and you do
14 now, acknowledge that Lowe's fits within this
15 definition?

16 MS. WOOTEN: Objection. Asked and answered.

17 THE COURT: I'm going to go ahead and let her answer
18 the question. Thank you.

19 MS. WOOTEN: Thank you.

20 A: It could.

21 Q: Okay. All right. I'm going to just do a
22 couple more and then I'll let you go, I
23 promise. You're familiar with this statute, of
24 what is a sale at retail?

25 A: Yes.

1 Q: Okay. And we've talked about that, as well.
2 Now, if Lowe's is a contractor then (e) would
3 apply, would it not?

4 A: Like I said, I think we need to look at the
5 whole picture. We would need to take that
6 code, along with other codes, to determine
7 that.

8 Q: Okay. Let me back up. I understand you think
9 Lowe's is not a contractor. I'll concede you
10 don't think they are.

11 A: Okay.

12 Q: So, for purposes of my question, assume they
13 are. You're not bound by that.

14 A: Okay. If I'm assuming ---

15 Q: No one's going to hold you to it.

16 A: --- they are.

17 Q: Right.

18 A: Okay. I'm assuming.

19 Q: Assume that Lowe's is a contractor, E would
20 apply, would it not?

21 A: It would.

22 Q: Okay. And the trigger would be when they're
23 buying the materials from the vendors?

24 A: Yes.

25 Q: And they would owe tax on their cost, whatever

1 it was, is that correct?

2 A: It was not purchased at -- it was purchased at
3 wholesale, free of the tax, the contractors
4 have to pay the sales tax.

5 Q: Okay. My question is if they were a
6 contractor, they would pay tax on what they
7 paid for the materials?

8 A: What they purchased the materials.

9 Q: Okay. Thank you. And if it's (e), it can't be
10 (c), can it? Because (e) is when they're
11 buying it and (c), they already have it. (c)
12 would have to take place after (e), is that
13 correct?

14 A: Right. They could not withdraw it unless they
15 had bought it, that's true.

16 Q: Okay. So, if (e) applies, (c) can't apply, is
17 that right?

18 A: I guess you're right.

19 Q: Okay. And I believe we're not in dispute here.
20 If Lowe's -- if the court finds that Lowe's is
21 a contractor when it performs these home
22 improvement contracts, it remitted the correct
23 amount of tax?

24 A: You want my opinion on that?

25 Q: Well, I know what your testimony was. Do you

1 want to change it? Well, first of all, what
2 did you say earlier?

3 A: What did I say earlier? That -- that
4 contractors needed to pay tax on the retail
5 price.

6 Q: Well, I believe when I asked you, and I'll read
7 it back to you, but my question is if Lowe's
8 was a construction contractor then it correctly
9 remitted the correct amount of tax in the
10 building materials and your answer was yes.

11 A: Okay.

12 Q: Is that a ---

13 A: That was my answer at that time.

14 Q: Okay. That's all. Thank you.

15 A: Thank you.

16 THE COURT: Thank you, sir. Cross?

17 MS. WOOTEN: Sir?

18 THE COURT: Yes.

19 MS. WOOTEN: Okay. Thank you. Since we're going a
20 little out of order with Mr. Smith calling you
21 first, I'm just going to go through a few
22 preliminary matters for Ms. Paulette Crawford,
23 if that's okay.

24 MR. SMITH: Sure.

25 MS. WOOTEN: Okay.

1 MR. SMITH: And, Nikki, if you wanted, you could
2 wait till you put on your case. I mean, you
3 don't have to question her at all.

4 MS. WOOTEN: Yeah.

5 MR. SMITH: I'm just fitting it into my ---

6 MS. WOOTEN: Right. And I understand. I just don't
7 want to waive any kind any of right of asking
8 my direct of Paulette later on in my case. Is
9 that okay with you, Judge Lenski?

10 THE COURT: Yeah. This is a little bit -- I mean,
11 she's a little bit out of ---

12 MS. WOOTEN: Right.

13 THE COURT: --- it's a little bit unorthodox but
14 however ---

15 MS. WOOTEN: Okay.

16 THE COURT: --- you want to do it. And I would not
17 find that you waived anything. So, if you
18 would just like to wait until you put her on
19 for your direct, pardon me, for your case, for
20 your own direct, that's fine. However.

21 MS. WOOTEN: Okay. I think I'm going to go ahead
22 and proceed, Your Honor. She's already up here
23 and she's testifying so I think the Department
24 would like to go ahead and proceed.

25 THE COURT: All right.

1 MS. WOOTEN: Okay.

2 MS. CRAWFORD - DIRECT EXAMINATION BY MS. WOOTEN:

3 Q: Ms. Crawford, you testified earlier that you've
4 been employed with the Department for 28 years,
5 ---

6 A: I have.

7 Q: --- is that correct? Can you just briefly
8 outline your employment history with the
9 Department the last 28 years?

10 A: I've been a field auditor for the last 28 years
11 with the Department.

12 Q: And what job duties or responsibilities do you
13 have as a field auditor?

14 A: I do auditing of various size taxpayers and
15 various types of taxes but my focus is on sales
16 and use tax. I also go out to -- out in the
17 field to manufacturers when they've asked for
18 an exemption certificate. I tour the plants to
19 see what they require and what they qualify
20 for. I help to train other auditors. I also
21 have a seminar that I help train sales and use
22 tax to the public on manufacturing. I just do
23 a variety of things.

24 Q: And what types of taxpayers or industries do
25 you routinely audit?

1 A: The -- resellers with multi-locations,
2 contractors, hospitals, just a little bit of
3 everything. You name it.

4 Q: And what are the general issues that come up in
5 those types of audits?

6 A: There's different things. In manufacturing,
7 sometimes we -- it's determining how something
8 is used in the manufacturing process. A lot of
9 times, it's delivery, freight and delivery
10 charges. Different types of -- when the
11 different special sales taxes, a lot of times
12 they're not paid correctly. Sometimes we
13 disallow discounts or deductions that are taken
14 on the tax returns, that type of thing.

15 Q: And you're familiar with the taxpayer in this
16 matter?

17 A: I am.

18 Q: And how are you familiar with Lowe's?

19 A: I completed the audit of Lowe's.

20 Q: And what are the audit years for the present
21 audit that we're here for today?

22 A: August the 1st of 2008 to July of 2011, July
23 31, 2011.

24 Q: Where did you conduct the audit of Lowe's?

25 A: We conducted it from the Rock Hill office of

1 the South Carolina Department of Revenue.

2 Q: And what type of audit was it?

3 A: Well, we requested from the taxpayer that we
4 use a computer-assisted method and that's what
5 we ended up doing. We did some statistical
6 sampling, some block sampling and -- well, I
7 guess that's it.

8 Q: And what was your role during the audit?

9 A: I was what we call the lead auditor. I was the
10 one that did most of the, I guess you'd say,
11 negotiation with the taxpayer, even though I
12 had other people helping me on the audit.

13 Q: And what were the roles of the other auditors
14 assigned to this particular audit?

15 A: The first one was Kim Hyatt was assigned to
16 help me on the audit and she was in training on
17 an electronic audit. So, she helped me with
18 the pre-audit work and also she helped review
19 the records. And I also had Carol Solomon,
20 who's our computer-assisted audit. I guess
21 you'd kind of call her an expert on -- on that
22 type of thing because that relieves the other
23 auditors from having to deal with the sampling.
24 She helps with that.

25 Q: And what's the Department's general audit

1 examination process in a sales tax matter?

2 A: Usually, we -- we start off, we look at sales.
3 That's one area we look at, sales. Then we
4 look at use tax on purchases. We look at
5 deductions to make sure the deductions have
6 been taken correctly. We look at the income
7 and compare it to the income from retail sales.

8 Q: All right. Let's start at the beginning of the
9 audit of Lowe's. What is the first document
10 that you sent to the taxpayer informing them
11 that the Department was conducting the audit?

12 A: That would be our audit appointment letter and
13 package.

14 Q: If you'll refer to Exhibit 1. Do you have that
15 in front of you?

16 MR. SMITH: Which exhibit number?

17 MS. WOOTEN: Exhibit 1.

18 Q: And is this the packet you were just
19 referencing?

20 A: Yes, this is the package that we sent to the
21 auditor.

22 Q: And what type of information is provided to the
23 taxpayer in the audit appointment packet?

24 A: We -- we tell what type of tax it is. This
25 says, tax type, sales tax. It gives the file

1 numbers of the locations that are being
2 audited. And actually, on this one, we had to
3 do supplemental pages. The next two pages show
4 the stores that were either open at the
5 beginning of the audit or had been opened or
6 closed during our three-year audit period.
7 That lists all their account numbers. It tells
8 the time and date of the appointment. It also
9 gives a list of records. This is kind of like
10 a template type thing and this gives us a
11 starting point of things we want to look at and
12 we need the taxpayer to provide for us to look
13 at. We also, in this letter, it references
14 that we would like to do some type of
15 electronic audit if we could. And it also
16 tells about the Taxpayer Bill of Rights in
17 which there's a copy in here. And it gives the
18 taxpayer 30 days to delay the start of the
19 letter -- the start of the audit. Also,
20 included in this package, since we did want to
21 do an assisted -- computer-assisted audit, it
22 also has a computer-assisted audit
23 questionnaire that's sent to the taxpayer and
24 that's asking them would they please complete
25 that and give us an idea of what type of

1 records they have on electronic means and we
2 use this to see if we can use their types of
3 software. And the Taxpayer Bill of Rights it
4 at the back. Excuse me, not at the back. And
5 we -- I also included a brochure of a computer-
6 assisted audit, it just describes a little bit
7 about the type of records we can use and the
8 different procedures of the audit of --
9 computer-assisted audit.

10 Q: If you'll flip to Exhibit 2. And do you
11 recognize these documents?

12 A: Yes. These are our consent to extend the time
13 to assess the tax and I guess the easiest way
14 to say that's a waiver, it holds the statute of
15 limitations. Like I said, we usually do a 36-
16 month audit and this holds the statute of
17 limitations open on those, especially the first
18 few months of the audit that's scheduled in the
19 audit. A lot of times, especially if we're
20 doing electronic, it takes time to get the --
21 for the exchange of records and the statute
22 would run out on those first periods if this
23 was not signed. It locks in, what I like to
24 tell the taxpayer is, it locks in that time
25 that we've already referenced as the 36 months.

1 It locks those 36 months in and we don't have
2 to drop a period off because of the statute or
3 add a period on to the end, that type of thing.

4 Q: Do you recall your next contact with the
5 taxpayer?

6 A: I think -- I don't think, I know, I received a
7 couple of emails back and forth with Mr. Brown.
8 And we set up a conference call to talk about
9 the audit plan, you know, to set the -- get the
10 audit started, to talk about the audit.

11 Q: And what audit plan did the parties agree upon?

12 A: Well, they did agree, excuse me, Mr. Brown
13 agreed with an electronic audit. We had asked
14 for -- we suggested that we look at two months
15 of records. And usually I look at three
16 because I pick one from each year of the audit
17 so we can get a better capture of what's going
18 on. But due to the volume of records that
19 would have been included in this, he suggested,
20 excuse me, Mr. Brown suggested that we use one
21 month and I agreed with that one month. And we
22 also suggested that we look at about half the
23 stores, I suggested that, and that was agreed
24 upon. And we were to pick the stores or we
25 picked the stores and then the taxpayer would

1 look at those and agree to those.

2 Q: What month did the Department and the taxpayer
3 agree upon to look at ---

4 A: The taxpayer suggested April 2011 and I had no
5 objection to that and did not object. I agreed
6 with that month.

7 Q: Okay. And other than the waiver that we were
8 just discussing, what other information did you
9 initially receive from the taxpayer at the
10 beginning of the audit?

11 A: The taxpayer sent electronic records to us. It
12 was the April 2011 transactions. They were
13 over, I think, four million lines of
14 transactions and that was a lot of material to
15 look at.

16 Q: And what issues did the Department look at in
17 that first document?

18 A: Repeat the question.

19 Q: What issues did the Department look at from the
20 document it first received from the taxpayer?

21 A: Oh, from the information, the sales information
22 for that one month, we had -- actually, let me
23 back up. We did -- that was the sales
24 information. We also received expense
25 information which, you know, was store

1 expenses. On the sales information, we looked
2 at any sales that were zero. There were two --
3 that information was divided into two types of
4 information or two -- two schedules. One was
5 zero tax paid, the other one was -- and that
6 means zero paid by the retailer, excuse me, by
7 the customer, no tax charged, it was zero tax
8 -- the other one was incorrect tax and the
9 incorrect tax was actually the local taxes had
10 been paid on that schedule but no state tax had
11 been paid on that schedule.

12 Q: And we're going to jump ahead to the proposed
13 assessment just to clarify an issue for the
14 court. If you'll refer to Joint Exhibit 3.
15 And do you recognize this document?

16 A: Yes, I do. This is my schedule. It's a
17 combined billing summary and distribution
18 report.

19 Q: What adjustments are on this particular
20 document?

21 A: The first, I have them numbered one and two,
22 the first one are the installed sales. The
23 second one, there were the other types of
24 information besides the installed sales. There
25 were other taxable sales which were -- that was

1 things that were -- the tax was not paid on.
2 It was some -- I believe it was some resale
3 certificates that had been accepted by Lowe's
4 that we said were not valid or we didn't have
5 those for some of the customers. There were
6 things like propane tanks that they were
7 selling, empty propane tanks that tax had not
8 been paid on. That was other taxable sales.
9 And the sales tax paid, incorrect amount, the
10 local tax had been paid on this but not the
11 state, and it was things that seemed to be
12 maybe miscoded. Like it was some trees that
13 were not fruit bearing, they did not qualify
14 for the unprepared food deduction. And it was
15 some candles that, when it said peppermint, I
16 think they were coded to like candy and they
17 still didn't charge the state tax. They had
18 that under the unprepared food sales. The
19 other thing was the stat sample for expenses,
20 that was for the store expenses, and then the
21 use tax accrual credit. So, actually, there
22 was four schedules under number two billing and
23 only the installed sales under number one
24 there.

25 Q: Are any of the issues related to adjustment

1 number two you just described, the other
2 taxable sales, sales tax paid, stat sample for
3 expenses, use tax accrual credits, are of those
4 issues before the court today?

5 A: No, they were all agreed on.

6 Q: So, we're only looking at the installed sales
7 issue?

8 A: That's correct.

9 Q: Okay. And just to clarify, too, for the court,
10 under adjustment number two, there is a line
11 for use tax accrual credits, does that relate
12 to the installed sales tax transactions?

13 A: No, that does not.

14 Q: Okay.

15 A: Would you like me to tell a little bit about
16 that now?

17 Q: No, that's ---

18 A: Okay.

19 Q: Yeah. Thank you.

20 A: Okay.

21 Q: All right. All right. Now, we're going to
22 jump back to the beginning of your audit since
23 we're looking just at the installed sales
24 transactions. With regard to the installed
25 sales, what did you do at the beginning of the

1 audit? How did you begin looking at the
2 installed sales transactions?

3 A: I segregated the installed sales from the
4 Lowe's information onto a separate spreadsheet.
5 And all this is on Excel so it was easy to move
6 them over. Then I started examining those to
7 see what had been purchased and I saw where the
8 -- we had the price that was charged to the
9 customer but we did not have the cost price on
10 those items and I requested information on the
11 cost from Lowe's.

12 Q: If you'll turn to Exhibit 5. And do you
13 recognize these documents?

14 A: Yes. These are the documents that I received
15 from Lowe's showing the sales price to the
16 customer, the cost of the item and then the tax
17 that was accrued or the tax that was paid to
18 the state on these items.

19 Q: Okay. Next we're going to flip to the third
20 page of this exhibit. It's Bates stamped page
21 545. Did you review this document first in
22 looking at the installed sales transactions?

23 A: I did. I needed -- this shows the price of the
24 -- this one, I think, was a dishwasher. And it
25 -- by the item code here, I was -- I had to

1 look back at these pages that were given to
2 trace this from the regular and an SOS sales
3 report, this is the portion that Lowe's gave me
4 to look at, and then I traced these items back
5 to make sure that the tax was paid to the state
6 on the other pages.

7 Q: So, looking at the third page of this exhibit,
8 does this document show that any sales tax was
9 paid on the item?

10 A: Not on that third document. It shows no tax
11 was paid.

12 Q: And did you request Lowe's to provide
13 additional information showing that tax had
14 been paid?

15 A: We did request more information on -- on the
16 tax accruals, yes.

17 Q: And what information did Lowe's give to you to
18 show that tax had been paid?

19 A: That's these sheets right here was what we got
20 and they are called ---

21 Q: When you say these right here?

22 A: I'm sorry. These sheets, they're called use
23 tax on installed sales invoice item detail.

24 Q: Is that page one of Exhibit 5?

25 A: It is page one, 543. Sorry.

1 Q: Okay.

2 A: And so I traced back these items, which it
3 shows the item number. It even gives the
4 invoice number here. It shows, on this first
5 one, that there's a dishwasher that Lowe's
6 charged \$339.15 to the customer and their cost
7 was \$262.93 and they paid us tax on -- paid the
8 amount \$21.03, which is the tax due on the cost
9 and not this sales price that's given here.

10 Q: How did you determine that the tax remitted to
11 the Department was based on Lowe's cost versus
12 their sales price?

13 A: Because of the accrual amounts that were given
14 in this third column here. And that's on page
15 543, underneath the tax. And also, I requested
16 more information from Mr. Brown.

17 Q: On this particular dishwasher, what is the
18 correct amount of tax to be remitted to the
19 Department?

20 A: It should be eight percent on the \$356.13. And
21 that store was 3040, which I believe is in
22 Lancaster County so Lancaster County is an
23 eight percent county and that means six percent
24 state tax and two percent local tax. So, the
25 tax that is due on the \$356.13 and not the

1 \$266.97.

2 Q: Based on the information that you learned from
3 Exhibit 5, what did you do next?

4 A: I asked Mr. Brown for additional information on
5 the cost to compare it to the selling price
6 that was charged by Lowe's.

7 Q: If you'll flip to Exhibit 6.

8 A: Okay. The information -- yes, this is my
9 schedule also.

10 Q: What is this document?

11 A: It's called worksheet markup of retail price
12 versus price at cost. I took the information
13 from Mr. Brown by the item number here on these
14 sheets that are called use tax on installed
15 sales and I plugged them in on the same item
16 numbers for the installed sale schedule that I
17 told -- how I told you I moved those installed
18 sales over to a separate schedule and these
19 were -- I had to use what they gave me here.
20 This information on these pages. And I plugged
21 those in and compared those cost prices to the,
22 I have retail price here, which was on the top
23 of their schedule. And I determined that the
24 markup was a 40 percent markup.

25 Q: And how did you determine the 40 percent

1 markup?

2 A: I compared the retail price to the cost and
3 divided the retail price by the cost and -- and
4 it was determined that it was a 40 percent
5 overall markup.

6 Q: Okay. And why do you believe the markup that
7 you calculated is accurate?

8 A: Because in the last audit, we did the same
9 procedure and the markup was 42 percent. So,
10 this fell right in line with the last audit.
11 And that audit, as Mr. Price said, was agreed
12 on and paid at the time.

13 Q: And why did you use 57 invoices on the markup
14 worksheet to determine -- to calculate it?

15 A: There was still a limited number of items that
16 were given to me by Lowe's and I had to work
17 with the information that I was given.

18 Q: You testified earlier that based on the
19 information in Five and -- well, in 5, that you
20 requested additional information from Lowe's?

21 A: Yes.

22 Q: Okay. If you'll flip over to Exhibit 7.

23 A: Okay. This is the information -- after I
24 determined the 40 percent, I was given this
25 information. This is the tax that was paid

1 for each store for each month of the audit
2 period. This was the tax that Lowe's remitted,
3 these amounts represent the tax that Lowe's
4 remitted to South Carolina on the items that
5 were withdrawn and used in the installed sales.

6 Q: And did Lowe's submit all of the information on
7 this document to you?

8 A: They did. This was a -- these are their
9 figures that they provided to me. This is the
10 tax that was paid. They came, I think, from --
11 excuse me, they said -- no. Mr. Brown said
12 these came from the weekly reports from each
13 store and this gives the total for each store
14 for the month. And they were provided for all
15 36 months of the audit period.

16 Q: And how did you use this particular document in
17 your audit examination process?

18 A: I took this information and calculated what the
19 tax should have been on the shelf price or
20 retail price and then compared the two.
21 Actually, I had to first of all start with the
22 store number to see what location the store was
23 in.

24 Q: And why is it relevant to know where the store
25 is located?

1 A: To see what the tax rate is in that store.
2 Since he gave me only the tax paid, then I
3 needed to -- I needed to convert it into a
4 figure, what the amount was -- what the cost
5 was, the total cost, not the use tax. In other
6 words, I guess a taxable figure. For me to
7 determine what the markup would be, I needed it
8 to convert it from tax to a taxable figure.

9 Q: And how did you do that?

10 A: I took this schedule and ---

11 Q: This schedule?

12 A: I'm sorry.

13 Q: Which schedule are you referring to?

14 A: I'm on 555.

15 Q: Okay.

16 A: Took what he gave me and I scheduled it -- I
17 think we -- I decided what store -- had to look
18 up each store to see what the tax rate was.
19 Then I took the tax that was paid and divided
20 it by the tax rate to come up with a figure
21 that -- to add the 40 percent markup to. And
22 what was charged is the difference between the
23 sales price and the price that Lowe's paid to
24 the -- to us, to the Department.

25 Q: Based on this information, let's flip to the

1 next exhibit, Exhibit 8, where you applied the
2 markup to the use tax ---
3 A: Okay.
4 Q: --- submitted to the Department.
5 A: On this ---
6 Q: All right. Let's walk through the first line
7 so you can just tell the court exactly what you
8 did on this particular document.
9 A: Okay. What we'll need to do is turn a little
10 bit further back to ---
11 Q: Okay.
12 A: --- it's an actual schedule. Let me find the
13 page number.
14 Q: I believe it's 277.
15 A: It is, 277. Okay. This information was taken
16 right off the journal voucher entries are
17 actually what the prior exhibit was. It has
18 the journal entry date. We're on page 277, I'm
19 sorry. The journal entry number, the account
20 number, the store number and then the tax rate.
21 I had to determine the tax rate. Then the use
22 tax amount paid. And then the taxable accrual
23 amount at cost. And then the last column is
24 the 40 percent markup, which would be the
25 difference between the amount of tax Lowe's

1 paid and the amount of tax that they owed on
2 the selling price.

3 Q: Okay. The column titled use tax amount paid?

4 A: Those are the actual figures that we can trace
5 back to the journal voucher entries in Exhibit
6 7.

7 Q: And then we'll go to the next column, the
8 taxable accrual amount at cost.

9 A: Okay. What I did was I took the tax paid from
10 these journal entries, I divided it. Number 1
11 would be it's in Columbia so the tax rate is
12 seven percent. I took that use tax amount,
13 divided it by seven percent and the taxable
14 amount or the cost amount for that one is
15 \$45,068.71. And if I mark that up, then the
16 taxpayer still owed tax on \$18,027.49, which is
17 40 percent markup.

18 Q: Did the Department give the taxpayer credit for
19 the use tax incorrectly remitted ---

20 A: Yes. Tax ---

21 Q: --- prior to the audit?

22 A: --- tax was only on the markup and not on the
23 difference, which would be the markup, not on
24 what they had already paid.

25 Q: And based on the information in Exhibit 8, what

1 did you do next? Excuse me. Yeah, Exhibit 8.

2 A: If you'll go back to the first pages, this is
3 the summary for that schedule on page 270.
4 This summarizes the actual schedule which we
5 just looked at on page 277 and then on back.
6 But this is the schedule summary for South
7 Carolina installed sales. It has the period,
8 it has each county there, divided because each
9 county wants their share. We collect the local
10 county's taxes so we have to pay it to them.
11 If we collect it for them, then we have to pay
12 it in. So, this is divided by each county and
13 how much money was owed to each county on this
14 front, the first two or three pages, I think.
15 Some of these get kind of long. Right, from
16 page 270 to 276, that was on the breakdown by
17 counties.

18 Q: All right. If you'll now refer to Exhibit 9.

19 A: This is the billing summary and it's also one
20 of our schedules and it's just a summarizing
21 again, by each county, the amount of tax, the
22 amount of interest due and the amount of
23 penalty and then the total tax here that goes
24 to each county. And that's from page 122, 123.
25 And then beginning in 124, it actually has a

1 page for each county there. It's a lot of
2 paperwork. We don't use quite this much
3 anymore. We've improved things a little bit
4 since then.

5 Q: All right. And if you will look at Bates
6 stamped page 123 of Exhibit 9. How -- does the
7 total on this exhibit correspond to the total
8 on Exhibit 3? If you'll flip back to Exhibit
9 3 and compare the totals of those two
10 documents.

11 A: Yes, they agree. This is the part only on the
12 installed sales portion of the audit that
13 pertained to the installed sales,
14 \$2,000,650.41.

15 Q: And that is the total amount of the findings
16 from your audit for the ---

17 A: It is.

18 Q: --- installed sales?

19 A: That's tax, interest and penalty.

20 Q: Okay. And what are the findings of your audit?

21 A: The findings of the audit were that Lowe's only
22 paid tax on the cost of the materials that
23 they withdrew from inventory and the business,
24 or the business, and that only tax was remitted
25 on the cost and not the retail price or the

1 selling price. I don't have to say retail
2 price. The selling price to the customer.

3 Q: And why do you believe that Lowe's remitting
4 tax on the cost of their inventory items versus
5 the sales price is incorrect?

6 A: Because they're doing -- they're performing
7 sales and installation. They are a retailer
8 and they're selling the product to the customer
9 and then contracting with a third party to
10 install. But they are actually selling the
11 product to the customer.

12 Q: After you completed your findings, what did you
13 do next?

14 A: I had a proposed assessment and turned it over
15 to our -- or turned it into my supervisor for
16 her to review.

17 Q: And what was the result of your proposed
18 assessment after review by your supervisor?

19 A: I sent it then to the taxpayer.

20 Q: Did you mail it to the taxpayer?

21 A: I did. I mailed it to the taxpayer, yes.

22 Q: Okay. And if you will refer to Exhibit 29.
23 What is this document?

24 A: This is a document that goes out with the
25 proposed assessment. This is our letter and it

1 was addressed to Mr. Brown. It was sent out or
2 dated September the 24th of 2012 and it -- with
3 it would be the audit documents, which would be
4 the summary, billing, distribution and the
5 explanations of what we did in the audit and
6 quotes or references to the law of why we did
7 each adjustment.

8 Q: After you mailed the proposed assessment to the
9 taxpayer, what was the next contact that you
10 had from the taxpayer?

11 A: There were a couple of emails back and forth
12 between myself and Victor Brown. And as a
13 result of those, I did send -- I guess I kind
14 of gave him an explanation of some of the
15 things. He asked questions and I answered
16 those questions in those emails.

17 Q: After that initial contact, what was the next
18 contact that you had with the taxpayer?

19 A: The next contact was during the 90-day appeals
20 period. We received a protest from the
21 taxpayer's Power of Attorney, Mr. John Allan.

22 Q: Did you, or anyone at the Department, contact
23 the taxpayer or his POA after you received the
24 protest?

25 A: Yes, we did. I contacted Mr. Allan by phone to

1 set up a conference call to talk about the
2 protest and then I followed that up with a
3 letter to Mr. Allan.

4 Q: And what was the result of that appeals
5 conference?

6 A: The -- we understood that we would be receiving
7 some more information from Lowe's to support
8 their protest.

9 Q: Did you receive any additional information?

10 A: We did not.

11 Q: What was the next information that you did
12 receive from Lowe's?

13 A: We received a supplemental to the first
14 protest.

15 Q: And after the supplemental protest, did you
16 have any other contact with the taxpayer?

17 A: Only to send him a letter and, excuse me, send
18 Mr. Allan a letter stating that we would turn
19 over the audit now to litigation, send it for
20 litigation.

21 Q: And if you'll refer to Exhibit 9. Excuse me,
22 10.

23 A: Yes, that's the letter that I sent to Mr.
24 Allan. I sent it on August the 19th. Excuse,
25 it's dated August the 19th of 2013.

1 Q: After the audit examination of Lowe's, did you
2 have an opportunity to review additional
3 documentation from the taxpayer regarding their
4 installed sales?

5 A: Yes. During the discovery period, we did
6 receive additional information and we received
7 all the, I guess, installed sales information
8 for the whole 36-month audit period showing the
9 selling price and the cost of the merchandise.

10 Q: And did you compare that information to the
11 information you previously reviewed during the
12 audit?

13 A: Yes, we did.

14 Q: Okay. If you'll turn to Exhibit 11.

15 A: Okay.

16 Q: Did you prepare this document?

17 A: I did.

18 Q: Okay. If you'll describe what this document
19 shows.

20 A: This was what I -- this was my original
21 worksheet, markup of retail price, and we
22 compared the information and the cost on those
23 36 months from the taxpayer to the figures that
24 I had plugged in to the markup worksheet for
25 these items and there were only penny

1 differences in the amount, the true amounts,
2 from the taxpayer's additional information from
3 than what I had originally used.

4 Q: Okay. Just looking at the columns that are not
5 highlighted, the white columns ---

6 A: Okay.

7 Q: --- is this the information that is contained
8 on Exhibit 6?

9 A: Yes, it is the same information that was used
10 for the markup. It's our worksheet markup of
11 retail price to the price at cost, yes.

12 Q: And if you'll flip back to Exhibit 11.

13 A: Okay.

14 Q: And looking just at the highlighted portion.

15 A: Okay.

16 Q: Did you add the highlighted portions to this
17 exhibit?

18 A: Yes. This was added after we received
19 additional information during discovery.

20 Q: Okay. And what is the purpose of column one of
21 the yellow, highlighted section?

22 A: That is the cost amount. The first one, I had
23 -- my original worksheet had the cost amount at
24 \$31.22 and the actual cost on that item, on the
25 additional information, was \$31.23. So, it was

1 just a few pennies off on just about all of
2 them all the way down.

3 Q: And did the new cost information reported in
4 the column entitled report cost amount, did
5 that change your markup percentage that you
6 calculated during the audit exam?

7 A: No, it did not change it.

8 Q: What, if anything, did you learn from this
9 additional information in the highlighted
10 sections?

11 A: That my markup was correct.

12 MS. WOOTEN: Your Honor, at this time, I'd like to
13 offer Exhibit 11 into evidence.

14 MR. SMITH: And the purpose is simply to confirm
15 that the markup was ---

16 MS. WOOTEN: That's correct.

17 MR. SMITH: If that's the purpose of it, then we
18 have no objection.

19 THE COURT: Okay. There being no objection to
20 Exhibit 11?

21 MS. WOOTEN: That's correct.

22 THE COURT: Okay.

23 MS. WOOTEN: Thank you.

24 THE COURT: It's admitted.

25 MS. WOOTEN: All right. Thank you.

1 (Joint Exhibit Number 11 was marked for
2 identification purposes.)

3 Q: All right. During the audit, did you review
4 any of the installed sales contracts of the
5 taxpayer?

6 A: No, we did not review any of those.

7 Q: Why did you not review any contracts?

8 A: After we came up with the 40 percent markup, I
9 felt like that was a fair markup considering
10 the last time it was 42 percent. I had no idea
11 at the time that the taxpayer would not agree
12 with that markup until after, you know, 90-day
13 appeal. So, at that time, I felt no need --
14 any -- I didn't feel any need to look at those.

15 Q: And after the audit examination, were you
16 provided with additional information regarding
17 the types of installed sales at issue in this
18 matter?

19 A: Yes, in that 36-months that were given, there
20 were some information on those different types
21 of sales.

22 Q: And what types of sales are there?

23 A: There were the regular installed sales and the,
24 what they call SOS or -- my mind just went
25 blank -- special order sales, excuse me.

1 Q: And as you understand it, what are special
2 order sales?

3 A: Those are sales of items that are not in stock,
4 that have to be special ordered.

5 Q: And from your perspective as a Department
6 auditor, does it make a difference that the
7 tangible personal property purchased by a South
8 Carolina customer and used in special order
9 sales may come from a vendor or manufacturer
10 outside of South Carolina?

11 A: I think that makes ---

12 MR. SMITH: Object to the form of the question.
13 Misrepresents the transaction.

14 THE COURT: I'm sorry, I didn't hear that last part.

15 MR. SMITH: She gave a question that does not
16 represent the transaction here and so I object
17 to the form of it.

18 MS. WOOTEN: Which particular part of the question
19 do you ---

20 MR. SMITH: Virtually, all of it.

21 THE COURT: Could you repeat the question?

22 MS. WOOTEN: Sure. From your perspective as a
23 Department auditor, does it make a difference
24 that tangible personal property purchased by a
25 South Carolina customer that's used in special

1 order sales may come from a vendor outside of
2 South Carolina?

3 MR. SMITH: Now, is that relating to a retail
4 transaction as opposed to a real property
5 improvement transaction? That's the basis of
6 my objection.

7 MS. WOOTEN: Your Honor, the Department believes
8 that these are retail sales, Petitioner
9 believes they are real property transactions.

10 THE COURT: I understand but we're always ---

11 MS. WOOTEN: I'm talking about ---

12 THE COURT: --- these installed ---

13 MS. WOOTEN: --- installed sales ---

14 THE COURT: --- sales ---

15 MS. WOOTEN: --- contracts.

16 THE COURT: --- contracts.

17 MS. WOOTEN: That's correct.

18 THE COURT: And I understand that the parties take
19 different positions on what those are but this
20 isn't the purchase of the item at the store
21 either, it has to be special ordered, or that's
22 there in stock and the customer walks out or
23 it's delivered to their home. This is the
24 installed sales contract.

25 MS. WOOTEN: That's correct. That's all we're

1 talking about in this particular question.

2 THE COURT: Do you want ---

3 MR. SMITH: I don't object to your question. I
4 objected to her question.

5 THE COURT: I understand. I understand. Is there a
6 way that ---

7 MS. WOOTEN: From looking only at an installed sales
8 transaction, and then repeat my question, would
9 that alleviate

10 MR. SMITH: Probably not. I'm sorry. Why don't you
11 ask her what the Judge's question is?

12 MS. WOOTEN: I believe I did but I'll try to restate
13 that question again.

14 Q: Looking only at an installed sales contract,
15 special order sales installed contract, does it
16 make a difference that the tangible personal
17 property purchased by the South Carolina
18 customer and used in the special order sales
19 installation contract may come from a vendor
20 outside of South Carolina?

21 MR. SMITH: And object because the testimony, the
22 unqualified, undisputed testimony, is that no
23 tangible personal property is sold to the
24 customer, they're buying a real property. So,
25 I object to the form of the question.

1 THE COURT: All right. I understand. Ms. Wooten, I
2 think what you're trying to get at, that any
3 sale, any installed sales contract, that may
4 involve tangible personal property ---

5 MS. WOOTEN: Yes, Your Honor.

6 THE COURT: --- that isn't the sale itself of that
7 tangible property, because there's a dispute
8 over that ---

9 MS. WOOTEN: I understand.

10 THE COURT: --- but the tangible personal property
11 that's part of that sale?

12 MS. WOOTEN: That's used in that special order sales
13 contract.

14 THE COURT: Right. That that's

15 MS. WOOTEN: Comes from ---

16 THE COURT: --- stock or comes from out of state?

17 MS. WOOTEN: Comes from a vendor located ---

18 THE COURT: Out of state?

19 MS. WOOTEN: --- outside of South Carolina. That is
20 my question.

21 MR. SMITH: I have no objection to that question.

22 THE COURT: Okay.

23 MS. WOOTEN: Thank you.

24 THE COURT: There being no objection.

25 A: There's no difference. It doesn't make a

1 difference.

2 Q: Why doesn't it make a difference?

3 A: If it's used in South Carolina, the South
4 Carolina tax is still due on that item.

5 Q: Can a retailer also hold a contractor's
6 license?

7 A: Yes, they can.

8 Q: Can a retailer that holds a contractor's
9 license act as both during the same
10 transaction?

11 A: No, they cannot.

12 Q: And why is that?

13 A: A retailer can buy everything at wholesale to
14 resale, they're reselling the property. And a
15 contractor should buy everything at retail and
16 pay the tax at the time of purchase and they
17 cannot -- they don't sell at retail.

18 Q: What is a retail license?

19 A: A retail license is a piece of paper that we
20 issue giving a taxpayer the right to sale at
21 retail to the end consumer and collect our tax
22 and remit that tax to us.

23 Q: And what is a licensed retail merchant?

24 A: That would be someone that holds a retail
25 license with the state of South Carolina that

1 is selling tangible personal property.

2 Q: Is Lowe's a licensed retail merchant in South
3 Carolina?

4 A: Yes, they are.

5 Q: What is a resale certificate?

6 A: A resale certificate is a certificate that can
7 be extended by other retailers or other
8 wholesalers, and I think the word is jobbers in
9 the law. They can complete this certificate
10 and put their retail license number on it and
11 that gives them the privilege of extending that
12 to their vendors so they can buy merchandise at
13 wholesale, free of the tax, because they're
14 going to in turn resale those items to the
15 general public and collect the sales tax.

16 Q: In your experience as an auditor, does a
17 contractor have the ability to accept a resale
18 certificate?

19 A: No, they cannot accept resale certificates.

20 Q: And why is that?

21 A: Because they are not a retailer and they are
22 not reselling anything at -- excuse me, I said
23 that wrong. They -- they cannot -- they don't
24 have anything to extend, they cannot accept
25 them either.

1 Q: Okay. In your experience as an auditor, does
2 a contractor have the ability to extend a
3 resale certificate?

4 A: No, they cannot extend a resale certificate.

5 Q: And, again, why can they not extend a resale
6 certificate?

7 A: Because they have to buy everything at retail
8 price. They are using it themselves and not
9 reselling and the purpose of that is to -- to
10 buy at wholesale.

11 Q: Okay. In the transactions at issue, do you
12 believe Lowe's extended a resale certificate to
13 the vendor for the purchase of the materials?

14 A: Yes.

15 Q: And why do you believe that?

16 A: Because they paid no tax at the time of
17 purchase and they would -- if they did not
18 extend that certificate, they would have been
19 charged tax at the time of the purchase.

20 Q: In the transactions at issue, do you believe
21 Lowe's accepted resale certificates from
22 customers purchasing materials from their
23 store?

24 A: They did accept them, yes.

25 Q: And how do you know that?

1 A: Because we reviewed those. In the information
2 that was provided to us by Lowe's, there were
3 exempt sales to customers that had extended the
4 resale certificate to them and we examined
5 those resale certificates and there were some
6 items that were -- or sales that were
7 disallowed. The deduction for that sale were
8 disallowed.

9 Q: All right. If you'll now flip to Exhibit 12.
10 Do you recognize these two pages?

11 A: Yes, I recognize these two pages, yes.

12 Q: And what are they?

13 A: Okay. This is a comparison from total sales in
14 the data file that we were given and it
15 compares it to the installed sales that -- the
16 amounts that I was given by Mr. Brown. The
17 first page lists the store number and the item
18 -- number of items that the data that we had,
19 I guess that would be line items. That would
20 be like the customer receipt and it may have
21 two or three different items on it. So, that's
22 why it's a line item. It recaptured the
23 information we were given, recaptured the
24 receipt that was given to the taxpayer. It
25 also, in the third column, has the sales amount

1 for that store during the month of April 2011
2 and it has the total at the bottom there of all
3 the sales for those stores. And then the next
4 page, these are the amounts given to me by
5 Victor Brown of installed sales. And we
6 determined a percentage of those sales and it
7 was less than two percent.

8 Q: What is the purpose of this document?

9 A: To show that the total installed sales for that
10 month were less than two percent of the total
11 sales.

12 MS. WOOTEN: Your Honor, at this time, I'd like to
13 offer Exhibit 12 into evidence.

14 MR. SMITH: Your Honor, we object to the
15 introduction of this exhibit. We received it
16 only recently, after we took Ms. Crawford's
17 deposition, and we have tried mightily to
18 figure out where these numbers came from.
19 We're trying to match them up to where we --
20 our own numbers but we can't do it. We've not
21 had a chance to cross-examine Ms. Crawford and
22 I don't know if we'll be able to do it here.
23 And it's information from one month out of 2011
24 and we presented comprehensive numbers for the
25 entire audit period showing the breakdown of

1 special order versus stock sales. I don't
2 think this has any meaning at all. I don't
3 know where the numbers come from.

4 THE COURT: Okay. I'm a little bit confused. Tell
5 me again, what does this represent?

6 MS. WOOTEN: I believe Ms. Crawford testified that
7 it represents the total amount of sales from
8 these particular stores from April 2011.

9 THE COURT: For that month?

10 MS. WOOTEN: For that month of these particular
11 stores, April 2011, compared to the installed
12 sales of those stores for this, again, April
13 2011.

14 MR. SMITH: So, this is not a breakdown between
15 special order and stock?

16 MS. WOOTEN: No, it is not.

17 MR. SMITH: Okay.

18 MS. WOOTEN: It is a -- it's total sales of all --
19 all sales that were represented on the original
20 Excel spreadsheet Lowe's provided compared to
21 the percentage of just installed sales. It
22 does not break out special order or regular
23 order items.

24 THE COURT: So, just for example.

25 MS. WOOTEN: Sure.

1 THE COURT: Store 385, just so I can understand it,
2 221,549, that's what? What is that?

3 MS. WOOTEN: Those are the -- look at the column
4 above it, it says, the number of line items.
5 That's the number of transactions in that
6 particular month for that store, I believe.
7 You may be able to verify that with Ms.
8 Crawford but that's my understanding. And Mr.
9 Smith ---

10 THE COURT: That's what I thought she said. Right.
11 And then 3,481,000, it must be a dollar amount,
12 right?

13 MS. WOOTEN: That's correct.

14 A: It is. That's the sales amount.

15 THE COURT: \$3,481,011.81, that is -- what does that
16 represent? That's the amount ---

17 MS. WOOTEN: That is the total dollar figure
18 represented by the sales of those 221 ---

19 THE COURT: --- of those 221,549 items?

20 MS. WOOTEN: Correct.

21 THE COURT: And then, I guess, if you go to the next
22 page, then that top column would be -- these
23 are like columns three and four of that same --
24 -

25 MS. WOOTEN: That's correct.

1 THE COURT: So, 59,471, that's the ---

2 MS. WOOTEN: The dollar amount of installed sales
3 for that particular store for April 2011.

4 MR. SMITH: 2011.

5 THE COURT: And then that last number is that
6 percentage of ---

7 MS. WOOTEN: Is the percentage of the dollar amounts

8

9 THE COURT: From the dollar amounts.

10 MS. WOOTEN: --- from the installed sales compared
11 to the dollar amount of the total sales. It's
12 an original spreadsheet and when you look at
13 it, it would be looked at.

14 THE COURT: Right. I see it. I see it. I do
15 realize that. Okay. I just want to make sure
16 I understand. And your objection, just haven't
17 been able to verify any of this?

18 MR. SMITH: I've now checked with the fabulous Mr.
19 Price here. He says the sales numbers we got,
20 those match up. The number of line items, no
21 clue.

22 MR. PRICE: No, we're good with those.

23 MR. SMITH: Oh, we're good with those.

24 MR. CRAIG: Good with those.

25 MR. SMITH: What are we not -- so, it's the third --

1 -

2 MR. PRICE: It's the column. We just don't know
3 where it came from.

4 MR. SMITH: Okay. The third column, we don't know
5 where it came from.

6 MR. PRICE: We just don't know. If Paulette can
7 point us to one or two numbers, we'll be able
8 to ---

9 MS. WOOTEN: And Ms. Crawford can provide that
10 information on cross, if Mr. Smith would like
11 to ask her about that.

12 THE COURT: I do want to give the petitioner in this
13 matter every opportunity to -- I mean, their
14 objection is they're not sure where these
15 numbers come from and they're trying to verify.

16 MS. WOOTEN: Sure.

17 THE COURT: Before I admit this, I do want to give
18 them the opportunity to ---

19 MS. WOOTEN: I understand. And Ms. Crawford
20 received the information from Lowe's, that's
21 what she used to compile this document, and
22 they can ask her specific questions about where
23 the numbers came from or anything like that.

24 THE COURT: All right. Well, I'm kind of assuming
25 Ms. Crawford's going to say she got this

1 information from Lowe's. But I'm going to
2 allow them to ask -- before I do -- before I
3 admit this, I'm going to let them ask some
4 questions about it.

5 MS. WOOTEN: Sure.

6 THE COURT: Okay.

7 MS. WOOTEN: I understand.

8 THE COURT: All right. And so I'll just wait. You
9 can ask some questions on cross examination if
10 you still ---

11 MR. SMITH: That'll be fine.

12 THE COURT: --- have objections to the document,
13 then you can restate those or additionally
14 state those at that time.

15 MS. WOOTEN: Okay.

16 THE COURT: Thank you.

17 MS. WOOTEN: If you'll bear with me just a moment,
18 please.

19 THE COURT: That's fine.

20 Q: Ms. Crawford, were any penalties assessed
21 against Lowe's for this audit period?

22 A: Yes, they were.

23 Q: And what were those penalties?

24 A: The negligence penalty was added.

25 Q: What is a negligence penalty?

1 A: The law says it's a disregard -- negligence or
2 disregard regulation.

3 Q: Okay. And who makes the determination of
4 whether or not to apply a penalty in the audit?

5 A: It's per statute.

6 Q: And did you recommend that the penalties be
7 applied?

8 A: I did recommend that, yes.

9 Q: Why did you recommend?

10 A: Because we had discussed this issue, the same
11 issue, with Lowe's in the prior audit back in
12 2005, I believe. And we were -- we also
13 proposed -- we made the same adjustments as we
14 did this time, in the same way, and they agreed
15 and paid on it. And so they knew what our
16 stance was, what the department's stance was on
17 this issue and they did not -- they did not
18 correct this from last audit.

19 Q: And were you present for Mr. Price's testimony
20 earlier?

21 A: I was.

22 Q: Did you hear him testify that he believed the
23 basis for the prior audit is different than the
24 basis for this audit?

25 A: I did hear him say that.

1 Q: Okay.

2 A: Yeah.

3 Q: Do you agree with that?

4 A: I don't agree with that. The same adjustments
5 were made. If there were items that tax was
6 paid on at the beginning of the audit, most
7 likely, we did not review those because if we
8 did electronic, and I think we did last time,
9 we probably would not have looked at those
10 transactions.

11 Q: Now, if you'll flip to Exhibit 14, please.

12 A: Okay. This is -- page 877 is our explanation
13 of audit and adjustments and this was for
14 period covered March the 1st of 2002 to
15 February 28th of 2005. And this was sent to
16 Mr. Victor Brown who, at that time, was state
17 tax manager. And it explains our adjustments
18 to the audit adjustments.

19 Q: And did the adjustments of the prior audit
20 include anything about withdrawing from
21 inventory?

22 A: It did.

23 Q: Okay.

24 A: It did. Would you like me to read what it
25 says?

1 Q: No, thank you.

2 A: Okay.

3 Q: And was interest added to Lowe's assessment?

4 A: Yes, it was.

5 Q: And why was interest added?

6 A: It's also mandated by statute.

7 Q: And when will interest stop accruing in this
8 matter?

9 A: When the audit is paid in full.

10 Q: And has the taxpayer paid the assessment in
11 full ---

12 A: No.

13 Q: --- as of today?

14 A: No.

15 MS. WOOTEN: Your Honor, if I could just ask one
16 followup question ---

17 THE COURT: That's fine.

18 MS. WOOTEN: --- before I conclude.

19 Q: In your assessment of Lowe's, is the assessment
20 only related to the shelf price or the sales
21 price?

22 A: The sales price to the customer.

23 Q: And do we have that information provided by
24 Lowe's?

25 A: Yes.

1 Q: For the sales price?

2 A: The sales price, yes.

3 Q: Thank you.

4 MS. WOOTEN: That's all from the Department, Your
5 Honor.

6 THE COURT: Thank you. Do we need to take a break
7 or anything?

8 MR. SMITH: That's probably a good idea. Can we
9 take a five-minute break?

10 THE COURT: How about ten? Let's do ten minutes.

11 MR. SMITH: Ten-minute break.

12 THE COURT: All right. We're at recess for ten
13 minutes.

14 (Off the Record)

15 THE COURT: Okay. We're back on the record.

16 MS. CRAWFORD - CROSS EXAMINATION BY MR. SMITH:

17 Q: Ms. Crawford, let's first talk about Exhibit 12
18 so we can get that out of the way. Is the
19 purpose of that document to give an estimate of
20 the installed sales as a percentage of gross
21 sales for the month of April in 2011?

22 A: Yes.

23 Q: Okay. There's no other purpose to it that you
24 can ---

25 A: (Nods head affirmatively.)

1 Q: Okay. On the numbers here, okay, line items is
2 clearly straightforward. Sales amount, that
3 includes all sales, that includes type two
4 sales, it includes gift cards, it includes
5 donations, any kind of sales that occur, is
6 that right?

7 A: As far as I know. I did not complete this
8 report but, yes, as far as I know.

9 Q: Okay. And then the third item, the third
10 column, is that the materials cost of installed
11 sales?

12 A: I believe that's true, yes.

13 Q: Okay. So, it doesn't take into account the
14 labor component of the contract sales?

15 A: I believe that's true, yes.

16 Q: Okay. So, if you put in the labor component,
17 that number will be substantially higher, would
18 it not?

19 A: Probably, yes.

20 Q: And so what you've done is you've multiplied
21 this kind of artificially low number against an
22 artificially high number to get a percentage,
23 is that right?

24 A: That's what's been done ---

25 Q: Okay.

1 A: --- it looks like.

2 MR. SMITH: Your Honor, I don't think it's a
3 meaningful document for that reason.

4 THE COURT: I'm struggling to see the relevance of
5 the document.

6 MS. WOOTEN: Yes, Your Honor. I think we were just
7 trying to show that the vast majority of, or
8 the majority of, the taxpayer's sales were
9 retails sales and not these installed sales
10 transactions. That was the only purpose of
11 this document, was just to show the difference.

12 THE COURT: Right, and I understand. But I think
13 it's a valid point that there's an element of
14 the installment sales that isn't included and
15 that would be the service, the labor, excuse me
16 ---

17 MS. WOOTEN: Right.

18 THE COURT: --- end of it. Which would likely
19 increase it. And, again, I don't know how much
20 more it would increase it and it would still
21 probably show that they're only a portion of
22 the overall sales. But due to the fact that it
23 doesn't include that aspect of the sell, I
24 would say that any relevance this has is
25 minimal. And in the sense that it lacks one of

1 the major components of the whole transaction,
2 the installment sale, that being the labor
3 cost, I don't think it really accurately
4 represents the sales anyway.

5 MS. WOOTEN: Understood. And I think that -- and I
6 can't speak for Ms. Crawford.

7 THE COURT: Right.

8 MS. WOOTEN: You might be able to ask her. I think
9 the labor was taken out because that's not
10 taxable in South Carolina. But I understand
11 the point of comparing it without it. But I
12 believe that was the reason why the labor
13 portion was taken out of it. Again, that's my
14 belief.

15 THE COURT: Right. I do see that. Well, I'm going
16 to sustain the objection.

17 MS. WOOTEN: Okay. Thank you, Your Honor.

18 THE COURT: All right.

19 Q: Okay. Ms. Crawford, now I'm trying to pin down
20 what the Department's position is. As I
21 understand your testimony that you just gave,
22 you consider home improvement contracts as two
23 separate transactions; there's a retail sale of
24 tangible personal property to the customer
25 followed by an installation service by Lowe's

1 of these goods that belong to the customer?

2 A: That's correct.

3 Q: Okay. And you made that interpretation because
4 that's what you think?

5 A: And -- and I was also given the contract copies
6 during discovery. I looked at some of those.
7 In fact, we might have looked at some during
8 the deposition, I'm not sure.

9 Q: That's correct. And at the time, you had said
10 you'd never looked at the contracts?

11 A: I had not until then, right.

12 Q: Okay. So, you made the ---

13 A: Yes.

14 Q: --- you made the decision to segregate the
15 transaction into two separate transactions
16 without ever seeing a contract?

17 A: That's exactly right.

18 Q: Okay.

19 A: Yes.

20 Q: And then we did look at the contract and, of
21 course, the contract ---

22 A: Right.

23 Q: --- provides the title to the material stays
24 with Lowe's until it's incorporated into the
25 real property. Do you recall that?

1 A: Was that on the contract itself?

2 Q: Yes.

3 A: Is that what you're saying?

4 Q: Yes.

5 A: I don't remember that but it -- I guess it
6 does.

7 Q: Okay.

8 A: I don't remember.

9 Q: And I asked you, at the time, does that change
10 your opinion that this is actually two separate
11 transactions as opposed to one comprehensive
12 transaction and you said, "No."

13 A: No.

14 Q: Okay.

15 A: Uh-huh (affirmative response).

16 Q: Why not?

17 A: Lowe's is a retailer and the contract, even
18 when I saw the contracts, it just kind of
19 cemented the decision I made anyway because
20 they were divided into material and labor and
21 any retailer can sell something at retail and
22 install. And that's exactly what Lowe's did.

23 Q: Okay. So, the fact that the contract itself
24 provides that it's a lump sum installation ---

25 A: Okay.

1 Q: --- home improvement contract and the title to
2 the tangible personal property retained with
3 Lowe's until it was affixed to the property and
4 became a part of it, you deem that irrelevant?

5 A: I deem that irrelevant.

6 Q: Okay.

7 A: Because the customer paid -- went to the
8 register and paid for the item at the time when
9 they went into the store and paid for the item
10 at the cash register.

11 Q: Okay. So, from your point of view, is there
12 anything that could be put in the contract that
13 would change your position?

14 A: I don't think so.

15 Q: Now, you've looked at the decisions from
16 Oklahoma and Indiana, have you not?

17 A: I have not looked at those.

18 Q: Okay.

19 A: Yeah. I know they're there but I have not
20 looked at them.

21 Q: Were you aware that, in fact, in both Oklahoma
22 and Indiana that exact position was taken, that
23 the contracts should be bifurcated into a sale
24 of tangible personal property followed by
25 installation service?

1 A: I did not know that. Like I said, I did not
2 look at those. I knew they were there but I
3 didn't have time to look at them, so.

4 Q: Okay. And were you aware, in both of those
5 cases, that position was rejected by the
6 courts?

7 A: I did not know that, no.

8 Q: Okay. Okay. Let's look briefly at 12-36-90
9 because that's where you get the fair market
10 value thing here. Now, do you recall I asked
11 you, you're not aware of any special meaning of
12 the phrase fair market value as applied to
13 sales tax?

14 A: Any special meaning?

15 Q: Yes.

16 A: What do you mean by special meaning?

17 Q: Any defined meaning?

18 A: The only defined meaning that I know of is in
19 one of our regulations.

20 Q: And we'll talk about that in a minute. But in
21 the code itself, you're not aware of any
22 definition of fair market value as it applies
23 to sales tax?

24 A: Not any special meaning that I know of.

25 Q: Okay.

1 A: Any defined meaning.

2 Q: And you recall, I asked you the question does
3 the -- well, I asked you this way; the
4 Department doesn't have authority to make up
5 its own definition of fair market value that
6 would be different from what the law says it is
7 and you agreed with that?

8 A: I don't think they can, no.

9 Q: Okay. And you also agreed that in determining
10 whether Lowe's is a contractor or not, the
11 Department must follow either what the statutes
12 say or what the regulations say, is that
13 correct?

14 A: Are you saying either one or the other?

15 Q: Or both?

16 A: And not both?

17 Q: Let's say both.

18 A: Like I said, I think the Department's stance is
19 that we need to look at all the code sections
20 and the regulations together and the
21 circumstances of the taxpayer and then go by
22 that.

23 Q: Okay.

24 A: Make a determination on that.

25 Q: So, we saw what the statute said about a

1 construction contractor?

2 A: Yes.

3 Q: Okay. Let's look at what the regulation says.

4 All right. Well, first of all, there's a term
5 "building materials," which includes all of
6 these things, including all other tangible
7 personal property which becomes part of the
8 real property. You will agree with me that the
9 items that are consumed in the course of the
10 home improvement contracts are building
11 materials?

12 A: Yes.

13 Q: Okay. And this regulation says that "Building
14 materials, when purchased by builders,
15 contractors or landowners for use in adding to,
16 repairing or altering real property, are
17 subject to either sales or use tax at the time
18 of purchase of such by builder or contractor or
19 landowner." So, you're supposed to, if you're
20 a contractor, the tax is triggered at the time
21 they purchase the materials from their vendors,
22 is that correct?

23 A: That's correct.

24 Q: There is a followup regulation, is there not,
25 and I note dual is misspelled, I will concede

1 that point, my bad, not the code's. It
2 recognizes that there are dual businesses?

3 A: Yes.

4 Q: Businesses that, in fact, sell items at retail
5 and are construction contractors?

6 A: Yes.

7 Q: But, it says, "Operators of business who both,
8 making retail sales and withdrawing for use the
9 same stock, are to purchase at wholesale all
10 the goods so sold or used and report both
11 retail sales and withdrawals for use under the
12 sales tax law." What that means is that if
13 you're a retailer and you make more than
14 isolated sales of retailers, you're required
15 by this regulation, even if you do construction
16 contracts, to purchase pursuant to a resale
17 certificate. That's what the Department
18 requires, is it not?

19 A: That's what that says, yes.

20 Q: Okay. And if, in fact, Lowe's paid tax at the
21 time it bought the products from vendors, it
22 would be violating this regulation, would it
23 not?

24 A: Would it also be violating that one where it
25 said that the building materials needed tax

1 paid when purchased ---
2 Q: Well, that states when ---
3 A: --- by contractors?
4 Q: --- the tax is due. And we don't disagree.
5 A: Okay.
6 Q: The tax is due ---
7 A: Due when they ---
8 Q: --- when they buy materials.
9 A: --- buy it. And Lowe's is remitting it after
10 the product's been sold.
11 Q: Correct, because the regulation requires that,
12 is that correct?
13 A: That's what that regulation says.
14 Q: Okay.
15 A: But again, I don't think we can just pick out
16 one regulation and use that as a basis. I
17 think we've got to look at the whole situation.
18 And I think that's the Department's stance,
19 that we need to consider everything, not just
20 one ---
21 Q: All right.
22 A: --- part of the regulation.
23 Q: So, we've looked at the statute and there's
24 only one statute that deals with contractors.
25 And we looked at regulations that deal with

1 contractors and building materials. Are any of
2 these saying that a retailer can't be a
3 contractor?

4 A: They are not saying that a builder -- a
5 retailer can't have a contractor's license, no.

6 Q: Okay. And it can't, I'm going to use the
7 statutory language, "contract directly with the
8 owner to perform general mechanical
9 construction?

10 A: I'm sorry, which number was that?

11 Q: That's the definition of prime contractor down
12 there.

13 A: Okay. So, what was the question? I'm sorry.

14 Q: Okay. I'm trying to give you -- you said we
15 need to look at the big picture, look at
16 everything that deals with it. So, I've looked
17 at all the statutes and all the regulations
18 that deal with sales tax, contractors and what
19 their obligations are. Is there anything that
20 says that someone who sells items at retail
21 cannot be a contractor, general contractor or
22 prime contractor, as defined under the statute
23 and as established under the regulations?

24 A: Not -- not for these transactions.

25 Q: Okay. There was a question I asked you, and I

1 did not ask it today, but during the
2 deposition, we talked about what if materials
3 were withdrawn from a distribution center
4 outside of South Carolina or a store from
5 outside of South Carolina and brought into the
6 state and what would be the tax obligation.
7 And you testified that use tax should apply and
8 that the use tax would be assessed on the
9 purchase price if it's a true contractor. Is
10 that still the position of the Department?
11 A: Okay. Repeat that again, I'm sorry.
12 Q: Okay. The question was we were talking about
13 withdrawing materials from out of state.
14 A: Out of state, okay.
15 Q: From a distribution center from out of state,
16 a store out of state, a vendor from out of
17 state, and then bringing it into the state to
18 perform a construction contract. And I asked
19 you if that sales tax statute would apply and
20 you said no, that wouldn't because you're not
21 withdrawing in the state but the use tax
22 statute would apply. And I asked you would the
23 use tax apply to the purchase price of the
24 materials by the contractor and you said, "Yes,
25 if it's a true contractor." Is that still the

1 position of the Department?

2 A: Yes.

3 Q: So, if a use tax is applied, well, the use tax
4 would apply any time the materials are
5 withdrawn outside of South Carolina or the
6 retail transaction occurs outside of South
7 Carolina and it's brought into the state for
8 purposes of performing a home improvement
9 contract, correct?

10 A: I'm sorry, repeat that again.

11 Q: Okay. The use tax would apply if the
12 withdrawal or whatever you deem to be the sale
13 at retail occurs outside of South Carolina and
14 the materials are brought into South Carolina
15 by Lowe's to perform a home improvement
16 contract, is that correct?

17 A: I still think it's retail because the customer
18 is going into the store and paying right there
19 at that store. Paying the tax at the store.

20 Q: Okay.

21 A: Not paying the tax at the store but paying for
22 the materials at the store.

23 Q: Okay. That was what I started with so I'm
24 trying to pin down ---

25 A: Okay.

1 Q: From what I now understand your testimony is,
2 this withdrawal thing has nothing to do with
3 it. You believe that it's an outright retail
4 sale, is that right?

5 A: It's a retail sale that they did withdraw the
6 materials from inventory or from their business
7 and used it and it should be a retail price.

8 Q: Is it a retail sale to the customer?

9 A: Yes.

10 Q: Okay. So, the trigger is not the withdrawal,
11 it's the sale of tangible personal property to
12 a customer, that's currently what the
13 Department's position is?

14 A: Yes.

15 Q: Okay. So, all this time we've been spending on
16 withdrawal is not relevant. You deem it a
17 retail sale?

18 A: It's still a part of the gross proceeds of sale
19 at the fair market value.

20 Q: Okay. So, we're backtracking a little but let
21 me just ---

22 A: Yeah.

23 Q: --- make sure I've got that right. Before, we
24 were obsessing over Part C, which deals with
25 the tax being on fair market value, but your

1 current position is that it's on the gross
2 proceeds of the sale because you deem a home
3 improvement contract is a retail sale of
4 tangible personal property to customers in
5 South Carolina?

6 A: These transactions that we're talking about.

7 Q: Okay.

8 A: Were retail sale. They were a sale, retail
9 sale, and installation.

10 Q: So, to the extent that the Department took the
11 position in the assessment that it was a
12 withdrawal that was the trigger, that's no
13 longer the Department's position?

14 A: We still think it was a withdrawal but it's --
15 it's also a retail sale. Yes, it can be both.

16 Q: That's where I'm confused. Help me. What is
17 the Department's position?

18 A: The Department's position is it's a retail
19 sale.

20 Q: Okay. So, forget the whole fair market value
21 thing?

22 A: I did bill it at the fair market value from 12-
23 36-90, which was the fair market value. I
24 would say the fair market value.

25 Q: Okay. Well, let's go to the prior audit.

1 A: Okay.

2 Q: Because there's confusion on that, too. Was
3 Lowe's assessed in the prior audit because it
4 was deemed by the Department that on that last
5 third of the audit period in which they stopped
6 collecting tax from customers that they should
7 have been collecting tax from customers?

8 A: I think it's still on the fair market value.
9 It was still billed for 12-36-90.

10 Q: Okay. But then it's not a retail sale to the
11 customer, is that right? I mean, you can't be
12 both. I don't mean to sound like a bully but
13 I'm really confused. You are giving two
14 different ways ---

15 A: That's true.

16 Q: --- they're being taxed.

17 A: Okay.

18 Q: Which one is it?

19 A: Okay. It's a retail sale to the customer.

20 Q: Okay.

21 A: That ---

22 Q: So, this?

23 A: Yes.

24 Q: Not that?

25 A: We -- no, it's (c). Fair market value.

1 Q: Okay. So, it's not a retail sale to the
2 customer?

3 A: It's the fair market value of what was
4 previously purchased at wholesale, which was
5 drawn from the business.

6 Q: Okay. So, the retail sale was not the sale to
7 the customer, it was the withdrawal from the
8 inventory?

9 A: Which was then sold to the customer.

10 Q: I'll move on.

11 A: Okay.

12 Q: I'm sufficiently confused.

13 A: Okay.

14 Q: You said there was an audit meeting when Lowe's
15 protested this latest assessment and some
16 information was requested by ---

17 A: A conference.

18 Q: Yeah.

19 A: Yes, uh-huh.

20 Q: What information was that?

21 A: I think, I'm not sure if we requested it but it
22 was suggested in that meeting that Lowe's
23 deserved discounts just like other contractors
24 received and we were -- we gave the taxpayer
25 and opportunity to provide information on that.

1 Q: Okay. Then you were treating it as a fair
2 market value item?

3 A: Yes.

4 Q: At that point?

5 A: Yes.

6 Q: And (c) if it was lower than the retail price?

7 A: (Nods head affirmatively.)

8 Q: Okay. And that information would be consistent
9 with what Mr. Crider testified about earlier,
10 is that correct?

11 A: I guess. I don't remember. I'm sorry. Don't
12 remember.

13 Q: Okay. Briefly, the negligence penalty. You
14 recommended it and it's based entirely on the
15 prior audit, correct?

16 A: It is.

17 Q: Okay. And in the prior audit, this is why it's
18 important, did you tell them that it was a
19 retail sale, that they should be collecting
20 from the taxpayer or did you tell them -- did
21 you tell them they were doing it right before,
22 when they were collecting it from the taxpayer?

23 A: No, I did not tell them either way because I
24 didn't know there was a change in the audit
25 period. I do not remember that.

1 Q: Okay.

2 A: At all.

3 Q: You just said they owe tax on the retail price
4 is what you said?

5 A: In that prior audit?

6 Q: Yes.

7 A: Is that what you're saying? I don't believe I
8 said that.

9 Q: Okay. What did you say?

10 A: I believe it was the fair market value of
11 anything that they -- we told them that the
12 withdrawals that they made, they paid only on
13 the -- on their cost and that it needed to be
14 marked up to the selling price.

15 Q: Okay. Did you specifically talk about
16 withdrawals at that time?

17 A: I believe we were, yes.

18 Q: Okay. Because I didn't see that in the audit
19 report. Do you recall, in around 2005, the
20 news stories where they went on the news and
21 said Lowe's should be charging customers sales
22 tax?

23 A: I knew there was something but I don't remember
24 what the details were. Yeah.

25 Q: Okay. But that wasn't what you assessed them

1 for in the prior audit?

2 A: No.

3 Q: Okay. One final thing. Do you agree and
4 acknowledge that the tax burden is higher on
5 Lowe's when it is performing home improvement
6 contracts than it is on any other construction
7 contractor performing the same types of work?

8 A: I don't believe I can say one way or the other
9 because I don't know what kind of discounts
10 others might be getting or -- you know, Lowe's
11 is buying it tax free, so that's a big discount
12 right there off the top from other contractors
13 because they have to pay the tax up front. So,
14 I have no idea what type of bulk they're buying
15 in so I don't think I can say one way or the
16 other on that.

17 Q: But you're not aware of any other construction
18 contractor that's being assessed on a 40
19 percent markup over and above what they've paid
20 for their materials?

21 A: I'm not aware of one but there could be. I do
22 not know.

23 Q: Okay. Hold on just a second. Let me confer.
24 I'm going to try to pin down one more thing.

25 A: Okay.

1 Q: You're saying it's fair market value?

2 A: Yes.

3 Q: So, the purchaser, the one who's the retail
4 consumer, is Lowe's?

5 A: Yes.

6 Q: Not the customer?

7 A: Yes.

8 Q: Okay.

9 THE COURT: That's it?

10 MR. SMITH: That's it.

11 THE COURT: Okay.

12 MR. SMITH: I'm sorry. That was my last question.

13 THE COURT: No further questions?

14 MR. SMITH: I didn't mean to ---

15 THE COURT: Oh, no, no, no. I was taking a note and
16 I was anticipating another question and I
17 shouldn't have done that. Ms. Wooten,
18 anything?

19 MS. WOOTEN: Yes, we may have one followup question,
20 Your Honor.

21 THE COURT: Okay.

22 MS. WOOTEN: If you can bear with us just for a
23 moment.

24 THE COURT: That's fine.

25 MS. WOOTEN: Thank you.

1 THE COURT: Take your time.

2 MS. CRAWFORD - RE-DIRECT EXAMINATION BY MS. WOOTEN:

3 Q: I'm going to ask you, what is Section 12-36-
4 110?

5 A: It's the definition of a sale at retail and
6 retail sale.

7 Q: Is it defining a retail sale?

8 A: It is.

9 Q: And under Subsection (c), what is a retail sale
10 under Subsection (c)?

11 A: "The withdrawal, use or consumption of tangible
12 personal property by anyone who purchases it at
13 wholesale," and then there's some exceptions.

14 Q: Okay.

15 MS. WOOTEN: All right. Thank you, Your Honor.

16 MR. SMITH: No further questions.

17 THE COURT: No further questions, all right. So,
18 Ms. Crawford, you may be excused, and you may
19 be excused to return to your seat. Thank you.
20 And I think we're flipping back over.

21 MR. SMITH: Yeah.

22 THE COURT: And did you have another witness?

23 MR. SMITH: I think Ms. Wooten and I are going to
24 briefly squabble on this last thing. I was
25 going to, as part of my case in chief, put in

1 some of the testimony of Mr. McCormack. Of
2 course, she has the right to put in the rest of
3 it ---

4 THE COURT: Right.

5 MR. SMITH: --- and she's, of course, reserved the
6 right to call him live. I believe that the
7 Administrative Court Rule 21(b) says that
8 discovery is conducted in accordance with Rules
9 26 and 37.

10 THE COURT: Yes.

11 MR. SMITH: And Rule 32(a), too, says, "Use of an
12 adverse party of a deposition taken pursuant to
13 30(b)(6) can be used for any purpose." So, I
14 think I can do this.

15 MS. WOOTEN: I have a couple objections. One is in
16 order to use the deposition transcripts, under
17 41, I'm sorry, Rules of Civil Procedure 41,
18 Subsection B, the opposing party was to file
19 the designations with the court and with
20 opposing party one day prior to using it. We
21 got an email after 5:00 p.m. last night, and I
22 don't know that the court received the same
23 information, designating it so that the
24 opposing party to that can also put in
25 deposition transcripts, I'm sorry, excerpts and

1 objections to those particular deposition
2 transcripts. Secondly, we just believe that
3 that would be presenting duplicative and
4 cumulative evidence. Mr. McCormack, pursuant
5 to the court's order, is going to be providing
6 live testimony at a later date. Anything Mr.
7 Smith wants to ask him at that time, he's more
8 than welcome to. And it would serve no purpose
9 to present additional discovery deposition
10 excerpts at this point when Mr. McCormack is
11 going to be providing live testimony later.
12 And we, under Rule 403, we also believe that
13 that would be more prejudicial than probative
14 to allow it at this point.

15 MR. SMITH: I'm making my case in chief. I don't
16 know if Mr. McCormack's going to be called live
17 later. I know they've reserved the right but
18 they may choose not to do so. I'm trying to
19 make sure I have my case in chief. There were
20 lots of admissions that Mr. McCormack made
21 which I think are helpful to us, much like Ms.
22 Crawford. And I can read it. I mean, these
23 are always awkward to read. I was going to put
24 the famous thespian John Allan on the stand to
25 play the role of Mr. McCormack or we can submit

1 it. I'll do it however you want to do it but
2 I'm just trying to make sure our case is made.

3 THE COURT: I do understand and I do want you to
4 have every opportunity to present your case.
5 And it is, you know, whether the Department
6 decides to call Mr. McCormack, after all of
7 this, is going to be the Department's decision
8 to make that.

9 MS. WOOTEN: And I can go on the record and state
10 that we will be calling Mr. McCormack as part
11 of our case. He is, unfortunately, still in
12 the hospital in Oconee County with his family.
13 He has not returned to work. The last I heard
14 is that he will be returning to work in
15 approximately two weeks, if everything goes
16 well.

17 THE COURT: I understand. Our sympathies do go out
18 to Mr. McCormack and his family. I try to
19 speak for everybody when I say that.

20 MS. WOOTEN: But, you know, we will -- I'm going on
21 the record and saying the Department will call
22 ---

23 THE COURT: I understand.

24 MS. WOOTEN: --- Mr. McCormack.

25 THE COURT: I guess what I'm thinking is in the

1 event that something changes and he doesn't
2 testify, I would prefer to allow you to reopen
3 and present anything at that time.

4 MR. SMITH: And I don't disagree. I just wanted to
5 make sure.

6 THE COURT: Yes, sir.

7 MR. SMITH: That we've heard that testimony.

8 THE COURT: I would prefer to do it that way rather
9 than go ahead and put something in at this
10 time.

11 MR. SMITH: Okay.

12 THE COURT: Because it would be much -- I think the
13 -- it would be better if we would just wait for
14 Mr. McCormack to testify. But if he doesn't
15 testify, then there are remedies and you could
16 offer it at that time.

17 MR. SMITH: Okay.

18 THE COURT: You'll be given the full opportunity to
19 offer anything at that time if he does not
20 testify.

21 MR. SMITH: We rest.

22 THE COURT: All right. Thank you.

23 MS. WOOTEN: Just two points to that, if I may,
24 really quick. We would just ask that the
25 petitioner file the specific designations in a

1 court filing for the court and the party.

2 THE COURT: Those portions of the ---

3 MS. WOOTEN: Those portions, if Mr. McCormack does
4 not testify.

5 MR. SMITH: No problem.

6 THE COURT: If we've reached that point, we'll ---

7 MR. SMITH: We'll be glad to do so.

8 THE COURT: --- we'll look forward to that. So, the
9 petitioner having rested ---

10 MS. WOOTEN: Yes.

11 THE COURT: --- it is now 4:30. Let's see. We can
12 go a little later and get this -- I mean, I
13 don't know how much testimony you have. I'd
14 assume Ms. Crawford was one of your witnesses
15 and we've ---

16 MS. WOOTEN: Yes, that's correct. We will not be
17 calling her again.

18 THE COURT: Right.

19 MS. WOOTEN: We do have two more witnesses. One is
20 probably a shorter, in time, witness. Our
21 expert witness may be more lengthy. I'm open
22 to whatever the court wants to do. If we want
23 to go ahead and get one out of the way and then
24 come back tomorrow. And there possibly could
25 be another one. So, we're happy to proceed as

1 far as the court would allow but we at least
2 have two more witnesses, if not a possible
3 third.

4 MR. SMITH: Your Honor, our preference is to muscle
5 through if we can do it. I don't know if we
6 can finish it today but I know someone wants to
7 get back on the trail.

8 THE COURT: I understand that.

9 MR. SMITH: And it's beautiful weather outside.

10 THE COURT: We can stay. You know, the court
11 officially closes at 5:00 but I mean we can
12 leave it open and people can go and so we can
13 stay a little bit beyond that. I don't like
14 staying much past 6:00 but we could stay up to
15 that point. So, why don't ---

16 MS. WOOTEN: Sure.

17 THE COURT: --- if you're ready, why don't we just -
18 --

19 MS. WOOTEN: Okay.

20 THE COURT: --- go ahead and see how far ---

21 MS. WOOTEN: We can do that.

22 THE COURT: --- we can get this evening.

23 MS. WOOTEN: The Department calls Cindy Krull to the
24 stand.

25 THE COURT: I'm sorry?

1 MS. WOOTEN: Cindy Krull to the stand.

2 THE COURT: Cindy Krull?

3 MS. WOOTEN: Uh-huh (affirmative response).

4 THE COURT: All right. Ms. Krull, please come
5 forward and be sworn in.

6 CYNTHIA KRULL, having been duly sworn, testifies as
7 follows:

8 MS. KRULL - DIRECT EXAMINATION BY MS. WOOTEN:

9 Q: Ms. Krull, where are you currently employed?

10 A: I'm employed with the South Carolina Department
11 of Revenue in the Rock Hill district.

12 Q: And how long have you been employed with the
13 Department?

14 A: For 32 years.

15 Q: Could you please give the court a brief
16 overview of your employment history with the
17 Department?

18 A: I started in '84 in Spartanburg as a field
19 auditor. I worked there doing various types of
20 audits. You know, any and every type of audit
21 that we do. I was certified in doing those.
22 In 2001, the office closed and I was
23 transferred to Rock Hill where I was still a
24 field auditor. And in 2008, I was promoted to
25 audit supervisor and I've been audit supervisor

1 since that time.

2 Q: And what are the general job duties as an audit
3 supervisor?

4 A: I am in charge of all the auditors in the Rock
5 Hill district. The audit plan, you know, the,
6 you know, reviewing the audits, assigning the
7 audits, approving the audits. I deal with the
8 issues after the audit, such as the appeals
9 hearings. And daily things, such as reports
10 and, you know, making sure time and everything
11 is -- there's a lot of different things that go
12 along besides just the audits and just deal
13 with that everyday.

14 Q: Okay. And if you could speak up a little bit.
15 I think some people are having some difficulty
16 hearing you.

17 A: Can't hear me? I don't have much voice.

18 MR. SMITH: And I'll go back to my table if you
19 could speak up. I couldn't hear you.

20 A: Is this on?

21 THE COURT: This is on, isn't it? That's on.

22 A: Okay.

23 THE COURT: But it's not amplifying, so.

24 A: Oh, okay.

25 Q: Okay. All right. And are you familiar with

1 the current audit of the taxpayer in this case?

2 A: I am. I am.

3 Q: And what is the nature of your involvement with
4 this audit?

5 A: I was the supervisor of the auditors that did
6 the audit.

7 Q: Did you have any direct participation in the
8 audit?

9 A: I reviewed the audit adjustments from time to
10 time with the auditors. As they were doing it,
11 they would discuss the issues with me and we
12 would -- you know, during the audit.

13 Q: And what is your understanding of the issue in
14 this case?

15 A: The issue in this case is the installed sales.

16 Q: And what type of tax did Lowe's initially remit
17 to the Department on these installed sales
18 transactions?

19 A: They submitted use tax on their cost of the
20 items.

21 Q: And did Lowe's accurately report the use tax?

22 A: No. They should have paid sales tax on the
23 cost -- on the sales price they sold it to the
24 customer.

25 Q: And with regard to the issue in this case, are

1 you aware of any new policy decisions by the
2 audit division prior to the issuance of the
3 proposed order?

4 A: No, I'm not.

5 Q: Okay. And in your position as audit
6 supervisor, are you familiar with the
7 definition of gross proceeds of sale under 12-
8 36-90?

9 A: Yes.

10 Q: And are you also familiar with the definition
11 of sale at retail as provided under 12-36-110?

12 A: Yes, I am.

13 Q: And in your position as audit supervisor, are
14 you familiar with the withdrawal for use as
15 provided by Regulation 117-309.17?

16 A: Yes.

17 Q: And that, in your position, are you familiar
18 with the Department's application of these
19 statutes and regulation?

20 A: Yes.

21 Q: And based on your experience with the
22 Department, what type of taxpayer falls within
23 the provisions of Regulation 309.17?

24 A: It would apply to any retailer that is
25 purchasing items wholesale, tax free.

1 Q: Are the activities of those taxpayers limited
2 to retailers who also provide contracting
3 services?

4 A: No.

5 Q: In your experience with the Department, what
6 types of taxpayers or industries have you
7 audited?

8 A: I've audited most all of them; manufacturing,
9 retailers, contractors, admissions, bingo,
10 highway use tax, gasoline, motor fuel.

11 Q: Is that it?

12 A: Individual income tax. I mean, partnerships,
13 fiduciaries.

14 Q: What are the general issues that arise in those
15 types of audits?

16 A: You just have to make sure the correct tax has
17 been paid. In the case of retailers, you make
18 sure that the gross proceeds of sales have been
19 reported and that any deductions, withdrawals,
20 are accounted for and paid correctly. With
21 contractors, you make sure that they pay --
22 they pay for their product to the vendor and
23 pay sales tax at the time of purchase. With,
24 you know, in any -- you know, whatever
25 different type it is, you just make sure that

1 they are following the procedures that are laid
2 out for those. You know, manufacturers get
3 exemptions. You make sure they don't misuse
4 those exemptions.

5 Q: Have you ever audited a retailer that also
6 operates as a contractor?

7 A: Yes.

8 Q: Okay. And do you recall some of the issues in
9 that particular audit?

10 A: It's pretty much you just make sure the gross
11 proceeds -- the gross sales are reported and
12 that deductions and withdrawals are handled
13 correctly.

14 Q: And have you ever audited a taxpayer that sells
15 and installs carpet?

16 A: Yes.

17 Q: Okay. And what was the result of your finding
18 in that particular matter?

19 A: In that particular matter, they were -- they
20 sold -- they sold the installed carpet. They
21 had a sale, retail sale of the carpet, and the
22 installation was separate and they paid on the
23 retail price of the carpet.

24 Q: Can a retailer hold a contractor's license?

25 A: Yes.

1 Q: Okay. Can a retailer that holds a contractor's
2 license act as both in the same transaction?

3 A: No, they can't.

4 Q: Okay. And why not?

5 A: Well, a retailer issues their resale
6 certificate when they're buying what they're
7 going to resale tax free. A contractor does
8 not have a resale certificate or a retail
9 license and they are not allowed to purchase
10 tax free. They have to pay the retail price to
11 the vendor that they're buying from.

12 Q: And Ms. Crawford testified earlier regarding
13 the proposed assessment and her findings. Do
14 you agree with her findings in the assessment?

15 A: Yes, I do.

16 Q: And why?

17 A: Because she charged the -- she picked up the
18 adjustment, which is making sure the tax was
19 paid on what Lowe's sold the item for, instead
20 of what they paid for the item.

21 Q: And to the best of your knowledge, as an audit
22 supervisor, is the testimony you've just given
23 to the court consistent with the audit
24 division's application of South Carolina case
25 law, statutes and regulations?

1 A: Yes, it is.

2 Q: Okay. Thank you.

3 MS. KRULL - CROSS EXAMINATION BY MR. SMITH:

4 Q: Good afternoon. Just a couple of questions.

5 A: Okay.

6 Q: Ms. Wooten had some confusion from the last
7 witness so I'll see if you can clarify here.

8 Is it the Department's position that the home
9 improvement transaction is two separate
10 transactions bifurcated, a sale of tangible
11 personal property to a customer followed by an
12 installation?

13 A: Well, on the documents that the auditors looked
14 at during the audit, both things were on, you
15 know, the sale of the dishwasher, let's just
16 pick a dishwasher, and the retail price that
17 they charged -- or I don't know if it was
18 retail but the price they charged the customer
19 for that dishwasher was on the document and
20 then the labor was separately stated. And
21 there might have been hoses involved, too, that
22 were on there. And, you know, they picked up
23 that amount and then when they tried to verify
24 that the tax had been paid on it, they went
25 back and found that, no, the tax had been paid

1 on the cost of the dishwasher and hose, and so
2 they took the difference just to make sure that
3 the total amount was paid.

4 Q: And I understand that. But I think my
5 question's kind of more philosophical here. Is
6 this a retail sale to a customer? Is that what
7 the Department deems it to be?

8 A: They made the sale to the customer and
9 installed the item that they sold.

10 Q: Okay. So, it's deemed to be a sale of tangible
11 personal property ---

12 A: And needs to ---

13 Q: --- to a customer?

14 A: Uh-huh (affirmative response).

15 Q: So, the customer owes sales tax?

16 A: Not necessarily. The tax is on the vendor.
17 You know, they could -- they have to remit the
18 sales tax to us; Lowe's, the retailer, whoever.
19 Any retailer can not charge the person tax but
20 they are required to pay it to us. It's not --
21 -

22 Q: But the Department's ---

23 A: --- the tax is not on the customer, it's on the
24 vendor.

25 Q: But then that's true for all retail sales?

1 A: All retailers.

2 Q: But it would be taxable, from the Department's

3 point of view ---

4 A: They could charge the customer tax.

5 Q: Okay. So, what was, in fact, said in this

6 television thing in 2005, the Department's

7 position is the customer should be paying sales

8 tax on home improvement contracts, that's still

9 the Department's position?

10 A: I don't remember that.

11 Q: Okay. But is that still the Department's

12 position?

13 A: They -- ask that question again.

14 Q: Is it still the Department's position that

15 customers are subject to sales tax when they

16 enter into home improvement contracts with

17 Lowe's?

18 A: When they buy things for installation, they are

19 subject to the tax.

20 Q: Okay. So, from the Department's viewpoint, is

21 the tax on the gross proceeds of the sale or is

22 it on the fair market value of the withdrawal?

23 A: Well, you know, generally, you have to look at

24 the fair market value if you don't know what

25 the -- what they charged. But we know exactly

1 what they charged the customer so that's what
2 we used.

3 Q: So, is this what applies?

4 A: Yes.

5 Q: Okay. And not this?

6 A: Well, we had -- we had the actual cost. I
7 mean, the cost and the price they sold it at.

8 Q: So, is it the Department's position that it is
9 a sale of tangible personal property to the
10 customer?

11 A: It is a retail sale of tangible personal
12 property.

13 Q: Now, contractors doing the exact same thing,
14 you deem that to be a sale of real property
15 improvement, is that right?

16 A: Contractors pay the retail price on the cost of
17 the tangible personal property.

18 Q: Okay. But the point being, a contractor doing
19 precisely the same thing that Lowe's is doing,
20 the customer would not owe sales tax, is that
21 the Department's position?

22 A: They wouldn't -- no, because the contractor is
23 the one buying it, not the customer.

24 Q: Because the customer is receiving a real
25 property improvement?

1 A: They are receiving a service.

2 Q: With tangible ---

3 A: With ---

4 Q: --- personal property that's turned ---

5 A: --- with no details. With no details of, okay,
6 the dishwasher cost \$380.00 and this is the
7 labor. They just receive a contract lump sum.

8 Q: Okay.

9 A: And -- and the contractor has to pay the retail
10 price and pay the sales tax on it at that time.

11 Q: Okay.

12 A: Now, he can pass that on to his customer and
13 I'm sure he does.

14 Q: I'm a customer now.

15 A: Uh-huh (affirmative response).

16 Q: And I want to buy cabinets for my kitchen. If
17 I go to Joe, the contractor, and he installs
18 the cabinets, I owe no sales tax, under your
19 interpretation, is that correct?

20 A: Well, it depends on if Joe, the cabinets, is a
21 retailer seller of cabinets or not.

22 Q: Let's say Joe, the contractor, is just a
23 contractor.

24 A: If he's just a contractor, he's going to come
25 in, he will -- he will pay retail price on the

1 cabinets when he purchases them to install in
2 my house.

3 Q: Okay. Now, Joe, the contractor, may be a big
4 time contractor. He may buy in bulk, might he?

5 A: He might.

6 Q: And he might have a warehouse full of stuff
7 that he buys because he's got lots of contracts
8 ---

9 A: Uh-huh (affirmative response).

10 Q: --- might he?

11 A: He might.

12 Q: Okay. But if I contract with Joe, the
13 contractor, big contractor with a warehouse
14 full of stuff that he's buying and stores, I
15 owe no sales tax. But if I go to Lowe's and
16 have the exact same work done, sign the same
17 contract, I owe sales tax. Is that the
18 Department's position?

19 A: The Department's position is that when you go
20 to Lowe's and you purchase a -- purchase
21 something that you want installed in your house
22 that the cost of the item is a sale of tangible
23 personal property. The installation labor is
24 exempt from that sale.

25 Q: So, the answer is, yes? If I have Joe, the

1 contractor, no tax, Lowe's, the contractor,
2 tax?

3 A: Right. Lowe's is acting as a retailer.

4 Q: Okay. All right. My lawyer has two good
5 questions to ask, in addition. Have you ever
6 seen any of the contracts that Lowe's has with
7 its customer?

8 A: Yes, I have.

9 Q: Okay. You note that the risk of loss stays
10 with Lowe's until the customer's happy with the
11 product?

12 A: Uh-huh (affirmative response).

13 Q: Lowe's may have to have its installers go and
14 redo it over and over again until they get it
15 right. And you note also that Lowe's retains
16 title to the tangible personal property until
17 it's installed at the customer's home?

18 A: Uh-huh (affirmative response).

19 Q: You recall that?

20 A: Right.

21 Q: Okay.

22 A: No matter who installs it.

23 Q: From the Department's point of view, that makes
24 no difference? It's still a sale of tangible
25 personal property to the customer?

1 A: Yes, it is.

2 Q: Okay. Second question then. Are you judging

3 the tax on what the customer paid Lowe's or are

4 you judging it on fair market value of the

5 materials possessed by Lowe's?

6 A: I'm judging it on what Lowe's charged the

7 customer on the sale. They had the price ---

8 Q: Okay. The number ---

9 A: --- documented.

10 Q: So, you're basing it on ---

11 A: They showed what they charged that customer for

12 whatever item it was.

13 Q: Okay.

14 A: And that's what I'm ---

15 Q: So, it's the proceeds from the sale ---

16 A: Proceeds from the sale.

17 Q: --- of tangible personal property?

18 A: We don't have to go and figure out what fair

19 market value is because that's what they

20 charged the customer.

21 Q: Okay. So, everything that we've spent this

22 morning on (c) is ---

23 A: Was a waste of time.

24 Q: Okay.

25 MR. SMITH: I just have a couple more questions.

1 THE COURT: Okay.

2 Q: I've done this exercise with others. I think
3 you've been in the courtroom the whole time.

4 A: I have. I haven't been able to see it from the
5 back.

6 Q: Okay. Well, now you can.

7 A: Now, I can see it.

8 Q: Okay. This is what I've been showing people
9 all the time. It's the statutory definitions
10 of contractors.

11 A: Uh-huh (affirmative response).

12 Q: Okay. Are you familiar with that code section?

13 A: No, I'm not.

14 Q: Okay.

15 A: This is the first time I've seen it.

16 Q: So, this is not something that you considered
17 or took into account when you concluded that
18 Lowe's is not a contractor?

19 A: Correct.

20 Q: Okay. So, if Lowe's is selling tangible
21 personal property to the customer, when does
22 the customer gain title to that tangible
23 personal property?

24 A: When they deliver it and install it. They pay
25 for it ahead of time.

1 Q: So, it is you deem it when they pay for it?

2 A: No.

3 Q: Or when it's ---

4 A: I'm just saying they do pay for it ahead of

5 time. But generally, when I have a contractor,

6 when I have a contractor install something, I

7 don't pay him until the work is done.

8 Q: Okay. That may be. My question being since

9 it's a sale of tangible personal property, when

10 did the customer get the personal property?

11 A: I don't know that I can answer that.

12 Q: Did they ever get tangible personal property?

13 A: Yes, they did.

14 Q: After it was installed in the house? Is that

15 correct?

16 A: Maybe so.

17 Q: Okay.

18 A: The -- you know, if I go and buy a dishwasher

19 from Lowe's and take it home, I've got a

20 dishwasher that's going to be -- become real

21 property and I still have to pay sales tax on

22 that dishwasher.

23 Q: Have you entered into an installation contract

24 to have it installed at your house?

25 A: With Lowe's?

1 Q: Uh-huh. I'm curious if that ---

2 A: I mean, I should have been charged tax on it.

3 Q: You have engaged contractors before, have you
4 not?

5 A: Very recently.

6 Q: Okay. What did you do recently? What was it
7 for?

8 A: I have been remodeling my house.

9 Q: Okay. And is it a Joe, the contractor, type or
10 is it a ---

11 A: I went to Lowe's to try to get carpet and
12 flooring and they didn't have what I wanted so
13 I found it somewhere else. I asked them if
14 they could install it and they said no, they
15 didn't have contractor services unless you
16 bought it from them. So, I bought it from
17 somewhere else and found another installer.

18 Q: Okay.

19 A: And then I proceeded to buy other things and,
20 you know, I would buy things from Lowe's and
21 have my contractor -- special order items,
22 included.

23 Q: Okay. So, in those cases, you are buying
24 tangible personal property and you're handing
25 it to your contractor?

1 A: They were delivered to my house by Lowe's.
 2 Q: Okay.
 3 A: Uh-huh (affirmative response).
 4 Q: And then you have a separate contract with a
 5 contractor to install it?
 6 A: Uh-huh (affirmative response).
 7 Q: And in those cases, you paid sales tax on the
 8 merchandise you bought from Lowe's?
 9 A: My contractor did.
 10 Q: Your contractor did?
 11 A: Either I paid for it at the register or he did
 12 because he got a -- like a five or ten percent
 13 discount.
 14 Q: Ah. Okay. So, on that ---
 15 A: Then I also bought a refrigerator from
 16 somewhere else and they installed it and ---
 17 Q: They, the contractor?
 18 A: No. The store that I purchased it from.
 19 Q: Okay.
 20 A: My contractor had nothing to do with it.
 21 Q: Okay.
 22 A: And sales tax was charged on that.
 23 Q: Sales was charged?
 24 A: Uh-huh (affirmative response).
 25 Q: Okay.

1 A: I didn't -- you know, I went to the store,
2 bought it, paid for it, sales tax included, and
3 it was delivered weeks later and installed.

4 Q: Now, with ---

5 A: But it was mine the day I bought it from Sears.

6 Q: Understood. Now, I had the question earlier
7 about the Lowe's contracts and when the
8 tangible personal property transferred to the
9 customer and you said you didn't know. Do you
10 have an understanding as to when the risk of
11 loss to the tangible personal property
12 transfers to the customer under the Lowe's
13 contracts?

14 A: I would hope that the laws would be even if
15 something went wrong after it was installed in
16 the house, it would still be up to Lowe's to
17 make it good.

18 Q: Do you know what the contracts say though?

19 A: No.

20 Q: Okay.

21 A: I do know that the contracts say that Lowe's is
22 not a contractor.

23 Q: Okay. Now, what are we referring to? Are we
24 referring to the materials list?

25 A: Something on just one of the contracts.

1 Q: Okay. That doesn't appear in any contract,
2 does it? That does not appear in any contract,
3 does it?

4 A: I believe I have seen it in the contract.

5 MR. SMITH: Okay. Nothing further.

6 THE COURT: Any redirect?

7 MS. WOOTEN: Nothing further from the Department,
8 Your Honor.

9 THE COURT: Okay. So, Ms. Krull may be excused?

10 MS. WOOTEN: Yes.

11 THE COURT: All right. Ms. Krull, thank you very
12 much. You can return to your seat, ma'am.

13 A: Thank you.

14 MS. WOOTEN: Your Honor, we have one more witness.

15 Would it be okay if we took a short ten-minute
16 break before we head into our ---

17 THE COURT: Sure.

18 MS. WOOTEN: --- Dr. van Bulck?

19 THE COURT: What do you think your direct is going
20 to take? I'm just curious. And yes, we can
21 take a short recess.

22 MS. WOOTEN: I would hope that it would not take
23 more than an hour but I don't know. Thirty
24 minutes to an hour, maybe. I don't know.
25 Time's hard to gauge when you're up there

1 talking.

2 THE COURT: I understand. Of course.

3 MR. SMITH: And I'm becoming more puzzled because
4 this is all on the fair market value issue and
5 I'm not sure that that's even in play here but
6 we will be prepared to cross examine him on
7 that.

8 THE COURT: Okay. All right. Well, let's go ahead
9 and take a ten-minute break.

10 MS. WOOTEN: Okay. All right. Thank you.

11 (Off the Record)

12 THE COURT: Okay. Ms. Wooten?

13 MS. WOOTEN: Thank you, Your Honor. The Department
14 calls Dr. Hennie van Bulck to the stand.

15 THE COURT: Okay. Sir, please step forward.

16 HENDRIKUS VAN BULCK, Ph.D. having been duly sworn,
17 testifies as follows:

18 DR. VAN BULCK - DIRECT EXAMINATION BY MS. WOOTEN:

19 Q: If you'll refer to Joint Exhibit 17, please.

20 A: Do you mind if I stand?

21 Q: Maybe ask Judge Lenski.

22 A: Your Honor, do you mind if I stand?

23 THE COURT: Do you need to stand, sir?

24 A: Yeah. I have lower back problems and ---

25 THE COURT: Oh.

1 A: --- this chair is very low and it really helps
2 me a lot.

3 THE COURT: Yes, sir. If you're more comfortable
4 standing ---

5 A: Sure. Thank you.

6 THE COURT: --- that's fine. Yes, sir.

7 Q: And is this a copy of your most recent C.V.?

8 A: It is.

9 Q: Okay. Please refer to it if you need to
10 refresh your memory as we're talking in the
11 next couple of questions. What is your
12 educational background?

13 A: I was born in the Netherlands. I went to
14 undergraduate school in the Netherlands called
15 NIB, Netherlands Institute for Business. I
16 obtained my undergraduate degree there. Then
17 in 1970, I came to the United States as a
18 graduate student, attended the University of
19 Georgia and got my M.B.A. Subsequent to that,
20 I stayed at the University of Georgia and got
21 a Ph.D. in International Business with an
22 emphasis on Marketing.

23 Q: And, Dr. van Bulck, may I call you Dr. van
24 Bulck?

25 A: Sure.

1 Q: Okay. Where are you currently employed?

2 A: I have two occupations. I am a Certified
3 Public Accountant in private practice. And I'm
4 also an associate professor with the University
5 of South Carolina on the Sumter campus.

6 Q: Let's start first with your private practice,
7 CPA private practice firm. When did you
8 receive your designation as a CPA?

9 A: 1985.

10 Q: And are you familiar with GAAP principles,
11 Generally Accepted Accounting Principles?

12 A: Yes, ma'am.

13 Q: And are you familiar with income and revenue
14 and cost and expenses?

15 A: Yes, ma'am.

16 Q: And what other standards or principles do you
17 use in your practice as a CPA?

18 A: Depending on the nature of the engagement, if
19 it is an accounting engagement, of course we
20 will use standards applicable to accounting.
21 If it is a tax engagement, we look at tax law
22 and tax regulations, whether it be income tax,
23 property tax or sales tax. If I do valuation
24 engagement, there will be several professional
25 standards that I will also consider applicable

1 to valuation engagements. As a CPA, I'm also
2 generally obligated to adhere to the ethic
3 rules of the AICPA.

4 Q: And what is the AICPA?

5 A: American Institute of Certified Public
6 Accountants.

7 Q: And if you'll please describe your employment
8 history as a CPA and the general duties and
9 issues that you've handled as a CPA.

10 A: I started the accounting profession in 1983,
11 staff accountant. Once I obtained my CPA
12 license, I became -- well, the year after, I
13 became a partner in the practice which was, at
14 that time, owned by my father-in-law.
15 Subsequent to his retirement in 1986, I became
16 managing partner, responsible for all
17 activities of the practice, including tax
18 accounting, valuation and general management
19 consulting.

20 Q: And what types of industries or taxpayers do
21 you routinely assist in your CPA practice?

22 A: Over the last 33 years, just about every
23 imaginable industry. Most of my clients are
24 family-owned businesses, professional
25 practices, from retailing to manufacturing to

1 construction.

2 Q: And what types of issues do you assist with
3 your clients?

4 A: What kind of issues?

5 Q: Yes. What kind of issues, in your practice as
6 a CPA?

7 A: Accounting issues, preparation of financial
8 statements, whether it be compiled or reviewed,
9 mostly complied financial statements,
10 preparation of income tax returns and income
11 tax advice, general consulting, preparation of
12 property tax returns, preparation of sales tax
13 returns, use tax returns and valuation
14 services. I think that's -- litigation
15 support, occasionally.

16 Q: You also testified that you're an associate
17 professor at USC-Sumter?

18 A: That is correct.

19 Q: Okay. How long have you taught at the college
20 level?

21 A: I have taught, all together, as a full-time
22 faculty member for 18 years. I started
23 teaching full-time, I believe it was 1973, at
24 the University of South Carolina on the Sumter
25 campus. Then I moved to Clemson, was on the

1 faculty there as an assistant professor.
2 Subsequent to that, I became an associate
3 professor and chair of the Department of
4 Economics and Business at St. Andrews College
5 in Laurinburg, North Carolina. When I left
6 there in the early 80's, I came back to Sumter
7 to go and practice with my then father-in-law.
8 I taught intermittently as an adjunct at the
9 University in the mid-80's. I rejoined the
10 faculty in 2006 as a full-time faculty member.
11 I'm currently an associate professor.

12 Q: And can you name some of the titles of the
13 classes that you teach, either in the past or
14 currently?

15 A: I've taught a broad spectrum of courses over
16 the years, including Micro and Macroeconomics,
17 Management, Marketing, Accounting, Principles
18 of Accounting I and II, which is cost
19 accounting and financial accounting, Business
20 Finance, Strategic Management,
21 Entrepreneurship, Small Business Management.

22 Q: And what are some of the topics discussed in
23 those classes?

24 A: The topics of those classes include as broad as
25 the range of courses. Just about anything in

1 business and economics that you can imagine.
2 I emphasize in my courses, especially in the
3 last ten years or so, the concept of adding
4 value, determining how you build value, what
5 value, is why are we in business as a business,
6 and what are the various aspects you need to
7 consider.

8 Q: Other than a CPA, do you hold any other
9 credentials?

10 A: I'm accredited by the AICPA, the American
11 Institute of Certified Public Accounting, as a
12 business valuation analyst, the AVD
13 designation.

14 Q: And what is an AVD designation?

15 A: That is a -- well, it's a designation awarded
16 by the AICPA as accredited in business
17 valuations. It is -- it is awarded after you
18 take a series of courses. And the standards
19 have changed since I took it. But when I took
20 it, we took, I think, 20 courses in business
21 valuation provided by the AICPA. Then you had
22 to provide several valuation engagements as
23 evidence of competency for peer review. And
24 then I -- then you take an exam.

25 Q: Are there any continuing education classes that

1 are required to maintain your AVD?

2 A: Yes, there are.

3 Q: And do you recall any of those or what those
4 requirements are?

5 A: I believe the requirements are 40 hours every
6 two years for business valuations, not
7 including the CPA requirements.

8 Q: Are you a certified appraiser?

9 A: No, I'm not.

10 Q: Okay. Is there a distinction between an
11 appraiser and a valuation individual?

12 A: The terms are usually -- often used similarly
13 in that -- but maybe apply to different fields.
14 You would appraise real estate, you would
15 appraise a diamond. You don't necessarily
16 appraise a business. You do business
17 valuation. In my understanding, the term
18 appraisal is used primarily when the value of
19 the subject matter is unknown. So, you try to
20 estimate or determine the value. Valuation may
21 be based on an appraisal because you may,
22 indeed, value an item where you don't know what
23 the actual market value is and you have to
24 determine it or estimate it. But valuation
25 could be based on the known values, whereas an

1 appraisal normally does not.

2 Q: And what are some principles or standards that
3 you use when performing a valuation for a
4 client?

5 A: Well, the first thing you need to do when you
6 engage -- when you are engaged for a business
7 valuation or any other kind of valuation is you
8 need to know the purpose of the valuation. Why
9 are we doing this? What are you going to do
10 with the -- with the valuation. Once you
11 understand the purpose of it, you need to find
12 out is there any applicable law that would pre
13 -- that would provide prerequisites of what
14 needs to be done or what should not be done,
15 what standards of value should be maintained.
16 You need to determine the subject matter, of
17 course. You need to know and determine the
18 date of the valuation, what we normally refer
19 to as the "as of" date. Then you need to
20 follow the standard that the profession may
21 require of you. For example, as a member of
22 the AICPA, I must follow the AICPA valuation
23 standards. Some valuation specialists may be
24 a member of the ASA and may be required to
25 follow USPAP. Occasionally, you may be

1 required to follow one standard or the other.
2 If there's a requirement, it may be a legal
3 requirement or some other requirement, while
4 you do. So, the valuation standards, you need
5 to consider before you get into the engagement
6 so you know what procedures you should follow.
7 Once you determine those things, then you need
8 to look at all facts and circumstances and get
9 a handle on what industry are we operating in,
10 what is the subject matter, what are the
11 particular facts and circumstances that are
12 important, what the valuation methods should we
13 use, such as the income approach, the sales
14 approach, is there a market approach that
15 should be considered. Once you then apply it
16 and then you collect the data about the subject
17 company, the subject matter at hand. There's
18 some mathematical models you may follow in
19 terms of income capitalization or cash flow,
20 discount of capitalization. You try to
21 determine the most appropriate formula. At the
22 end of the day, you're going to look at any
23 discounts or premium that should be applied and
24 then if you come up with some estimate, then
25 you need to have a little bit of just -- we

1 often say it's an art and a science. The art
2 part is the, you know, you may have to come up
3 with a professional determination for what the
4 true estimated value of the subject truly is.
5 In the process, you probably make some
6 assumptions, which you need to test. Are the
7 assumptions reasonable and fair? Are they
8 logical? Can you substantiate why they are
9 reasonable assumptions?

10 Q: If you'll refer to Exhibit 18. Excuse me, 19.

11 A: Nineteen?

12 Q: Yes, 19.

13 A: There is nothing in 19.

14 Q: There's nothing in 19?

15 A: No, but there's something in 18.

16 THE COURT: I'm looking at a pie chart.

17 Q: Yes, that's what I'm looking for. There's not
18 a ---

19 A: There's no pie chart.

20 Q: I'll give you mine.

21 A: Okay.

22 Q: For reference.

23 A: Okay. Thank you.

24 Q: Are these the principles and practices process
25 that you were just referring to?

1 A: Well, this is an outline of -- a general
2 outline of the process you would follow. I
3 mentioned the fact that you need to look at
4 certain laws and authority. Oftentimes, what
5 I will do is consult with a lawyer and get the
6 legal opinion on what must be done. Then
7 you're going to, also at the same time,
8 consider the purpose of the valuation and
9 determine the applicable standards, as well as
10 the premises. Does it go to concerned
11 valuation or a liquidation valuation? What's
12 going on there? You look at the professional
13 standards that you may need to follow, such as
14 USPAP or the AICPA valuation standards. You
15 collect the facts, the history of the company
16 or the subject matter. You make certain
17 assumptions about those facts that you may not
18 know, such as inflation rates going forward
19 into the future, and things like that, and then
20 you arrive at the conclusion.

21 Q: Okay. If you'll now refer to Exhibit 20. Are
22 you familiar with a company's Form 10-K?

23 A: Yes, ma'am.

24 Q: Is a company's 10-K available to the public?

25 A: Yes, ma'am, it's public information.

1 Q: And why would a valuation individual review a
2 Form 10-K of a company?

3 A: Because you try to learn as much about the
4 subject company, or the subject matter, as you
5 can. If the subject company is a publicly
6 traded company, there is a good bit of
7 financial information available. Part of the
8 information will come from management
9 representation. A 10-K is more than just
10 management representation. It is usually an
11 audited statement, as it's filed with the SEC
12 if it's a publicly traded company so it's
13 reliable information.

14 Q: Now, if you'll refer to Joint Exhibit 21. And
15 are you familiar with the company's annual
16 report?

17 A: Yes, ma'am.

18 Q: And what is an annual report?

19 A: An annual report is a document that includes
20 reports from management as well as financial
21 information, all of the financial information,
22 that is provided to interested parties, usually
23 stockholders and all the other interested
24 parties for a company.

25 Q: Do companies sometimes make the annual report

1 available on the website?

2 A: Yes, ma'am.

3 Q: And why would a valuation individual review a
4 company's annual report?

5 A: Again, you try to learn all you can. What we
6 call intelligence -- you want to be as
7 intelligent about the company to the extent
8 it's reasonably possible.

9 MS. WOOTEN: Bear with me just a moment, Your Honor,
10 please.

11 Q: If you'll now refer to -- I believe my book
12 might be messed up because of yours. Is there
13 anything in 18 on yours? In Exhibit 18?

14 A: Yes, ma'am.

15 Q: Okay. And what is Exhibit 18?

16 A: Eighteen is a list of engagements that I have
17 performed in the area of business valuations.

18 Q: And, approximately, how many times have you
19 been qualified as an expert witness in court?

20 A: I've been qualified four times, three times of
21 which was as an expert witness. And I was
22 qualified in the court the fourth time by the
23 court of Vermont Family Court as an expert
24 witness.

25 Q: And have you ever served as an expert witness

1 in a matter, in a deposition, but the matter
2 did not go to court?

3 A: Have I been deposed in a deposition?

4 Q: Yes. And the matter did not ---

5 A: Many times.

6 Q: --- go to court?

7 A: Many times.

8 Q: All right. Referring back to Exhibit 18, your
9 valuation engagements.

10 A: Uh-huh (affirmative response).

11 Q: Are there any experience of particular note
12 with regard to Exhibit 18 that you think is
13 relevant today?

14 A: Well, some of these engagements involved
15 retailers and, by nature, are therefore
16 included. An assessment of or valuation of
17 inventory.

18 MS. WOOTEN: Your Honor at this ---

19 A: Retail inventory.

20 MOVE TO QUALIFY WITNESS

21 MS. WOOTEN: Your Honor, at this time, the
22 Department would like to offer Dr. van Bulck as
23 an expert in valuation principles and
24 practices.

25 THE COURT: Any objection?

1 MR. SMITH: Your Honor, I will stipulate to his
2 expertise as a CPA and on GAAP principles and
3 to the extent that includes business valuation
4 skills. I believe he is an expert in that.
5 He is not an appraiser so he is not an expert
6 in appraising methodologies.

7 THE COURT: Yes. You moved for his qualification as
8 an expert in valuation principles.

9 MS. WOOTEN: And practices.

10 THE COURT: And practices.

11 MR. SMITH: And I'm just limiting it to his field of
12 expertise. He's a CPA.

13 THE COURT: Yes.

14 MR. SMITH: And he knows GAAP principles.

15 THE COURT: Yes.

16 MR. SMITH: And he's an expert at that.

17 THE COURT: Yes.

18 MR. SMITH: Okay.

19 MS. WOOTEN: And he also holds a designation, a
20 business valuation designation credential, in
21 addition to the CPA designation.

22 THE COURT: I am going to qualify or recognize
23 Mister, or excuse me, it's Doctor, isn't it,
24 I'm sorry, Bulck ---

25 A: van Bulck.

1 THE COURT: --- van Bulck, yes, sir, Dr. van Bulck
2 as an expert in valuation principles and
3 practices. If you feel he's testifying outside
4 of that expertise that I've qualified him in,
5 I'm sure you will let me know.

6 WITNESS QUALIFIED

7 MR. SMITH: I will let you know.

8 THE COURT: Thank you.

9 Q: Dr. van Bulck, have you reviewed any documents
10 in preparation for this hearing?

11 A: Yes, I have.

12 Q: What types of documents have you reviewed?

13 A: I have reviewed some of the correspondence
14 involved between the plaintiff and the Revenue
15 Department prior to these procedures. I've
16 reviewed their Form 10-K. I've reviewed their
17 annual report. I have reviewed several of the
18 expert's testimonies, depositions, such as Mr.
19 Crider's.

20 Q: As part of your preparation, what did you learn
21 about the taxpayer in its operations?

22 A: What I learned is that Lowe's is a large
23 retailer in substance, as represented by their
24 annual reports, as well as by their Form 10-K,
25 as well as my own personal experience being a

1 customer there on a frequent basis. They have
2 engaged, over time, to some extent, in
3 installation contracts where customers may come
4 into the store or contact them in the virtual
5 store by the internet and ask for additional
6 information about appliances, home improvements
7 and so forth and go through the retail
8 experience and then subsequently have those
9 items installed in their home. And it's my
10 understanding from the case, that the Revenue
11 Department is taking the position that there
12 was an under-reported sales tax or use tax in
13 this case. And I was asked to look at the
14 level of trade that might be applicable in a
15 case like this.

16 Q: And are you familiar with the term levels of
17 trade?

18 A: Yes, I am.

19 Q: Okay. And could you please explain that to the
20 court?

21 A: Yes. I come at -- as a valuation analyst, I
22 come at this problem a little bit in terms of
23 added value. I look at there's a chain of
24 events from a producer to a wholesale or
25 distributor to a retailer to an installer or a

1 consumer. And in each of these steps, there is
2 an added value. And we need to look at which
3 marketplace is -- we need to look at which
4 marketplace is relevant to determine what fair
5 market value really means. May I come up there
6 and see?

7 Q: It's on the screen ---

8 A: Great.

9 Q: --- in front of you. Can you see that on the
10 screen?

11 A: I'll try, yes. Okay. So, the first level of
12 trade would be from the producer to the
13 wholesaler or distributor, both of the links in
14 the chain involved. Then the red one next to
15 that would be the retail level or Lowe's. And
16 then the next level would maybe be Lowe's and
17 the final user of the product. And those would
18 be the levels of trade.

19 Q: And can you explain the concept of inventory at
20 rest versus inventory that is moving?

21 A: Yes. I believe those terms are significant
22 because the valuation of inventory depends on
23 the purpose for which you value it. For
24 property tax purposes, inventory is valued at
25 what I call at rest. It comes into the store

1 or comes into the business and it sits there.
2 While it sits, nothing happens to that
3 inventory. Once the inventory leaves the store
4 or the business, now it moves to the next link
5 in the chain. And at that time, the value that
6 justifies the existence of the entity, such as
7 Lowe's in this case, suddenly becomes part of
8 the product.

9 Q: From a valuation perspective, do you have an
10 opinion about what standard or value should be
11 used regarding the products that are withdrawn,
12 used or consumed in the installed sales at
13 issue in this matter?

14 A: Fair market value.

15 Q: And what level of trade should be considered
16 when determining the fair market value of the
17 products withdrawn, used or consumed in the
18 installed sales at issue?

19 A: Retail.

20 Q: And why do you believe that retail level of
21 trade should be used?

22 A: Because all transactions that involve installed
23 items at Lowe's go through the store. Whether
24 it's the physical store, their parking lot, or
25 whether it's the virtual store on the internet,

1 all transactions go through their store. All
2 the services that Lowe's renders, and they're
3 listed on the chart, that add value to the
4 products, which includes convenience, location,
5 opening hours, display of products, collection,
6 assortment, education of customers, all of
7 these things that Lowe's admits are
8 prerequisites for their existence and are
9 necessary for them to be able to compete in
10 this marketplace, they attach to that product.
11 They can't unattach them. So, when the
12 customer, whether there's a customer that is
13 just a consumer like myself or an installer who
14 buys at Lowe's, all of those services become
15 part of the value of the product and that is
16 the retail market.

17 Q: From a valuation perspective, does it matter
18 whether the products in the installed sales at
19 issue are withdrawn from their retail inventory
20 or whether the products are used in a special
21 order sale?

22 A: I don't believe it makes any difference because
23 as I said a minute ago, all these contracts are
24 initiated at the retail level. They are
25 initiated at the retail level, they're paid for

1 at the retail level, you have to go to the cash
2 register, the man with the red jacket takes
3 your money, whether it's a credit card or cash
4 or check, you pay for it at the retail level.

5 All the activities are retail activities,
6 whether they are installed or not.

7 Q: Have you ever performed a valuation of
8 inventory that's held by a retailer?

9 A: Yes, I have.

10 Q: And for what purpose?

11 A: I have done it for business valuation purposes
12 as well as sales tax purposes.

13 Q: And do you recall what level of trade you used
14 in the particular instance, whether you used
15 wholesale level of trade or retail level of
16 trade?

17 A: For sales tax purposes, it's retail. For
18 business valuation purposes, it would be
19 wholesale because that is inventory at rest.

20 Q: And is a wholesale level of trade valuation
21 different from the valuation in this case?

22 A: Yes, it is because when you value the inventory
23 for a business valuation or you value inventory
24 for property tax purposes, in states that have
25 a property tax, you value the inventory as a

1 whole, you do not value individual items. When
2 a sales tax is calculated or a use tax is
3 calculated, the sales tax is attached to the
4 value of that specific item, not the inventory
5 as a whole. That's why the notion of
6 discounting or anything like that makes no
7 sense in the sales tax arena.

8 Q: And in this case, the items that are used in
9 the installed sales transactions, are they
10 being valued at rest in Lowe's inventory or is
11 the inventory moving?

12 A: The moment the customer walks in the store and
13 buys the item or contracts for the items, all
14 the value that Lowe's renders, as a retailer,
15 has attached to that product and therefore I
16 believe it needs to be the retail level. In
17 other words, the customer comes through the
18 front door, the customer does not go through
19 the back loading dock, figuratively speaking.

20 Q: From a valuation perspective, how does the
21 concept of fairness affect the value of the
22 items on which sales tax is calculated in this
23 case?

24 A: Repeat that, please.

25 Q: How does the concept of fairness affect the

1 value of the items on which sales tax is
2 calculated in this matter?

3 A: Okay. That's an interesting question. The
4 fair market value

5 MR. SMITH: Your Honor, I'm going to have to make my
6 objection about outside the scope of his
7 expertise here.

8 THE COURT: Okay.

9 MR. SMITH: He's testifying about fairness.

10 MS. WOOTEN: And I asked -- I prefaced the question
11 from a valuation perspective.

12 THE COURT: You're trying to get at the fair market
13 value term, fair in terms of fair market value
14 or ---

15 MS. WOOTEN: No, Your Honor. I believe there were
16 some issues raised if whether or not Lowe's was
17 being treated fairly and I'm asking him, from
18 a valuation perspective, is there a concept of
19 fairness that's attached to valuing the
20 property?

21 MR. SMITH: Your Honor, I believe that's outside his
22 expertise.

23 THE COURT: I mean, have we qualified him as an
24 expert in the area of fairness? I mean,
25 valuation, yes, but fairness?

1 MS. WOOTEN: No. I'm just asking him, based on what
2 he has learned and what his credentials are in
3 valuation, is there a fairness concept related
4 to the valuation process. That's all I was
5 asking him.

6 THE COURT: I'm going to go ahead and let you go --
7 let her ask the question.

8 A: The term fair market value has three words in
9 it; fair, market and value. So, in order to
10 understand and use fair market value, you must
11 consider an element of fairness, unavoidably.
12 The definition of fair market value most
13 commonly used is somewhere along the line of
14 there's a transaction in which a buyer and a
15 seller, neither under any compulsion to buy or
16 sell, agree to transact. Well, that implies a
17 fairness. There's not a monopoly and a small
18 participant or the other way around. It
19 assumes a fairness. So, fairness is implicit
20 any time you value something at fair market
21 value, which is one reason why fair market
22 value is a different standard from other
23 valuation standards you may use. So, fair
24 market value presumes fairness.

25 Q: Are you familiar with the special order items

1 at issue in this case?

2 A: I believe I am.

3 Q: Okay. Does your opinion that Lowe's should pay
4 sales tax on the retail price of an item that
5 it charges to its installation customers change
6 if the item is a special order item?

7 A: I don't believe it has anything to do with it.
8 I don't think it affects it.

9 THE COURT: Can you wait for one second, Ms. Wooten?
10 Did you have an objection?

11 MR. SMITH: Is he testifying as an expert that
12 Lowe's should be paying sales tax on -- I mean,
13 is he giving sales tax expertise? I thought we
14 were just talking about fair market value
15 issues.

16 MS. WOOTEN: No, he is not. I'm just -- from his
17 perspective from a valuation expert, I'm just
18 trying -- or, yes, from a valuation practice,
19 that his principles and practice are what we
20 consider to be consistent with the regulations
21 and statutes. I'm not asking him to testify on
22 the regulations. I'm not asking him for
23 anything about sales tax.

24 MR. SMITH: Okay. It sounded like you were.

25 MS. WOOTEN: Okay.

1 MR. SMITH: That was my objection.

2 THE COURT: Yeah, I would just caution. I don't
3 think the witness has been qualified to
4 testify about the -- I guess I'm sort of
5 confused. Because you asked him specifically
6 about the special order items.

7 MS. WOOTEN: Uh-huh (affirmative response).

8 THE COURT: And the tax that should be levied on
9 those special order items.

10 MS. WOOTEN: Okay. And I can withdraw that
11 question, if you have an issue with it.

12 THE COURT: I just don't see how he's qualified to
13 testify about that.

14 MS. WOOTEN: Okay.

15 Q: From a valuation perspective, why is
16 determining the fair market value of the
17 installed items at the wholesale level
18 inconsistent with industry practices in South
19 Carolina?

20 A: May I use my other exhibit at this point?

21 Q: Sure.

22 MR. SMITH: Your Honor, is he an expert on industry
23 practices in South Carolina? Has there been
24 testimony on that? Is he going to talk about
25 the construction industry?

1 A: May I respond to that, Your Honor?

2 THE COURT: Wait.

3 MS. WOOTEN: Yeah.

4 THE COURT: Not just yet.

5 MS. WOOTEN: Your Honor, as a CPA in private

6 practice, he has been involved with multiple

7 industries, retail, construction,

8 manufacturing. He testified to that. I'm

9 asking based on his knowledge of work in the

10 CPA industry as well as valuation practices and

11 principles that he's used in other engagements.

12 MR. SMITH: I understood the question to be about

13 industry practices and I do not believe he's

14 qualified to testify on industry practices.

15 THE COURT: Do you want to go ahead and rephrase the

16 question?

17 MS. WOOTEN: Sure.

18 Q: From a valuation perspective, why is

19 determining the fair market value of the

20 installed items at the wholesale level

21 inconsistent with a retail industry?

22 MR. SMITH: Your Honor, I will lodge an objection

23 but I'm curious as to what his answer is. I

24 don't think he's qualified as a retail expert.

25 THE COURT: I'm going to go ahead and allow him to

1 answer the question. Do you understand the
2 question, Dr. van Bulck?

3 A: I'll try to answer within the context -- in the
4 framework y'all provided for me. Valuation
5 guidelines, whether that be USPAP or AICPA
6 guidelines, require or direct you to look at
7 the market in which those transactions take
8 place. You can infer that that's levels of
9 trade. Retailers clearly operate in the retail
10 market. They buy at the wholesale level, they
11 sell at the consumers, or the users, of the
12 product. That is, by definition, the retail
13 market. Therefore, for my fair market value,
14 at that point, if it is moving inventory,
15 moving out of the store, it would be valued at
16 the retail level for fair market value
17 purposes. If it was moving inventory. And,
18 again, it goes to the purpose of the valuation.

19 MS. WOOTEN: If we could just have a moment, Your
20 Honor.

21 THE COURT: Sure. Absolutely.

22 Q: You testified earlier that you look at
23 information on a company to learn more about it
24 ---

25 A: Correct.

1 Q: --- is that correct? In this matter, did you
2 look at the NAICS code for Lowe's?

3 A: Yes, I did.

4 Q: And what is the NAICS code?

5 A: Lowe's -- Lowe's publishes their annual report
6 and 10-K using the Code 440, which is retail.

7 Q: And why would you look to see what type of code
8 they report?

9 A: NAICS codes are uniform industry classification
10 codes that came about when NAFTA was -- talking
11 about North Atlantic Trade Association -- it
12 replaces the old SIC codes. It is a way of
13 classifying industries and companies in a
14 logical, numerical sense so that statistical
15 and financial data can be compiled by industry
16 and by codes and that if you need to look it up
17 or research a company in the industry, you can
18 find that information efficiently. It's
19 collected through the Census Bureau. Agencies
20 such as the IRS will use it on the sales -- on
21 the income tax returns. I think it's used on
22 property tax returns as well as sales tax
23 returns.

24 Q: And when you looked at the NAICS code, what did
25 you learn?

1 A: That Lowe's classifies itself as a retailer.

2 Q: Is there another code classification for home
3 improvement contractors?

4 A: Yes, there is.

5 Q: Does Lowe's use that home improvement NAICS
6 code?

7 A: I have not seen any evidence that they do.

8 Q: Okay. As a valuation expert, do you have an
9 opinion regarding the determination of fair
10 market value at the wholesale level in an
11 unfair trade advantage?

12 A: Would you please repeat that question?

13 Q: As a valuation expert, do you have any opinion
14 regarding the determination of fair market
15 value at the wholesale level in an unfair trade
16 advantage?

17 A: Well, the -- the wholesale level of trade would
18 be used for the valuation of inventory at rest,
19 such as for property tax purposes or a
20 contemplated buy/sell agreement of the business
21 perhaps or estate valuation purposes because in
22 an estate tax valuation where the inventory is
23 valued as a whole at rest. It's my
24 understanding that contractors will also use
25 that basis for the determination of use tax in

1 construction contracts.

2 Q: Were you present for Mr. Price's testimony
3 earlier this morning?

4 A: I was.

5 Q: And did you hear him testify that Lowe's
6 competes against home improvement contractors?

7 A: I believe I heard him say that.

8 Q: Okay. Do you believe Lowe's competes against
9 home improvement contractors?

10 MR. SMITH: What's the basis for that testimony?

11 MS. WOOTEN: Mr. Price testified earlier that they
12 compete against home improvement contractors.
13 Dr. van Bulck, in looking at information from
14 Lowe's, has reviewed their company information,
15 has looked at the NAICS codes to determine
16 what Lowe's reports and I'm asking if he
17 believes that they are competing against home
18 improvement contractors.

19 MR. SMITH: I don't think there's any foundation for
20 him to answer that question.

21 THE COURT: I don't know that he can answer that. I
22 mean, we have had testimony from another
23 witness ---

24 MS. WOOTEN: Uh-huh (affirmative response).

25 THE COURT: --- regarding that.

1 MS. WOOTEN: Okay.

2 THE COURT: But I don't see how Dr. van Bulck, as an
3 expert in property valuation, he's not an
4 expert in Lowe's competition methods.

5 MS. WOOTEN: Okay.

6 THE COURT: All right.

7 MS. WOOTEN: Thank you. Can I have just a moment,
8 Your Honor?

9 THE COURT: Uh-huh (affirmative response).

10 MS. WOOTEN: All right. Thank you, Your Honor,
11 that's all from the Department for Dr. van
12 Bulck.

13 THE COURT: Okay. Thank you.

14 DR. VAN BULCK - CROSS EXAMINATION BY MR. SMITH:

15 Q: Dr. van Bulck, we too met before?

16 A: Yes, we did.

17 Q: We had a spirited deposition, I think, last
18 fall during the rainstorms. You are not
19 holding yourself out as an expert in appraisal
20 procedures, standards or methodologies, is that
21 correct?

22 A: I'm not an appraiser, no.

23 Q: Okay. And from your valuation engagements,
24 which was Exhibit Eighteen, you've provided
25 valuations for estate tax, gift tax, income

1 tax, property tax and buy/sell agreement

2 purposes, is that correct?

3 A: Valuation engagement, yes, sir.

4 Q: Okay. For all of those purposes?

5 A: Correct.

6 Q: And in the course of the work, you've valued
7 some retail inventories?

8 A: Correct.

9 Q: A lounge, a liquor store chain, pharmacy. And
10 you consider yourself an expert in valuing
11 inventories, is that correct?

12 A: I value -- I help or assist clients with the
13 valuation of inventory on a monthly basis for
14 non-valuation engagements, such as sales tax.

15 Q: Okay.

16 A: Financial statements, income tax and so forth.
17 And that's a monthly activity.

18 Q: Now, in every single one of those engagements,
19 for every single one of those purposes, you
20 used a valuation method known as lower of cost
21 or market, is that correct?

22 A: It depends on the purpose of the valuation. If
23 it is an income tax valuation and we value the
24 inventory for income tax purposes, it's of
25 course the lower of cost. If it is an estate

1 tax, same thing. If it were property tax, same
2 thing. If it is sales tax, not so much.

3 Q: Well, you've never done a valuation for sales
4 tax purposes, have you?

5 A: I assist my clients with the -- with completing
6 sales tax returns on a monthly basis.

7 Q: Okay. My question is, in every engagement that
8 you've done in valuation of a business
9 inventory, for all those purposes, you used a
10 valuation method known as lower of cost or
11 market?

12 A: Correct.

13 Q: Okay.

14 A: Inventories at rest.

15 Q: And that means you valued the inventory at its
16 acquisition cost plus transportation charges
17 but minus any depreciation in value?

18 A: Could be.

19 Q: And so the highest value in lower of cost or
20 market is the cost?

21 A: For inventory at rest, yes, sir.

22 Q: Okay. So, the inventory can be valued below
23 the acquisition cost but never above?

24 A: For inventory at rest, correct.

25 Q: Okay. But for purposes of your expertise,

1 every valuation you've done of a retail
2 inventory has been at lower of cost or market?

3 A: For those particular business valuations, yes.
4 From accounting engagements, no.

5 Q: Now, you've never valued a retail business
6 inventory at its retail value?

7 A: Not the entire inventory, no, sir.

8 Q: Okay. You've never -- well, I believe your
9 testimony is you've never valued a retail
10 business inventory at its retail value?

11 A: That's correct. Because if you value the
12 entire business, then you value the entire
13 inventory and that is at cost. That is
14 inventory standing still. It is not moving
15 inventory. So, again ---

16 Q: And we will talk about the moving.

17 A: --- again -- if I may finish ---

18 Q: Oh, yeah.

19 A: --- again, the purpose of the valuation
20 dictates how you're going to do that.

21 Q: Okay. And you have given us your philosophy on
22 the moving.

23 A: Correct.

24 Q: And we're going to talk about that in a minute.
25 But for all the work that you've ever done, you

1 have valued it cost, lower of cost or market?

2 A: For business valuations, yes.

3 Q: I understand. Okay. And for publicly traded
4 companies like Lowe's, you looked at the 10-K
5 and their inventory was valued at the lower of
6 cost or market?

7 A: Yeah, but this -- on those, it's inventory at
8 rest on the financial statements, yes, sir.

9 Q: And so for financial statement purposes, which
10 is your area of expertise fair market value
11 means, when you're applying to a retail
12 inventory, lower of cost or market?

13 A: Correct.

14 Q: Correct? Okay. Now, you testified during your
15 deposition that you hold yourself out as an
16 expert in the contractor industry trade
17 practices, is that true?

18 A: Can you repeat that, please?

19 Q: Do you hold yourself out as an expert in the
20 contractor industry trade practices?

21 A: I believe I have expertise in the field, yes,
22 sir.

23 Q: Okay. Well, let me ask you some questions
24 about that. You have prepared sales and use
25 tax returns for contractors?

1 A: Yes, sir.

2 Q: And whenever contractors have purchased
3 building materials outside the state and
4 brought them in to use and consume in the
5 business, you reported use tax on those
6 materials?

7 A: Correct.

8 Q: And you always reported that tax on its
9 acquisition cost?

10 A: Correct.

11 Q: Okay. And that's your understanding of the
12 rule in South Carolina? A contractor is deemed
13 the final user consumer of the building
14 materials, they owe sales or use tax on their
15 cost to acquire the materials?

16 A: Correct.

17 Q: In fact, you've hired a contractor to make
18 modifications to your home? We chatted about
19 that.

20 A: We did.

21 Q: And you paid no sales tax?

22 A: Matter of fact, I've hired a contractor since
23 our conversation.

24 Q: Okay. And you, again, paid no sales tax?

25 A: I paid no sales tax.

1 Q: Okay. The improvement was not subject to sales
2 tax?

3 A: That is correct.

4 Q: The tangible personal property that went into
5 the improvement was subject to sales tax when
6 the contractor bought the materials?

7 A: Correct.

8 Q: And you are assuming your contractor paid tax
9 at its acquisition cost?

10 A: I hope he did.

11 Q: And if you advised him, you would have said,
12 "Pay tax on your acquisition cost."

13 A: If I had advised him -- I would have as a
14 consumer, I hope he did.

15 Q: Okay. You're not aware of any contractor who
16 pays sales tax on anything other than the cost
17 of their materials, is that correct?

18 A: Any contractor?

19 Q: Yes, any contractor.

20 A: Correct.

21 Q: Okay. You will agree with me, a big box
22 retailer can be a home improvement contractor?

23 A: I haven't seen it but I guess it could be.

24 Q: And you will agree with me that similarly
25 situated taxpayers engaging in similar

1 transactions should be assessed a tax in the
2 same manner?

3 A: I agree.

4 Q: Now, when I was taking your deposition, you
5 brought a bunch of publications with you. You
6 said that you'd brought everything you could
7 look up to study the issue so that you could
8 give your opinion. And you brought the
9 Statement on Standards for Valuation Services
10 by the American Institute of Certified Public
11 Accountants.

12 A: Correct.

13 Q: And you reviewed it and you scoured it stem to
14 stern and you acknowledged that there was
15 nothing there that would require that inventory
16 in the hands of a retailer be valued at its
17 retail value, isn't that correct?

18 A: The standards do not dictate that, correct.

19 Q: Okay. So, there's nothing there that says
20 that.

21 A: Uh-huh (affirmative response).

22 Q: Okay. And then you brought the IRS Revenue
23 Ruling 59-60, which addresses this issue, and
24 you said there's nothing there that would
25 indicate that inventory held by retailers

1 should be valued at fair market value at the
2 retail level of trade. Nothing in the IRS
3 rates?

4 A: Yes.

5 Q: Okay. And so then you brought the
6 International Valuation Standards Council and
7 you, again, acknowledged nothing there to
8 suggest that retail inventory in the hands of
9 a retailer should be valued at the retail level
10 of trade.

11 A: Correct.

12 Q: And then you brought the NorCal Valuations
13 publication on equipment valuation. Nothing
14 there, is that correct?

15 A: (Nods head affirmatively.)

16 Q: And you went through everything you had and you
17 acknowledged there was nothing in anything that
18 you found that says that retail inventory in
19 the hands of a retailer should be valued at the
20 retail level of trade?

21 A: No. But they do say -- but the standards that
22 I go by, which is normally the AICPA standards
23 because I have to, and occasionally the USPAP
24 because sometimes I should, direct you to
25 consider all materials, facts and

1 circumstances, including level of trade. They
2 don't tell you which level of trade it must be
3 but they tell you to consider the appropriate
4 level of trade. So, it is the assignment to
5 the valuation analyst to determine what that
6 level of trade should be. That's my job.

7 Q: That's your job, is level of trade. And that's
8 kind of where you are forming your opinion.

9 A: Right.

10 Q: Is what is the ---

11 A: Professional opinion.

12 Q: --- appropriate level of trade? And you've
13 concluded that it should be at the level that
14 Lowe's actually sells individual items to
15 retailers over some period of time and the
16 price that they would get at that level of
17 trade that you've ---

18 A: Lowe's doesn't sell to retailers.

19 Q: Pardon?

20 A: Lowe's does not customarily sell to retailers.
21 Lowe's sells customarily to customers and
22 installers.

23 Q: Understood. Although, as you know ---

24 A: You said retailers.

25 Q: --- in a fair market value valuation, you have

1 to presume that there's a willing buyer,
2 willing seller, at the same level of trade?

3 A: Correct.

4 Q: Whether or not that happens, you have to
5 presume it. You recall, and you heard it
6 earlier because I read it to Mr. Crider, the
7 excerpt from the JCPenney case.

8 A: Correct.

9 Q: And it did address the level of trade issue.
10 And it was, of course, for ad valorem tax
11 purposes and we'll acknowledge that.

12 A: Property tax, yes.

13 Q: Yes. "For ad valorem" -- well, ad valorem
14 means ---

15 A: At value.

16 Q: --- valued based tax, does it not?

17 A: Which could be any value.

18 Q: Yes. So, any fair market value taxes and ad
19 valorem tax?

20 A: Any -- any tax assessed on the -- on the basis
21 of value would be ad valorem.

22 Q: Okay.

23 A: It doesn't say which valorem it is.

24 Q: Okay. Well, let's see what this principle is.
25 It says, "For ad valorem tax purposes, fair

1 market value is not the retail value to the
2 taxpayer but the current wholesale value
3 adjusted for the fair market. Thus, the
4 taxpayer's," who was JCPenney here, "cost may
5 be adjusted upward, downward or remain the same
6 to reflect the wholesale market as it
7 determines the fair market value of the
8 tangible personalty in the taxpayer's
9 possession at that economic moment in time."
10 A: Uh-huh (affirmative response).
11 Q: And I believe you praised that as being
12 beautifully stated.
13 A: I thought it was beautifully stated ---
14 Q: Okay.
15 A: --- yes, sir. The applicant's ---
16 Q: How you measure ad valorem tax ---
17 A: For property ---
18 Q: --- for (inaudible) tax?
19 A: --- for property tax purposes, absolutely.
20 Q: Well, in property tax ---
21 A: That's a property tax case.
22 Q: I understand.
23 A: Okay.
24 Q: Property tax is based on fair market value, is
25 it not?

1 A: At that level of trade, yes. Fair market value
2 is not a level of trade that needs to be
3 determined at the appropriate level of trade,
4 whichever that might be.

5 Q: Well, actually, they say the appropriate level
6 is the wholesale level.

7 A: For property tax purposes, yes, sir.

8 Q: Okay. When dealing ---

9 A: That's the purpose.

10 Q: --- when dealing with retail inventory held by
11 a retailer, you measure ---

12 A: For property tax purposes, you use that basis.

13 Q: Okay.

14 A: Not for sales tax.

15 Q: Okay.

16 A: As I said at the beginning of my testimony,
17 sir, you begin your valuation engagement by
18 finding out what the purpose of the engagement
19 is. Why do we determine the value? The
20 purpose will direct the engagement.

21 Q: Okay. So, we have concluded, over the course
22 of this day, there's no definition of fair
23 market value in the sales tax code in South
24 Carolina and you agree with that?

25 A: Correct.

1 Q: We have concluded that if you're measuring fair
2 market value of retail inventories for income
3 tax, estate tax, gift tax, property tax,
4 transfer tax, for all of those purposes or for
5 public filings, you measure at the lower of
6 cost or market?

7 A: Because you measure inventory at the whole,
8 standing still, yes, sir.

9 Q: Okay. And then you heard Mr. Crider giving
10 testimony as to appraisal methodology, which is
11 not your area of expertise, and he said fair
12 market value has a generally accepted meaning,
13 when applied to retail inventory, of cost minus
14 depreciation, which is the same thing as lower
15 of cost or market, is it not?

16 A: Now, Mr. Crider testified that to USPAP, which
17 he's required to follow, which I have also
18 studied also as part of my education in
19 preparation of the AVD, and USPAP does not
20 direct you that it should be at cost. It says
21 you must consider all levels of trade and the
22 relevant circumstances for which you use for
23 the valuation. So, if Mr. Crider testified
24 that it must be cost, I must disagree with him,
25 under USPAP.

1 Q: Okay. But to this day, despite your efforts,
2 you've not found any publication, any standard,
3 any statute, we'll talk about the regulation
4 in a minute, but anything written that states
5 that when valuing retail inventory for fair
6 market value for sales tax purposes ---

7 A: Yes, sir.

8 Q: --- it must be valued at what they would sell
9 it for over-the-counter, over a period of time?

10 A: If it's -- if it's -- if the -- if the law
11 says, and I'm not interpreting the law, but if
12 the law says it, if we stipulate that the law
13 says that it must be fair market value, then to
14 determine its fair market value you need to
15 look at the transaction and the market in which
16 that transaction takes place, which would be
17 the market between Lowe's and the customer.

18 Q: Okay. And I ---

19 A: That's the level of trade. And you must
20 consider that under the valuation standards.

21 Q: Now, let's talk about sales tax.

22 A: Okay.

23 Q: Sales tax is a transaction tax, is it not?

24 A: Correct.

25 Q: So, in order to determine when and what tax is

1 due, you first have to determine who the
2 taxpayer is?

3 A: Correct.

4 Q: And you have to determine what's the trigger,
5 what is the retail sale, is that correct?

6 A: Correct.

7 Q: When Lowe's installs a home improvement under
8 the installation contract, who did you deem to
9 be the taxpayer?

10 A: If Lowe's installs?

11 Q: Home improvement. They install a custom window
12 at your house. They put tile in your kitchen.
13 I believe that's what you had.

14 A: It wasn't Lowe's but yes.

15 Q: Okay. Who's the taxpayer?

16 A: It seems to me that if I buy materials at
17 Lowe's and they're going to install it, and
18 there is an installed service agreement, that
19 I buy the materials from them and they agree to
20 install them, so I would technically be the
21 customer.

22 Q: Okay. So, you're basing your opinion ---

23 A: Or at least I buy it at that level.

24 Q: Okay. You're basing your expert opinion on
25 level of trade on your understanding and

1 assumption that the customer is the taxpayer?

2 A: Well, the market in which the customer operates
3 is the relevant market.

4 Q: And so you're assuming the title to the
5 tangible personal property transfers to the
6 customer at some point?

7 A: I don't given any legal opinions on when the
8 title transfers, sir. I'm not a lawyer.

9 Q: Well, I understand. But in order to have an
10 opinion on sales tax, you do have to determine
11 when it triggered and who's the taxpayer. You
12 have to.

13 A: For all practical purposes, when that customer
14 goes to the counter over there, as shown in
15 that picture, and he goes to the man with the
16 red coat and he pays for the materials, he has
17 bought the stuff.

18 Q: Okay. So, your assumption for your opinion,
19 customer received tangible personal property
20 when he paid the invoice at the cash register?

21 A: He knows how much it was, the amount is
22 certain, the date is certain and the item is
23 certain.

24 Q: Okay. And you're assuming the customer is the
25 final end user of the tangible personal

1 property and not Lowe's?

2 A: It could be the customer, it could be the
3 installer that works for the customer.

4 Q: Okay. Now, have you compared your assumptions
5 to form this opinion with the Department's
6 assumptions of who the taxpayer is and when it
7 was transferred?

8 A: I have not compared my assumption to the
9 Department's assumption. That's a legal
10 matter. That's not for me to determine. My
11 determination was what constitutes fair market
12 value.

13 Q: Okay. Well, if your assumptions ---

14 A: And at what level of trade should that be
15 determined. That's what I've been asked to do.

16 Q: Okay. Well, these assumptions that you just
17 gave me are inconsistent with your experience
18 dealing with a contractor, are they not?

19 A: If they are, they are. I can't help it.

20 Q: Okay. So, it is your opinion, as I understand
21 it, that the fair market value of home
22 improvement products sold and installed by
23 Lowe's, whether withdrawn from the retail
24 inventory or obtained by special order, should
25 be determined at the retail price level?

1 A: Yes, sir. I have not to find as to who should
2 pay the tax. I only find at what level of
3 trade that tax should be determined.

4 Q: Okay. Even though that's inconsistent with
5 every inventory valuation you've ever made?

6 A: It's not inconsistent. It's just a different
7 purpose.

8 Q: Okay.

9 A: Not inconsistent. It is a different purpose.
10 Don't confuse those two things, please.

11 Q: I understand.

12 A: Okay.

13 Q: And it's not supported by any published
14 accounting or valuation resource that you're
15 aware of?

16 A: It is -- it is supported by every valuation
17 published standard that says you must consider
18 the appropriate level of trade. And I deem
19 that, as a professional, to be the appropriate
20 level of trade.

21 Q: But you're basing that on assumptions regarding
22 the transaction?

23 A: No. I base my assumptions, or my conclusion,
24 on the information provided by Lowe's in their
25 published financial statements and the

1 published Form 10-K where they stated that it
2 is a prerequisite to the existence of their
3 business that they provide those services that
4 add value to the products at the retail level.

5 Q: Okay.

6 A: That's what I base that on, sir.

7 Q: Have you read any of the installation
8 contracts?

9 A: I've seen a few.

10 Q: Okay. Are you familiar with the terms and
11 conditions?

12 A: I've glanced over them, I don't have them
13 memorized, if that's what you're asking.

14 Q: From your point of view, they're completely
15 irrelevant?

16 A: From determining the level of trade, yes, sir.

17 Q: Okay.

18 A: I don't believe that, and, again, I don't want
19 to issue a legal opinion, but I don't believe
20 that Lowe's can verbally write themselves out
21 of a sales tax obligation.

22 Q: Okay. Now, I recall that you testified that if
23 other major contractors in the state, and we
24 mentioned Pulte and Mungo ---

25 A: Uh-huh (affirmative response).

1 Q: --- perform the same home improvements that
2 Lowe's performs, they would pay sales tax on
3 their cost?

4 A: Well, to the best of my knowledge, they don't.
5 They build homes.

6 Q: They don't pay ---

7 A: They build homes. Lowe's doesn't -- do not
8 build homes. Lowe's does not build homes and
9 the Mungo's build homes. They are contractors,
10 they don't have a store, they don't sell
11 materials. When you build a home, you don't
12 get a list of the itemized items that go into
13 the construction of the home and how much each
14 item cost. They build the home and they give
15 you a turnkey solution and they have one price
16 for the sale of the home. That's what a
17 construction contractor does. As what most of
18 the installers do. If they don't, they might
19 actually end up operating as a retailer and
20 they might end up having to pay sales tax at
21 the retail level.

22 Q: But all the contractors you're aware of, they
23 don't pay tax on the markup, they pay tax on
24 the ---

25 A: Contractors who operate as contractors, they do

1 not, correct.

2 Q: Okay. So, you acknowledge that Lowe's, when
3 it's performing an installation contract, bears
4 a greater tax burden than other contractors in
5 the state?

6 A: I -- I conclude, in my analysis, that when
7 Lowe's engages into an installation contract,
8 that they should be treated at the same level
9 as other installers that install the same
10 materials and perhaps buy those materials at
11 Lowe's at the price that Lowe's charges at the
12 retail level.

13 Q: But contractors can buy in bulk? They can buy
14 at discount?

15 A: Contractors in the market in, according to
16 government published information, Census Bureau
17 published information, contractors in South
18 Carolina are small operators. They're between
19 one and five employees, they are small
20 operators, by and large, 99 percent of them
21 are. Therefore, they do not have the economies
22 of scale advantage that Lowe's has as a
23 retailer. Lowe's has an enormous economic
24 advantage as a retailer because they can engage
25 in large acquisition contracts that the small

1 contractors simply can't. Small contractors,
2 small installers, buy typically at retail
3 outlets, such as Lowe's and maybe other
4 providers, and I based that conclusion on 30
5 years of experience in accounting working with
6 companies like that.

7 Q: And for that reason, you think it's appropriate
8 for Lowe's to bear a higher tax burden?

9 A: They are bearing the same tax burden. If
10 Lowe's is charged, whether it's the sales tax
11 or use tax, at the retail level, they then
12 carry the same sales tax burden as the small
13 mom and pop installer that buys the same
14 materials at Lowe's and pays the sales tax at
15 Lowe's at the same price level.

16 Q: Now, we talked, I thought I was through with
17 these but I'm going to touch them just one more
18 time ---

19 A: I was hoping you were done with those.

20 Q: It's always the last one. The one thing that
21 is written that you're relying on to support
22 your opinion of treating Lowe's, when it's
23 performing installation contracts, different
24 from other contractors is this regulation, is
25 it not?

1 A: Can you repeat that question?

2 Q: Okay. The one written thing that you're
3 relying on to support your position that
4 Lowe's, when it's performing installation
5 contracts should be treated differently from
6 construction contractors when they're
7 performing installation contracts is this
8 regulation?

9 A: I don't see the word contractor or installer in
10 there, no.

11 Q: No, it's not in there.

12 A: Okay. Then I don't rely on that.

13 Q: Well, the question I asked you at your
14 deposition, because we talked about it and you
15 kept saying this is the basis of your opinion,
16 and my question was ---

17 A: No, I don't recall saying that. I think you
18 started going down the road, during the
19 deposition, asking legal questions and I told
20 you I wasn't going to opine on legal issues.

21 Q: I understand. But when I asked you the basis
22 of your opinion, you said this regulation. And
23 my question was so the regulation provides an
24 answer that is, from your opinion, inconsistent
25 with what is normally understood to be what tax

1 would be applied is if the person withdrawing
2 it from inventory is not selling it but using
3 it for its own purpose and your answer was
4 that's my understanding. You were basing your
5 support of the Department's position on its own
6 regulation and nothing else.

7 A: I'm not opining on the Department's position,
8 sir. I'm opining on what level of trade would
9 be relevant for the determination of fair
10 market value in those installation contracts
11 for a company such as Lowe's.

12 Q: All right. Let's try another one that I asked
13 you about. This one, which is the definition
14 of sale at retail. And my question to you --
15 well, first of all, you said you were familiar
16 with that. We talked about it and you said ---

17 A: I've seen it.

18 Q: --- you're familiar with that.

19 A: I've seen it.

20 Q: And, of course, you do tax returns for
21 contractors. And I asked you would the sale of
22 kitchen tile by a manufacturer to Lowe's for
23 use in installing or performing an installation
24 contract for you in South Carolina be
25 consistent with (e), which is a retail sale,

1 "Sales to contracts for use in the performance
2 of a construction contract." And what is your
3 answer?

4 A: I'm going to paraphrase your question before
5 answering to make sure I understand ---

6 Q: Sure.

7 A: --- the question correctly.

8 Q: Sure.

9 A: Is that all right? Now, here you asked me if
10 a manufacturer or a wholesaler sells an item to
11 Lowe's ---

12 Q: We'll say a manufacturer.

13 A: --- manufacturer sells kitchen sink to Lowe's.

14 Q: Uh-huh (affirmative response).

15 A: And Lowe's subsequently intends to use that for
16 what they call an installation service
17 contract.

18 Q: In your kitchen.

19 A: In my kitchen. Well, then what is the
20 question?

21 Q: Would that sale by the manufacturer to Lowe's
22 be consistent with (e)?

23 A: No. They're not acting a contractor. They're
24 acting as a retailer that agrees to install the
25 items itself. I believe their contract says

1 installation service contract.

2 Q: Okay. So, you're ---

3 A: When I bought my home from a contractor, he
4 didn't say it's an installation contract, he
5 said it's a contract for the building and
6 construction of a home. And I did not get an
7 itemized statement of items. He just came in,
8 one price, that's it, and we shook hands on it
9 and we agreed on it and that was that he
10 constructed the home for me. Lowe's is a
11 retailer or personal property and they have
12 agreements with their customers, evidently,
13 that they will install at a price.

14 Q: And you think that because they list the stuff
15 on the contract?

16 A: Yes, sir. I -- I engaged in a contract with a
17 contractor recently for my condominium to have
18 certain light fixtures installed and plumbing
19 fixtures installed and he gave me one of the
20 examples of what he could do. He gave me one
21 price at the bottom of the contract, it says,
22 this is the installed price. I asked them then
23 how much is it for the fixtures and how much is
24 the labor, he says, we do not disclose that
25 information because we are a contractor.

1 Q: So ---

2 A: Lowe's acts as a retailer that installs the
3 products they sell. They don't act as a
4 contractor. If you're going to be a
5 contractor, I believe he must act as one.

6 Q: Okay. We understand your opinion.

7 A: Yeah.

8 Q: Thank you.

9 THE COURT: Anything further?

10 MR. SMITH: Actually, one more question.

11 THE COURT: All right.

12 Q: So, you had talked about the NAICS, how you
13 describe your company?

14 A: North Atlantic Industry Classification System,
15 yes, sir.

16 Q: Yes. And you pointed out that Lowe's lists
17 itself as a retailer and you couldn't find that
18 it list itself a home improvement contractor?

19 A: I looked at a Form 10-K and they are listed as
20 a, I think, 440, 444, whichever one it is.

21 Q: Okay. And have you ever looked at their
22 frequently asked questions, such as can a
23 business have more than one NAICS code?

24 A: Whose listing?

25 Q: This is from NAICS.

1 A: Okay.

2 Q: Okay. It just says you should only have one

3 code and you should list what is your primary

4 business.

5 A: I did not say that.

6 Q: No, they say that. Are you aware that they say

7 that you should only list one code ---

8 A: No.

9 Q: --- and it should be ---

10 A: I never said that. I'm not opining on that.

11 No, I did not.

12 Q: Okay.

13 A: I have not seen Lowe's using any other codes in

14 public information but that doesn't mean they

15 do or don't. I just haven't seen it.

16 Q: Okay.

17 MR. SMITH: That's all, Your Honor.

18 THE COURT: Thank you. Any redirect?

19 MS. WOOTEN: No, Your Honor, nothing further from

20 the Department.

21 THE COURT: Okay. So ---

22 MS. WOOTEN: For this witness.

23 THE COURT: --- Dr. van Bulck can be excused?

24 MS. WOOTEN: Yes.

25 THE COURT: Yes.

1 A: Thank you.

2 THE COURT: Sir, thank you very much. Return to
3 your seat. Okay.

4 MS. WOOTEN: Can we have one moment, Your Honor?

5 THE COURT: You may.

6 MS. WOOTEN: Thank you. Okay. Can I confer with
7 opposing counsel for just a few minutes?

8 THE COURT: Do you want to take a five-minute
9 recess?

10 MS. WOOTEN: Yeah, can we take a five-minute break.
11 And I think we may be able to conclude,
12 depending on our conversation.

13 THE COURT: Okay. Let's do. Let's take -- let's
14 give you ten minutes.

15 MS. WOOTEN: Ten.

16 THE COURT: Ten minutes.

17 (Off the Record)

18 MS. WOOTEN: Your Honor, we have one last witness,
19 Mr. Andy Reed.

20 THE COURT: Okay. Mr. Reed, please step forward and
21 be sworn in.

22 ANDREW B. REED, having been duly sworn, testifies as
23 follows:

24 MR. REED - DIRECT EXAMINATION BY MS. WOOTEN:

25 Q: Mr. Reed, where are you currently employed?

1 A: I'm currently employed with Lowe's companies.

2 Q: Okay. And what is your position at Lowe's?

3 A: Senior accounting manager.

4 Q: And what are your responsibilities and duties
5 as a senior accounting manager for Lowe's?

6 A: I work in the margin and cost accounting
7 department. My specific responsibilities are
8 focused on three areas, first being revenue
9 recognition. So, my team is responsible for
10 ensuring the proper revenue recognition, both
11 from an internal operational reporting
12 perspective, as well as all of our external
13 financial statements. We're also responsible
14 for monitoring inventory, ensuring the accurate
15 reporting of inventory. Once again, both
16 internally in our operational reporting from an
17 item level reporting perspective and then
18 externally, taking into consideration all of
19 the GAAP requirements to ensure the accurate
20 statement of inventory. And then also from a
21 marginal perspective, as well, making sure our
22 margin is reported timely and accurately.

23 Q: And are you also familiar with the installed
24 sales contracts or installed sales transactions
25 that we are talking about here today?

1 A: Yes, ma'am.

2 Q: Okay. And we're just looking at the installed
3 sales transactions. So, from an operational
4 perspective, when does Lowe's record the sale
5 for special order items?

6 A: From an internal operational reporting
7 perspective, that sale is recognized on our
8 internal statements as soon as the sale is
9 tendered.

10 Q: Is that through the point of sale system?

11 A: Yes, ma'am.

12 Q: Okay. And from a financial perspective, when
13 does Lowe's recognize the sale of that special
14 order item in the installed sales contract?

15 A: Once the obligation of Lowe's to the customer
16 is complete. So, if it's a -- if it's --
17 because I think Craig went through a lot of the
18 delivery types that we have. If it's a, you
19 know, a carry with, it's recognized
20 immediately. If it's a Lowe's delivery, once
21 the item is delivered, if it's an installed
22 contract specifically here, once the
23 installation is complete.

24 Q: And the answers that you just gave from the
25 operational perspective and financial

1 perspective with regard to the special order
2 sales items in the installed contract, would
3 your answer change from the stock item
4 installed contract transactions?

5 A: As long as they're all associated with an
6 installation, I don't believe there would be
7 any difference.

8 Q: Okay.

9 MS. WOOTEN: That's all, Your Honor.

10 MR. SMITH: No questions, Your Honor.

11 THE COURT: All right. No cross examination of Mr.
12 Reed, all right. So, Mr. Reed, sir, you may
13 step down. Thank you very much, sir. All
14 right.

15 MS. WOOTEN: We have no further witnesses to call
16 today.

17 THE COURT: Today.

18 MS. WOOTEN: We would just like to hold the record
19 open ---

20 THE COURT: Yes.

21 MS. WOOTEN: --- for Mr. McCormack's full testimony
22 at a later date.

23 THE COURT: Yes.

24 MS. WOOTEN: And after review of the transcript.

25 THE COURT: Yes.

1 MS. WOOTEN: Is that correct?

2 THE COURT: Yes.

3 MS. WOOTEN: Okay.

4 THE COURT: And that was kind of our understanding,

5 isn't it?

6 MR. SMITH: That's our understanding, Your Honor.

7 THE COURT: Okay. That is our understanding. So,

8 do we want to just, I don't know how you feel,

9 but do you want to just go ahead and we'll

10 probably reconvene. Is that sort of the

11 thought there?

12 MS. WOOTEN: That was our ---

13 MR. SMITH: I think so.

14 MS. WOOTEN: Yes, sir.

15 THE COURT: And then we can ---

16 MS. WOOTEN: Right.

17 THE COURT: --- if people want to make some closing

18 remarks at that time, we can do that.

19 MR. SMITH: Okay.

20 MS. WOOTEN: Okay.

21 THE COURT: That would seem appropriate because you

22 would certainly maybe want to incorporate

23 anything that you develop from Mr. McCormack's

24 testimony, one way or the other ---

25 MS. WOOTEN: Right.

1 THE COURT: --- into your closing remarks. So, is
2 there anything we need to take up any further?

3 MS. WOOTEN: No, Your Honor. Just ---

4 THE COURT: I would ask that the Department just let
5 us know ---

6 MS. WOOTEN: Sure.

7 THE COURT: --- when Mr. McCormack has returned and
8 perhaps, at that time, we can all have a
9 telephone conference or something to that
10 nature and get a date that we can all agree
11 that would be convenient for everyone to
12 reconvene and get Mr. McCormack's testimony.
13 Or, if there are changes in circumstances, then
14 address those things at that time.

15 MR. SMITH: That would be -- we'd prefer as soon as
16 possible ---

17 THE COURT: Yes.

18 MR. SMITH: --- for that.

19 THE COURT: Obviously, as soon as possible. We
20 recognize -- again, sympathies go out to Mr.
21 McCormack -- we're recognizing that his
22 situation is what it is.

23 MS. WOOTEN: Right.

24 THE COURT: You know, the sooner, the better. So,
25 it's ---

1 MR. SMITH: Right.

2 THE COURT: The transcript will ---

3 MS. WOOTEN: And thank you for allowing Mr.

4 McCormack to come back and testify. We

5 appreciate that.

6 THE COURT: I certainly want to have the Department

7 to have every opportunity to present its case,

8 as well. So, we will work towards that goal of

9 getting Mr. McCormack back and then moving

10 forward from there.

11 MS. WOOTEN: All right.

12 THE COURT: All right.

13 MR. SMITH: Thank you, Your Honor.

14 THE COURT: So, at this time, we are recessed till

15 we reconvene. Thank you.

16 MS. WOOTEN: Thank you.

17 THE COURT: Everyone, thank you very much and have a

18 very safe trip home.

19 (There being nothing further at this time, the

20 hearing recessed at 6:33 p.m.)

21

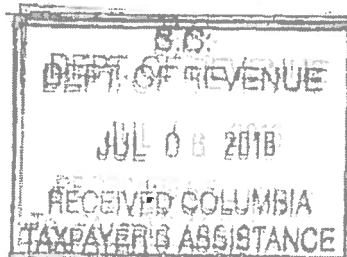
**TRANSCRIPT OF PROCEEDINGS
DATED JUNE 7, 2016**

Transcript of the Testimony of **LOWE'S V. SC DOR**

Date: June 7, 2016



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STATE OF SOUTH CAROLINA
ADMINISTRATIVE LAW COURT DIVISION
Docket No. 14-ALJ-17-0552-CC

Lowe's Home Centers, Inc.,)
Petitioner,)
v.)
South Carolina Department of)
Revenue,)
Respondent.)

ADMINISTRATIVE HEARING

Tuesday, June 7th, 2016
9:39 a.m. - 12:32 p.m.

The hearing before the Honorable Sebastian Phillip Lenski, was taken at the Edgar A. Brown Building, 1205 Pendleton Street, Suite 224, Columbia, South Carolina, on the 7th day of June, 2016 before M. Sean Cary, Court Reporter and Notary Public in and for the State of South Carolina.

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STIPULATIONS

It is stipulated and agreed that this hearing is being taken pursuant to the rules of the Administrative Law Court and the South Carolina Rules of Civil Procedure.

Page 2

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THE COURT: Good morning everyone. We're back on the record. This is the Lowe's Home Center, LLC, Petitioner, versus the South Carolina Department of Revenue, Docket Number 14-ALJ-17-0552-CC. This is the 7th of June, 2016 and we are reconvening on this matter. We recessed on the 20th of April after taking testimony all day and receiving evidence in order to give Mr. McCormack an opportunity to return for the Department and provide testimony at this time. So I think that's where we are at the time. Has anything come up? Do we have any motions or anything that party's need to take up before we get started?

MS. WOOTEN: No, Your Honor.

MR. SMITH: No, Your Honor.

THE COURT: All right. Thank you very much. Ms. Wooten?

MS. WOOTEN: Thank you.

THE COURT: Yes.

MS. WOOTEN: The department calls John McCormack to the stand.

THE COURT: All right. Mr. McCormack, please come forward. And just if you'll be sworn in by the court reporter before you take your seat sir.

1 (Pages 1 to 4)

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1 COURT REPORTER: Do you solemnly swear or affirm
 2 that the testimony you're about to give will be
 3 the truth, the whole truth and nothing but the
 4 truth so help you God?
 5 MR. McCORMACK: I do.
 6 COURT REPORTER: Thank you very much, sir.
 7 THE COURT: Make yourself comfortable, sir.
 8 JOHN PATRICK McCORMACK, having been duly sworn,
 9 testifies as follows:
 10 MR. McCORMACK - EXAMINATION BY MS. WOOTEN:
 11 Q: Would you please state your name for the
 12 record?
 13 A: John Patrick McCormack.
 14 Q: And where are you currently employed?
 15 A: At the South Carolina Department of Revenue.
 16 Q: How long have you been employed by the
 17 Department?
 18 A: A little over 36 years.
 19 Q: What is your current position with the
 20 Department?
 21 A: I'm the general manager for the Policy Section
 22 within the Office of General Counsel.
 23 Q: What job duties or responsibilities do you have
 24 as the policy manager?
 25 A: Well the policy section drafts advisory

1 Q: How does the regulation process work with
 2 regard to regulations concerning taxes?
 3 A: Well the Department in promulgating a
 4 regulation has to first publish a Notice of
 5 Drafting in the State Register. And this
 6 allows taxpayers 30 days to provide comments.
 7 And then based on those comments and -- and the
 8 Department will -- then the next step will be
 9 a Notice of Proposed Regulation. And that's a
 10 -- a notice where we actually publish the
 11 proposed text of a regulation. And we will --
 12 again, there will be 30 days for comments. And
 13 -- and -- and we have to answer certain
 14 specific questions that the General Assembly
 15 has set down. Again, it's a very specific
 16 process. And then eventually, if that goes
 17 well, we make some changes based on those
 18 comments and we're ready for the next step.
 19 Then if someone has -- if either a public
 20 official or at least 20 people or an
 21 organization with 20 people requests a public
 22 hearing then that hearing will be held over
 23 here at the Administrative Law Court to
 24 determine the need and the reasonableness of
 25 the regulation. If not, then basically it will

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1 opinions for the recommendation to the
 2 Director. These include revenue rulings,
 3 revenue procedures, private letter rulings.
 4 And so we provide those, and those become the
 5 official position of the Department of Revenue;
 6 and they provide guidance to taxpayers and also
 7 to our employees. We also provide informal
 8 advice to department management, division
 9 directors and the director himself as well as
 10 all employees. We also assist with the
 11 regulation process. The -- there's a very
 12 specific process that regulations have to go
 13 through in being promulgated and we do the --
 14 the drafting and assist in that process. We
 15 also will review legislation that maybe our
 16 legislative services sections would like us to
 17 look at to see if there's any concerns about
 18 whether we can, you know, administer it, and
 19 whether we have suggestions for -- for changes
 20 if there are any concerns. We also will make
 21 recommendations on legislation through a
 22 process and in order to usually fix -- make
 23 technical corrections with respect to the
 24 statute. And so we work in those various areas
 25 and I'm the general manager over that area.

1 go be filed with the General Assembly typically
 2 in January, the beginning of the session, and
 3 will go for their approval. And they can either
 4 approve it through a resolution or they can
 5 allow it to sit for 120 days and it will be
 6 automatically approved. But eventually all
 7 regulations have to be approved by the General
 8 Assembly.
 9 Q: Mr. McCormack, what is your educational
 10 background?
 11 A: I have a Bachelor of Science in Accounting from
 12 Clemson University in 1978.
 13 Q: And could you please give the Court an overview
 14 of your employment with the Department starting
 15 from the beginning?
 16 A: I started out with the Department in nine- --
 17 in 1980, in February of 1980, and I was in what
 18 was referred to at that time was the License
 19 Tax Division. And I was a license tax agent.
 20 And at that time we would handle taxes and the
 21 collection of taxes and ensuring licen- --
 22 locations had licenses with respect to such
 23 taxes as soft drink taxes, documentary stamp
 24 taxes, cigarette and tobacco taxes, admissions
 25 taxes. And so we would handle those type of --

2 (Pages 5 to 8)

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1 of taxes. And then in July of 1981 I became a
 2 licensed tax auditor and I audited those type
 3 of taxes. Then in 1985 the Department went
 4 through a reorganization and instead of being
 5 organized along tax lines where we had a set
 6 license tax division, a sales tax division and
 7 an income tax division, we reorganized along
 8 functional lines and it was created a -- what
 9 was referred to as a Field Services Division
 10 which is essentially the audit and collection
 11 division. And I was put in the appeals section
 12 in that section would handle appeals that came
 13 through the -- the audit and collection
 14 section. And so I did that for -- and that's
 15 where I first dealt with sales tax. And that
 16 was like 1985. And so that's -- started
 17 dealing with sales tax almost -- you know,
 18 pretty much exclusively in a lot of ways at
 19 that time. And then in 1987 I was promoted
 20 into a position in the policy section where I
 21 am now. It's had various names over the years
 22 but I've been in there since that time and
 23 started off as what I will call an analyst.
 24 Again, the names have changed several times
 25 over, but an analyst. And then I became a

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1 manager of the policy area. And then about
 2 three years ago I became the general manager of
 3 the policy section and I work directly for the
 4 office -- the General Counsel -- the Office of
 5 General Counsel. And so that's pretty much my
 6 employment over the years.
 7 Q: When you transferred to the policy section in
 8 1987, did you primarily focus upon issues
 9 related to a specific type of tax?
 10 A: Yes.
 11 Q: And what was that?
 12 A: Sales tax.
 13 Q: And I'm going to move on to some policy
 14 questions. What does the Department do?
 15 A: The Department administers and collects the
 16 taxes and revenue -- taxes of the state and
 17 also -- we also collect some local taxes like
 18 the local sales taxes that the General
 19 Assembly's given us the authority to do so.
 20 And so we do that on behalf of local
 21 jurisdictions.
 22 Q: What duties or responsibilities does the
 23 Department have with regard to creating or
 24 altering a tax law?
 25 A: The Department does not create or alter tax

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1 laws. Those are -- that's done by the General
 2 Assembly. Now we will -- as I mentioned
 3 earlier, we will offer suggestions for maybe
 4 making technical improvement, and those
 5 suggestions, since we are a cabinet agency,
 6 have to be approved by the -- the Governor's
 7 office. But eventually if someone, you know,
 8 with the General Assembly is willing to
 9 introduce that suggestion then that begins the
 10 process there. But basically our -- ours is --
 11 you know, as far as creating and altering laws
 12 it's only offering suggestions from time to
 13 time.
 14 Q: How must the Department interpret tax laws that
 15 are enacted by the General Assembly?
 16 A: The Department -- you know, first we look at
 17 the -- I'm sorry, could you repeat that
 18 question again?
 19 Q: Sure.
 20 MR. SMITH: Nicky, I'm sorry but I'm having a little
 21 trouble hearing you.
 22 MS. WOOTEN: That's fine. I'm sorry. I'm trying to
 23 speak as loud as I can.
 24 MR. SMITH: I know, we're both struggling today.
 25 THE COURT: I understand. Is -- are you able to get

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1 everything?
 2 COURT REPORTER: (Nods affirmatively.)
 3 THE COURT: Okay.
 4 MS. WOOTEN: Okay.
 5 THE COURT: You're doing fine.
 6 Q: How must the Department interpret tax laws
 7 enacted by the General Assembly?
 8 A: The -- we have to follow the intent of the
 9 General Assembly and we do that by looking at
 10 the usual rules of construction. You know,
 11 again, looking at the statute as a whole, the
 12 plain meaning of the statute. So we look at
 13 the various rules of construction but we're
 14 trying to get to -- you know, the primary focus
 15 is to get to the -- the intent of the General
 16 Assembly.
 17 Q: Well let's move on to sales tax. What is the
 18 sales tax in South Carolina?
 19 A: It's a tax imposed on persons engaged in the
 20 business of selling tangible personal property
 21 at retail. And it's imposed upon -- at a rate
 22 of 6 percent on the gross proceeds of sales.
 23 Q: How does the Department determine what type of
 24 transaction is subject to the sales tax?
 25 A: Well we look at the -- the primary things we

3 (Pages 9 to 12)

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1 look at are -- are the imposition section,
 2 which in the case of the sales tax is code
 3 section 12-36-910. In the case of the use tax
 4 it's 12-36-1310. But also we -- in order to do
 5 that you have to look at the definitional
 6 sections: the -- the definition of tangible
 7 personal property, the definition of sale at
 8 retail. So we have to look at those -- those
 9 two things. And then we also have to look at
 10 the -- the transaction itself to determine --
 11 as part of that is to determine what is a
 12 retail sale? And so we look at those things
 13 together to make a determination as to what
 14 transactions are subject to the tax.
 15 Q: Are you familiar with the issues under
 16 consideration today?
 17 A: Yes.
 18 Q: What is the issue or specific transaction in
 19 this case as you understand it?
 20 A: The issue is the withdrawal, use or consumption
 21 of tangible personal property by the taxpayer
 22 -- by Lowe's in making improvements to real
 23 property; and the specific issue is the -- what
 24 is the value to be placed on that withdrawal,
 25 use or consumption?

1 A: It's a -- a purchase at wholesale.
 2 Q: And from the Department's perspective, what is
 3 the retail sale in this case?
 4 A: The retail sale is the withdrawal, use or
 5 consumption of the tangible personal property
 6 by Lowe's in making the improvement to the real
 7 property for their customer.
 8 Q: And what value should those retail sales be
 9 calculated for sales tax purposes?
 10 A: They should be taxed at fair market value.
 11 Q: If you will refer to -- thank you. I'm going
 12 to put it up on the overhead. Can you see that
 13 Mr. McCormack?
 14 A: Yes.
 15 Q: Are you familiar with this Exhibit One -- or
 16 excuse me, Exhibit Two?
 17 A: Yes.
 18 Q: Respondent's Exhibit Two. Did you complete
 19 this illustration?
 20 A: Yes. I prepared this.
 21 Q: And is this the testimony that you've just
 22 given or an illustration of the testimony
 23 you've just given?
 24 A: Yes. In this case Lowe's had purchased
 25 building materials from a supplier and so they

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1 Q: And what is your understanding of Lowe's
 2 primary business activity?
 3 A: They are a retailer.
 4 Q: At the time of purchase how much tax did Lowe's
 5 pay on the materials used in the installed
 6 sales at issue here?
 7 A: Lowe's did not pay any tax at the time of
 8 purchase.
 9 Q: And when did Lowe's remit tax on materials in
 10 these transactions?
 11 A: They remitted on the -- the tax on when they
 12 withdrew it, used it or consumed it in making
 13 those improvements to real property.
 14 Q: And what was the basis of the tax remitted on
 15 those materials?
 16 A: They remitted the tax on their cost.
 17 Q: How can a business purchase items without
 18 paying sales tax at the time of purchase?
 19 A: Well relevant to the -- to the issues here, a
 20 -- a retailer can use a resell certificate to
 21 purchase tangible personal property at
 22 wholesale or free of the tax.
 23 Q: What is the term for purchasing goods without
 24 paying a sales tax at the time of purchase by
 25 using a resale certificate?

1 purchased it wholesale and, you know, did not
 2 pay tax at the wholesale level right here
 3 (indicating). But then Lowe's is -- because
 4 they're going to be reselling that tangible
 5 personal property, those building materials,
 6 and they will resell them in one of two ways.
 7 What I call -- what I call the ordinary sale,
 8 which is the upper one up here (indicating).
 9 And that's where, okay if I go in and I want to
 10 buy a -- a dishwasher and I -- so I just buy a
 11 dishwasher and I pay \$500 for that dishwasher
 12 and I'm going to take that dishwasher myself
 13 because I'm a handyman type person and I'm
 14 going to install it myself; or I've got
 15 somebody else that I've hired to install it.
 16 So whatever I pay the tax on that's what --
 17 excuse me, whatever I paid for the -- the
 18 product, in my example \$500, that's what I
 19 would pay the tax on. The other type of -- of
 20 -- of retail sale for Lowe's is -- is the
 21 installed sale, and that's a -- basically a
 22 retail sale by law. You have in the definition
 23 of sale of retail, code section 12-36-
 24 110(1)(c), that is where you tax the
 25 withdrawal, use or consumption of tangible

4 (Pages 13 to 16)

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1 personal property previously purchased at
2 wholesale by anyone who is going to use it in
3 their business or for their personal purposes.
4 And so Lowe's had previously purchased these
5 products at wholesale and then -- so that makes
6 it when they withdraw it, use it or consume it
7 here (indicating), that makes that a retail
8 sale by definition, by statute. And so and
9 that -- and that's where the tax says -- the
10 law says -- if you look at code section 12-36-
11 90, that's where the law says the tax is based
12 on the fair market value of the tangible
13 personal property previously purchased at
14 wholesale that is used by the business or the
15 person withdrawing it.

16 Q: And we're going to -- you somewhat started
17 talking a little bit about specifics but we're
18 going to jump into the transaction specifics a
19 little bit more in detail. What are the
20 specific statutes relevant to the Department's
21 position and basis in this matter?

22 A: Well first of all you have to get to the -- the
23 imposition, 12-36-910, which is -- imposes tax
24 on anybody engaged in the business of selling
25 at retail tangible personal property. Then you

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1 have code section 12-36-110, which defines a
2 sale of retail to include a withdrawal, use or
3 consumption of tangible personal property
4 previously purchased at wholesale and used and
5 consumed by the business or the person using
6 it. And then you have code section 12-36-90,
7 which defines gross proceeds of sales to
8 include the fair market value of tangible
9 personal property previously purchased at
10 wholesale that is used or consumed by the
11 business or the person withdrawing, using and
12 consuming it.

13 A: Let's jump back to statute 12-36-110,
14 specifically, subsection 1(c). Who does the
15 Department apply this subsection to?

16 Q: This would apply to -- to any retailer. The --
17 who is basically purchasing something at
18 wholesale and instead of selling it in an
19 ordinary sale is using and consuming it.

20 Q: And what are the specific regulations relevant
21 to the Department's position and basis in this
22 matter?

23 A: Well the -- as far as the -- the basis upon
24 which the tax is fair market value, which is
25 again goes back to that code section 12-36-90,

Page 19

1 it's regulation 117-309.17. And then you have
2 also -- you have code section -- excuse me,
3 regulation 117-324 which is what we call the
4 dual business regulation.

5 Q: All right. Let's jump back to the withdrawal
6 for merchant's regulation, regulation 117-
7 309.17. What is the Department's understanding
8 of this regulation?

9 A: This regulation is basically defining what is
10 the fair market value for a withdrawal as use
11 or consumption of something by a taxpayer who
12 had previously purchased it at wholesale.

13 Q: And we talked earlier about the promulgation
14 process of the Department regulation. Do you
15 recall when this particular regulation was
16 promulgated?

17 A: As it's -- as it's numbered now as three --
18 excuse me, as 117-309.17, it was promulgated in
19 2002 I think.

20 Q: And were you involved in the process of
21 promulgating that particular regulation?

22 A: Yes.

23 Q: Okay. And do you recall why the regulations
24 were promulgated?

25 A: Well that was part of a overall reorganization

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1 of regulations. This regulation along with
2 many others were -- had been around for years.
3 In fact this -- this particular regulation was
4 numbered 117-174.225 I believe. And it was
5 part of a reorganization of a regulation. We
6 -- we had taken I think like 237 different
7 sales and use tax regulations and combined them
8 down into 37. We had kind of grouped
9 regulations along subject matter. Because you
10 would have -- for example, you might have a
11 regulation deal with manufacturers and then 20
12 regulations later you'd have another one and
13 then another one and then -- we put them all
14 together and made it easier for taxpayers and
15 our employees to -- to find them. And so this
16 was part of reorganization. And this was a
17 regulation that had been around for a good
18 while.

19 Q: I'm looking at this regulation. What has the
20 Department interpreted fair market value to
21 mean in this matter?

22 A: In this matter basically it's the -- it's what
23 the taxpayer would normally sell that tangible
24 personal property for allowing for all
25 customary discounts.

5 (Pages 17 to 20)

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1 Q: What type of industries or taxpayers does the
 2 Department apply this regulation to?
 3 A: This applies to -- to all retailers.
 4 Q: Has the Department applied it to a retailer
 5 such as a convenience store?
 6 A: Yes. The -- for example, like a convenience
 7 store -- if I run a convenience store -- so I
 8 buy various products to sell, let's say like
 9 bread and milk. And instead of selling that
 10 bread and milk, one night a week or a couple of
 11 times a week I maybe take some of the milk off
 12 the shelf and bring it home for my family.
 13 That is a withdrawal for use and by definition
 14 is a retail sale and the tax is due based on
 15 its fair market value: in other words what I
 16 normally sell it for. It would -- that would
 17 be one example.
 18 Q: When applying the withdrawal regulation we were
 19 just talking about, does the Department believe
 20 it is necessary to conduct an appraisal of the
 21 items in question?
 22 A: No.
 23 Q: And why is that?
 24 A: Because the regulation which has been approved
 25 by the General Assembly has set the definition

1 A: It's applied the same way across all retailers.
 2 In other words that a -- if you have a
 3 retailer, then when they -- when they buy their
 4 building material they buy it at wholesale tax-
 5 free; and then when they -- as you can see from
 6 the chart, when they sell it they pay tax on
 7 when they sell it in an ordinary sale or they
 8 pay tax as a withdrawal for use -- what we
 9 usually refer as withdrawal for use but it's
 10 really withdrawal, use or consumption of that
 11 tangible personal property previously purchased
 12 wholesale. They pay tax on its fair market
 13 value.
 14 Q: And as part of the Department's position, is
 15 there a South Carolina case the Department
 16 believes is applicable in this matter?
 17 A: I believe that the -- the relevant case would
 18 be the Colonial Stores v. The South Carolina
 19 Department of Revenue.
 20 Q: And what is the Department's understanding of
 21 that case?
 22 A: Well that was a case in which Colonial Stores
 23 purchased premium merchandise that they would
 24 give away if you purchased a certain amount of
 25 groceries through their I think it was called

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Page 24

1 as what the taxpayer normally sells that
 2 tangible personal property for allowing for all
 3 customary discounts.
 4 Q: You also mentioned another regulation entitled
 5 or what is known as the dual business
 6 regulation. Are you familiar with this
 7 regulation?
 8 A: Yes.
 9 Q: What is the Department's understanding of this
 10 regulation?
 11 A: That's regulation 117-324, and essentially it
 12 says that if you're -- if you're selling items
 13 and you're also using those items then you're
 14 to purchase those items at -- at wholesale and
 15 then pay the tax when you sell it based on
 16 gross proceeds or essentially your sales price
 17 and -- or when you use it, you pay it based on
 18 gross proceeds which in that case is fair
 19 market value. And then you go back to the --
 20 the 117-309.17 regulation, and fair market
 21 value is what you normally sell it for allowing
 22 for all customary discounts.
 23 Q: How does the Department apply this regulation
 24 when a retailer also provides contracting
 25 services?

1 a save a stamp, kind of like a Greenback stamp
 2 program. And so they would -- they would buy
 3 this premium merchandise. I -- I -- I don't
 4 know exactly what it was but I'm kind of
 5 guessing it's kind of somewhere along the lines
 6 of the dishes you used to see in stores where
 7 they would show the dishes that you could get
 8 if you had saved a certain number of stamps.
 9 And so they would buy those -- those premium
 10 merchandise tax paid. They -- people said they
 11 were going to use them, they were going to give
 12 them away, they weren't selling those things.
 13 And the -- the Court said that the tax was
 14 based on the cost, but the Court went on to say
 15 a different valuation method applies when you
 16 purchase something at wholesale for -- for
 17 resale purposes and you use it instead of
 18 selling it, and that would be the reasonable
 19 and fair market value of the property.
 20 Q: Let's move on to the specific transactions in
 21 this matter. Have you had an opportunity to
 22 read the transcript from the April 20th hearing
 23 of this matter?
 24 A: Yes.
 25 Q: And are you generally familiar with the

6 (Pages 21 to 24)

Page 25

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1 description of the business operations of
 2 Lowe's regarding the installed sales
 3 transactions?
 4 A: Yes.
 5 Q: What is your understanding of the taxpayer's
 6 regular installed sales transaction?
 7 A: Well that would typically be like my earlier
 8 example of the -- of the dishwasher, is those
 9 are items that -- that either Lowe's had
 10 purchased it for sale in their -- in the store
 11 or there in the -- the distribution center
 12 which I believe is out of state. And they
 13 would -- if a customer comes in and wants to
 14 obtain a -- a dishwasher and then also have it
 15 installed then they would take that out of
 16 their inventory and they would make that
 17 improvement to real property for the taxpayer.
 18 Q: And just looking at the regular installed sales
 19 transaction, what is your understanding of
 20 where the materials used in those transactions
 21 come from?
 22 A: That is usually going to be either their -- the
 23 -- the inventory -- the stock in that
 24 particular store or the local distribution
 25 center.

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1 Q: And what effect does the location of material
 2 used by Lowe's in these regular installed sales
 3 have on the Department's position in this
 4 matter?
 5 A: It would not make a difference. It would still
 6 -- tax would still be based on fair market
 7 value.
 8 Q: And why is that?
 9 A: Because the -- the statute defines a retail
 10 sale to include the withdrawal, use or
 11 consumption. So if you have it in your
 12 inventory at the local store, then when you
 13 withdraw it that's a retail sale by statute.
 14 And so then -- so in a sense Lowe's has made a
 15 -- a -- a retail sale to itself, -- a --
 16 it's a deemed retail sale or you could call it
 17 a retail sale by -- by statute or by law. And
 18 so they made that there. If they happened to
 19 have -- if the material is at the distribution
 20 center and that's out of state, then when they
 21 use it in South Carolina in making those
 22 improvements to real property for their
 23 customer that's the retail sale that's
 24 occurring in South Carolina. So this is a --
 25 a -- a retail sale that occurs in South

1 Carolina, so it's a sales tax under South
 2 Carolina law.
 3 Q: And what is your understanding of the special
 4 order sales installed transactions?
 5 A: Those are sales - I think the example used in
 6 the testimony were -- were like windows. And
 7 so they -- they don't have those in the local
 8 store. They don't have those in the
 9 distribution center. Those -- a thing like
 10 windows might have to be specially made for
 11 that customer because, as you can imagine,
 12 everybody's windows in everybody's houses might
 13 be slightly different in size. So, they have
 14 to be specially made. And so Lowe's, again,
 15 purchased those at -- at -- at wholesale, you
 16 know, for use in these improvements to real
 17 property.
 18 Q: What is your understanding of where the
 19 materials used in those installed sales
 20 transactions come from?
 21 A: I think they will come from a person
 22 manufacturing that purchased that -- from the
 23 -- from the company that's manufacturing that
 24 -- that window for example, to meet the
 25 specifications of that particular customer.

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1 Q: Is that manufacturer always located in South
 2 Carolina?
 3 A: No, not necessarily.
 4 Q: What effect does the vendor's location and
 5 material used by Lowe's in the special order
 6 installed sales transactions have on the
 7 Department's position in this matter?
 8 A: Again it's the same as the ordinary sales. I
 9 mean they purchase them at wholesale so either
 10 they -- either when the withdrawal, use or
 11 consumption occurs in South Carolina, one of
 12 those three things, then the retail sale has
 13 occurred in South Carolina and therefore you
 14 have a -- a sales tax based on the fair market
 15 value.
 16 Q: And now we're moving on from the vendor's
 17 location. What is your understanding of where
 18 the materials used by Lowe's in the special
 19 order installed sales are delivered?
 20 A: From what I understand, Lowe's will either have
 21 those delivered to the local store where that
 22 customer went to and -- and have them set
 23 aside. They will either deliver them to the
 24 installer -- have the manufacturer deliver them
 25 directly to the installer, and the installer

7 (Pages 25 to 28)

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1 may keep them in their warehouse because the
 2 installer may not get to that job for two or
 3 three weeks, or they'll be delivered directly
 4 to the customer's location.
 5 Q: Now what effect does the delivery place on the
 6 material used in these special order sales
 7 transactions have on the Department's position
 8 in this matter?
 9 A: Again it -- it does not affect the -- affect
 10 that the fact that the tax is based on the fair
 11 market value because either the withdrawal from
 12 the business occurred or you have the -- the
 13 use or the consumption of the item that was
 14 previously purchased at wholesale. And so the
 15 only thing it may affect would be if it's --
 16 where it's delivered would be the local tax
 17 application.
 18 Q: And are you familiar with the taxpayer's
 19 argument that it is a contractor in this
 20 matter?
 21 A: Yes.
 22 Q: And what is your understanding of that position
 23 asserted by the taxpayer?
 24 A: I believe if -- if you look at the -- the
 25 example here on the screen, I believe the --

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1 they're -- they're saying that okay, the
 2 withdrawal use is -- or consumption is
 3 occurring when they take it out of the business
 4 or the inventory is occurring here, but the tax
 5 should be based on the -- the cost when they
 6 originally purchased it at wholesale.
 7 Q: What statute is the taxpayer relying upon for
 8 that argument?
 9 A: They're relying on code section 12-36-110, I
 10 think it's 1(a), which says that the retail
 11 sale includes the sale of building materials to
 12 construction contractors.
 13 Q: And what is the Department's position regarding
 14 the application of subsection 1(a) to the
 15 transactions at issue here?
 16 A: The -- our position is that it does not apply
 17 when Lowe's is initially purchasing the
 18 building material. The -- the retail sale
 19 occurs when it's -- under the previous exhibit,
 20 the retail sale occurs when they withdraw, use
 21 or consume it there; and therefore again, under
 22 -- under the statute you go to 1(c) where it's
 23 a -- the tax is based on that withdrawal, use
 24 or consumption of that tangible personal
 25 property previously purchased at wholesale.

1 Q: What problems result from the taxpayer's
 2 application of subsection 1(a)?
 3 A: I think that the -- I don't think 1(a) applies
 4 because if you -- if you read 1(a) it -- it
 5 says that the sale of retail includes the sale
 6 of construction -- sale of building materials
 7 to a construction contractor. Well it doesn't
 8 say, you know, that they can -- you know, it
 9 basically says that's a retail sale so you have
 10 to pay taxes due on that transaction. And
 11 Lowe's is -- in addition to build- -- selling
 12 building -- Lowe's is not just a contractor;
 13 Lowe's is a retailer. And so Lowe's should be
 14 purchasing at wholesale and then using and
 15 consu- -- because the statute -- the
 16 methodology behind the statute, it basically
 17 says all building material sold to a contractor
 18 is -- is sold at retail, so that would mean
 19 that every- -- like in the dishwasher example,
 20 all dishwashers they buy would be subject to
 21 tax when they bought them. And that's kind of
 22 reaching to an absurd conclusion, you know,
 23 because Lowe's is going to be reselling some of
 24 those in an ordinary sale. So I think that the
 25 statute is designed to set up a methodology

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1 where the only person that can really buy
 2 something at wholesale is a retailer. And so
 3 then you get into this situation where they buy
 4 it at wholesale here and then again as a
 5 retailer they can sell it to me without
 6 installation and pay the tax based on what they
 7 sell it to me for or they can withdraw, use and
 8 consume it and pay the tax based on its fair
 9 market value. And so the only -- only type of
 10 taxpayer that can make this initial purchase at
 11 wholesale, you know, in the -- relevant to the
 12 issues we're talking about here is a retailer
 13 and -- because a contractor has to buy
 14 everything at -- at retail.
 15 Q: And what is the Department's position regarding
 16 the application of subsection 1(e) of 12-36-110
 17 to the transactions at issue?
 18 A: Again, that's sale -- it defines a sale at
 19 retail as sale of -- of tangible personal
 20 property for the use and performance of a
 21 contract. So, I think that is trying to take
 22 care of -- while 1(a) is taking care of
 23 building material, 1(e) is taking care of those
 24 things that they may use in the performance.
 25 For example, equipment, saws and that sort of

8 (Pages 29 to 32)

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1 thing. They are the user consumer of
 2 everything they buy. So everything they sold
 3 to them, you know, is a retail sale.
 4 Q: Your Honor, at this time the Department would
 5 like to offer Respondent's Exhibit One and Two
 6 into evidence.
 7 THE COURT: All right. Respondent's Exhibit Two was
 8 that, right? Is it ---
 9 MS. WOOTEN: Both of them are up there Your Honor.
 10 THE COURT: Both of them are. Okay.
 11 MS. WOOTEN: They're kind of on top of each other.
 12 THE COURT: All right.
 13 MS. WOOTEN: We'll take them one at a time if you'd
 14 like.
 15 THE COURT: Okay.
 16 MS. WOOTEN: This is Exhibit One.
 17 THE COURT: All right. Any objection?
 18 MR. SMITH: I do not object to them as being
 19 illustrative of Mr. McCormack's opinion. I
 20 don't think they should be submitted as
 21 substantive evidence because they're contrary
 22 to the law and contrary to the facts, but they
 23 -- they do illustrate his opinion. So I do not
 24 object to them as being demonstrative; I do
 25 object to them being substantive evidence.

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1 MS. WOOTEN: Your Honor, Mr. McCormack is speaking
 2 on behalf of the Department and presenting the
 3 Department's position. This is the
 4 Department's position. I understand petitioner
 5 does not agree with our position but this
 6 Exhibit demonstrates and illustrates his
 7 testimony that he's just given in this matter
 8 on behalf of the Department.
 9 THE COURT: So you're offering them as ---
 10 MS. WOOTEN: I'm offering them as an exhibit in
 11 this matter.
 12 THE COURT: (c) and as illustrative of his
 13 testimony?
 14 MS. WOOTEN: That's correct.
 15 THE COURT: Any objection? I -- I understand your
 16 objection to this.
 17 MR. SMITH: As long as you understand the objection.
 18 THE COURT: Exactly. Certainly the Court's not
 19 going to take these exhibits as -- as if they
 20 were the law but rather simply illustrating Mr.
 21 McCormack's -- which I've actually wrote them
 22 down myself in my notes. I will go ahead and
 23 allow both One and Two.
 24 (Respondent's Exhibit's Numbered One and Two were
 25 marked for identification purposes.)

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1 MS. WOOTEN: (c) One and (c) Two?
 2 THE COURT: Yes.
 3 MS. WOOTEN: Thank you, Your Honor. Just go ahead
 4 and leave those up there. That's all for the
 5 Department, Your Honor.
 6 THE COURT: Thank you Ms. Wooten.
 7 MR. McCORMACK - EXAMINATION BY MR. SMITH:
 8 Q: Good morning Mr. McCormack.
 9 A: Good morning. Both Ms. Wooten and I are both
 10 struggling so I'll try to be heard as well.
 11 You've had a chance to review the testimony
 12 from the April 20th trial in this matter?
 13 A: Yes.
 14 Q: Okay. And -- and you've reviewed your
 15 deposition as well?
 16 A: Yes.
 17 Q: When Ms. Crawford testified the first time, I
 18 asked her some basic principals of taxation
 19 which I had asked you in your deposition; and
 20 I wanted to go over them again here, which I
 21 think we're in agreement on. The first one,
 22 Department of Revenue has no authority to
 23 create its own tax laws or to repeal or alter
 24 tax laws enacted by the legislature. And you
 25 agree with that. Is that correct?

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1 A: Yes.
 2 Q: And the Department of Revenue cannot impose
 3 interpretations of tax laws that are
 4 inconsistent or in conflict with statutes
 5 passed by the legislature. And you agree with
 6 that?
 7 A: Yes.
 8 Q: And if there's any uncertainty or ambiguity in
 9 how a tax statute should be applied to a
 10 taxpayer the uncertainty and ambiguity should
 11 be resolved in favor of the taxpayer. Do you
 12 agree with that?
 13 A: If -- if there is ambiguity, you know, you have
 14 to go by the plain meaning in the statute --
 15 Q: Sure. Sure.
 16 A: -- and the intent of the General Assembly.
 17 Q: And -- and over the course of my discussions
 18 with you this morning we're going to revisit
 19 those principals from time to time. Now, and
 20 just to clarify your understanding of South
 21 Carolina law, if you hire a contractor to
 22 install cabinets in your kitchen, that
 23 transaction is not subject to sales tax to you.
 24 Is that correct?
 25 A: If -- if a person is a true contractor, then

9 (Pages 33 to 36)

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1 the transaction between myself and the
2 contractor is not subject to tax. The tax
3 transaction is when the contractor is
4 purchasing the material.
5 Q: Okay. And that's because a sale of a
6 improvement to real property is not subject to
7 sales tax in South Carolina.
8 A: The services of improving real property is not
9 subject to sales tax, again, when you're
10 talking about a -- a -- a purchase from a --
11 excuse me, a transaction with a true
12 contractor.
13 Q: Okay. We're going to talk about that true
14 contractor thing in a minute. So the
15 contractor's purchase of the building materials
16 is what's subject to sales tax in South
17 Carolina?
18 A: That's the retail sale.
19 Q: Okay. And again the recipient of the real
20 property improvement doesn't owe any tax?
21 A: The -- the person receiving the -- the services
22 of the improvement is not subject to the tax,
23 that's correct.
24 Q: Okay. Now in your deposition I -- I made the
25 statement which you agreed with and I wanted to

1 value when it's withdrawn which is what you
2 normally sell it for.
3 Q: At which you deem to be substantially higher
4 than the cost?
5 A: I would not provide an opinion on whether it's
6 substantially higher or not. It depends on the
7 facts. But it -- it is based on fair market
8 value which would be higher than cost.
9 Q: Okay. So those two taxpayers would be treated
10 differently for performing the exact same
11 transaction?
12 A: They would -- the tax base would be different
13 because they are different types of taxpayers.
14 Q: Okay. Now you used the phrase true contractor,
15 which of course Ms. Crawford has used that term
16 as well. I think you described it earlier,
17 someone who installs everything that they're
18 involved with. In other words, they're not a
19 retailer. Do you have a different -- what --
20 what is a true contractor?
21 A: Exactly what I said there. That they're not a
22 retailer.
23 Q: Okay. And you'll acknowledge to me the term
24 true contractor appears absolutely nowhere in
25 the tax code?

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1 see if it's still correct. I -- I asked you:
2 under the Department's interpretation, if
3 you're a contractor retailer and you perform
4 contracting work you will be taxed at your cost
5 plus a markup. If you're a contractor not a
6 retailer performing the exact same service
7 you'll be taxed at your cost. Is that correct?
8 A: The -- under the statute that if you're a -- a
9 true contractor and you're not a retailer then
10 the -- the retail sale occurs when you're --
11 when you purchase the material as a contractor
12 for making those improvements. As a -- as a
13 retailer, the retail sale is when you withdraw,
14 use or consume that product from inventory or
15 from your business and that's the retail
16 transaction is based on fair market value under
17 the statute.
18 Q: Okay. So -- so just to clarify, exact same
19 thing is done, exact same kitchen cabinets
20 installed, if a -- what you call a true
21 contractor installs it he's taxed at this
22 level. If you're a contractor who also does
23 retail work, same transaction, you're taxed at
24 a substantially higher level. Is that correct?
25 A: You're taxed at your -- at the fair market

1 A: The phrase true contractor does not.
2 Q: Okay. And the Department in fact invented that
3 term. Is that correct?
4 A: I don't know whether the Department invented
5 it. That's what I call the situation.
6 Q: Did you invent it? Who invented the term true
7 contractor? Where'd it come from?
8 A: Can't -- can't speak to that.
9 Q: Okay. It's not -- no legislature ever
10 distinguished between a non-true contractor and
11 a true contractor?
12 A: The Legislation does not use those terms. The
13 -- the -- the Legislation does talk about a --
14 a -- a retail sale to a contractor, a purchase
15 by a contractor are retail sales.
16 Q: All right. Well first let's look at the term
17 contractor because the legislature does define
18 that. We talked about this earlier. This is
19 section 40-11-20 which is all the definitions
20 dealing with contractor code. And to you
21 knowledge is there any other place in the
22 entire South Carolina code that addresses
23 contractors other than here?
24 A: I can't speak to that one way or the other.
25 Q: Okay. So if we want to see what the General

10 (Pages 37 to 40)

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1 Assembly says is a contractor it would be under
2 the chapter 11 that deals with contractors.
3 Would you agree with that?
4 A: I would say that that's -- the General Assembly
5 has set forth rules for contractors in that
6 section and they provide definitions there.
7 Q: Okay. And in this tax code there is no
8 definition of contractor is there?
9 A: Not in the code. In the regulations there is.
10 Q: I understand. We're dealing with the
11 legislature at this point.
12 A: But the legislature approves all regulations.
13 Q: We're -- we're going to get to that too. Under
14 this statutory definition, when Lowe's is
15 performing an installation contract it is in
16 fact both a -- it's a prime contractor. Is
17 that correct? It's an entity which contracts
18 directly with an owner to perform general or
19 mechanical construction, and general
20 construction means installation, replacement or
21 repair of a building and all these other things
22 or improvement of any kind to real property.
23 So under those statutory definitions, when
24 Lowe's performs an installation contract for a
25 customer, it is a prime contractor. Is that

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1 correct?
2 A: When they're making improvement to real
3 property they're providing contracting
4 services.
5 Q: Okay. And you're not aware of any conditions,
6 any caveats, any exceptions, any distinctions
7 between contractors who also do retail sales
8 and contractors who don't also do retail sales
9 in this section?
10 A: Not in that section but in the sales tax code
11 I would say yes.
12 Q: In the sales tax code?
13 A: Right.
14 Q: Okay. We'll get to that. Let's look at your
15 regulations then under contractors. This
16 (indicating) was promulgated by the Department
17 of Revenue. Is that correct?
18 A: Yes.
19 Q: And it defines what building materials are.
20 A: Yes.
21 Q: And it's very broadly defined and includes, if
22 you go all the way down, all other tangible
23 personal property which becomes part of real
24 property.
25 A: Yes.

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1 Q: So when Lowe's performs an installation
2 contract for a customer, makes a home
3 improvement for the customer, it is consuming,
4 utilizing building materials under this
5 regulation. Is that correct?
6 A: Yes. When they withdraw from inventory or use
7 or consume it they're utilizing building
8 materials.
9 Q: Okay. Here's another regulation, 117-314.
10 Under this regulation, sales of building
11 materials to contractors for resale or use in
12 the form of real estate are retail sales in
13 whatever quality -- quantity is sold. That's
14 a regulation promulgated by the Department. Is
15 that correct?
16 A: Yes.
17 Q: And so when building materials, which we know
18 are what Lowe's consumes when it performs
19 installation contracts, are sold to Lowe's as
20 a contractor, and we know under the code
21 section they're a contractor, that is a retail
22 sale under this regulation is it not?
23 A: I would say when -- not when they're sold to
24 them because they are a retailer as well, but
25 I would say when they withdraw, use or consume

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1 from inventory that particular retail sale by
2 definition is -- is the sale that applies
3 there.
4 Q: Okay. Just -- is there any caveat? Is there
5 any exception? Is there any condition on this?
6 That seems quite a universal -- sales of
7 building materials to contractors. Wouldn't
8 that cover every sale of building material to
9 every contractor?
10 A: But then you start getting -- because if you
11 don't look at the statute as a whole you start
12 getting into absurd results. Because if -- if
13 that's the case, then all those dishwashers
14 that Lowe's buys are building materials. And
15 so even though they're going to sell some of
16 them they're building materials. And so I
17 don't think the General Assembly intended when
18 they said the sale of retail includes building
19 materials to a contractor, to include a -- a --
20 a -- all sales to a retailer because then the
21 retailer is going to be reselling those and
22 that's why they set up the withdrawal for use
23 provision.
24 Q: And I understand that's your opinion. There's
25 no caveat or condition or exception to this

11 (Pages 41 to 44)

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1 regulation is there?
 2 A: No. It's a sales of building materials. It --
 3 as mentioned earlier, it depends on what sale
 4 you're talking about and the Department's
 5 talking about the withdrawal, use or
 6 consumption, that retail sale.
 7 Q: Okay. Now you once signed an installation
 8 contract with Lowe's --
 9 A: Excu- --
 10 Q: -- to install a dishwasher, did you not?
 11 A: Excuse me. I didn't hear you.
 12 Q: You once signed an installation contract with
 13 Lowe's to install a dishwasher.
 14 A: Yes. I believe I mentioned that in my
 15 deposition.
 16 Q: You did. And you didn't pay any sales tax on
 17 that transaction.
 18 A: No. The gentleman said that there was no sales
 19 tax on that transaction but I knew he was
 20 wrong. There's sales tax on the transaction.
 21 Q: Did you think you owed sales tax on that
 22 transaction?
 23 A: I did not think I owed sales tax on the
 24 transaction because the sales tax is imposed
 25 upon the retailer. It's not imposed upon the

1 from Lowe's, they listed the sales tax they
 2 paid to Lowe's and then they listed their --
 3 their cost per hour. But they were still
 4 making an improvement to real property to me.
 5 That's just how they did their invoices so
 6 that's why I would have paid it if Lowe's would
 7 have charged it -- on it to me as well.
 8 Q: I -- I -- I'm not trying to be a pest. We had
 9 some -- if you've read the trial transa- or
 10 trial transcript, there was some confusion as
 11 to the basis of the tax from the Department's
 12 viewpoint. So I'm trying to pin down the
 13 Department's position. And you've given some
 14 testimony today and I think I understand it and
 15 I -- I want to confirm because I'm going to
 16 ask you some questions about the prior
 17 testimony. But from your understanding of the
 18 Department's position, the transaction when
 19 Lowe's enters into an installation contract
 20 with a customer, that is not a retail sale of
 21 tangible personal property to the customer.
 22 The homeowner is not subject to sales tax on
 23 the real property improvement and the customer
 24 doesn't owe any sales tax. Is that the
 25 Department's position?

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1 consumer in South Carolina.
 2 Q: Okay.
 3 A: So either way, however you regard it, whatever
 4 type of sale your concern is I'm not legally
 5 liable for the tax. They can pass it on to me
 6 but I'm not legally liable, the retailer is.
 7 Q: Well if Lowe's tried to collect sales tax from
 8 you on that transaction would you have paid it?
 9 A: Yes.
 10 Q: Okay. You were buying a real property
 11 improvement were you not?
 12 A: I was buying improvement to real property, yes.
 13 Q: Okay. Which you have indicated is not subject
 14 to sales tax in South Carolina. So I'm -- what
 15 I'm trying to determine is did you believe that
 16 that transaction was handled correctly as to
 17 you the customer? Did you owe sales tax on it
 18 or not?
 19 A: I did not owe sales tax on it, again, the
 20 retailer did. What my point is that -- that --
 21 that contractors can do things a lot of
 22 different ways. I've had contractors come to
 23 my house who have given me an invoice that
 24 listed material and list their -- the cost of
 25 materials and they actually did purchase it

1 A: The Department's position is that when Lowe's,
 2 and after making that contract, when they
 3 withdraw, use or consume that building
 4 material, that's the transaction that's subject
 5 to tax so that the -- the transaction of
 6 entering into that contract with me is a -- is
 7 a improvement to real property so that it's not
 8 taxed on -- on a sale - it's not considered a
 9 sale to me. It's considered a deemed sale to
 10 Lowe's itself and therefore it's based on their
 11 withdrawal, use or consumption of that tangible
 12 personal property --
 13 Q: Okay.
 14 A: -- based on the fair market value.
 15 Q: I -- I think we're in understanding but what I
 16 -- my question was focused on the customer.
 17 The customer doesn't owe any tax. Lowe's you
 18 claim owes the tax because they're using,
 19 consuming -- they -- they're the last consumers
 20 of the tangible personal property.
 21 A: Yes.
 22 Q: Before it turns into real --
 23 A: Yes. Lowe's is a consumer. My only point
 24 earlier when you asked me about whether I would
 25 pay the tax on it is that sometimes contractors

12 (Pages 45 to 48)

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1 do list out tax.
 2 Q: Okay.
 3 A: So that -- that was -- you asked me that
 4 question and I answered that question.
 5 Q: That's just passing it on.
 6 A: It -- it wasn't a legal opinion. It was just
 7 you asked me if I would pay.
 8 Q: Understood. Okay. And there -- there are
 9 actually two cases that you're relying on as I
 10 understand this, Colonial Stores, which we're
 11 going to talk about, and the Graystone Catering
 12 Company case. You're familiar with that one
 13 too?
 14 A: Yes.
 15 Q: And you believe that those two taken together
 16 form the basis for the Department's position as
 17 expressed by you today?
 18 A: I think the primary one is -- is -- is Colonial
 19 Stores but I think, you know, Graystone
 20 Catering deals with the same type of issue as
 21 to whether someone's using or consuming
 22 something.
 23 Q: Okay. And the Graystone was about 25 years
 24 after Colonial Stores. Colonial Stores I think
 25 is '69 and Graystone was '97 so it's the latest

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1 statement as to how it is to be interpreted.
 2 Is that correct?
 3 A: The -- I don't know whether that's the latest
 4 statement. I think the -- because I can't
 5 remember what level the Graystone Catering case
 6 was at. I know that the Colonial Stores was a
 7 Supreme Court case I believe. I just don't
 8 remember wha- -- what level the Graystone
 9 Catering case was at.
 10 Q: Okay. Now we'll go into statutes now. That's
 11 always fun. 12-36-90, and this is -- we talked
 12 a good bit about this with Ms. Crawford and Mr.
 13 Polk, about the gross proceeds of sales, how
 14 you measure what the tax is due on. And the
 15 Department's position as stated by you is it's
 16 C, which is the fair market value of tangible
 17 personal property previously purchased at
 18 wholesale which is withdrawn from the business
 19 or stock and used or consumed in the business
 20 or used or consumed by any person withdrawing
 21 it. And B is not applicable from your
 22 viewpoint. Is that correct?
 23 A: Well I mean B would be applicable in the one
 24 sense that on that fair market value when you
 25 define it as what you normally sell it for you

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1 cannot deduct any of the cost of goods out of
 2 there. But essentially the key provision here
 3 is C, based on fair market value.
 4 Q: Okay. Okay. And so what -- what the
 5 Department's position is, it is assuming every
 6 item that was consumed or used in every
 7 installation contract that was performed in
 8 South Carolina during the audit period involved
 9 building materials that were previously
 10 purchased at wholesale and withdrawn from the
 11 business or stock. Is that correct?
 12 A: Yes.
 13 Q: Okay. And since the withdrawal is the deemed
 14 retail sale the withdrawal would have to occur
 15 in South Carolina would it not?
 16 A: No.
 17 Q: Okay. So what you're saying is if it's
 18 withdrawn outside of South Carolina and brought
 19 into the state that would not be use tax or
 20 would it be a use tax?
 21 A: No. It's a sales tax because the definition of
 22 retail sale under 12-36-110 defines a retail
 23 sale to include the withdrawal, use or
 24 consumption of tangible personal property
 25 previously purchased at wholesale.

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1 Q: Okay. So you're interpreting this to -- to
 2 trigger -- be triggered by an event that occurs
 3 outside the state of South Carolina.
 4 A: No. It's triggered by the use that occurs in
 5 South Carolina.
 6 Q: So it's not the withdrawal then?
 7 A: This -- what I'm saying is that this provision
 8 establishes the amount on which the tax is
 9 based. Code section 12-36-110 establishes the
 10 transaction upon which it was based. So if it
 11 was based on the withdrawal, use or consumption
 12 of tangible personal property previously
 13 purchased at wholesale which is used or
 14 consumed by the business or the person, here
 15 it's establishing a base and saying, okay, fair
 16 -- it's based on the fair market value of items
 17 that you withdraw and you use and consume. So
 18 the use or consumption is the -- is the retail
 19 sale transaction deemed by law and this fair
 20 market value occurs after you withdraw and use
 21 it or consume it.
 22 Q: Okay. Now from your position as the policy guy
 23 for the Department, if one were to say that the
 24 sale of the real property improvement to the
 25 customer is the taxable transaction and that

13 (Pages 49 to 52)

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1 the tax is owed on the gross proceeds of the
 2 sale of the real property improvement to the
 3 customer and the customer owes the tax, that
 4 would be wrong, wouldn't it?
 5 A: What I'm say- -- what the -- the Department is
 6 not saying that it's due on the -- on the
 7 transaction, it's due on the withdrawal for
 8 use.
 9 Q: Okay.
 10 A: At what we call the withdrawal for use which is
 11 the withdrawal, use or consumption.
 12 Q: So reply- -- relying on this would be wrong,
 13 would it not, as a matter of law from your
 14 understanding of the law?
 15 A: Well, relying on the idea that the -- that you
 16 have a -- a -- a sale under the statute, that
 17 it's the -- that you have a sale to the
 18 customer in the case of a installed sale, what
 19 you have is a use by the withdrawal, use or
 20 consumption by a retailer, in this case Lowe's,
 21 is the -- is the retail transaction that we're
 22 dealing with.
 23 Q: Okay. And you -- you understand the Department
 24 has slapped Lowe's with a \$300,000 negligence
 25 penalty in this assessment?

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1 A: That's my understanding from reading the
 2 transcript.
 3 Q: And is it your understanding it's that because
 4 from the Department's viewpoint Lowe's should
 5 have known what the Department's position was?
 6 A: I don't recall but I think I remember from the
 7 -- from the transcript that there was an issue
 8 about whether they had been discussed in a
 9 previous audit or not, but I'm not sure.
 10 Q: Okay. Now again you've read Ms. Crawford's and
 11 Ms. Krull's testimony at trial. Did you also
 12 read Dr. Van Bolk's testimony, the Department's
 13 designated expert witness?
 14 A: Yes. I've read all the -- all the testimony.
 15 Q: And Ms. Crawford and Ms. Krull were the ones
 16 who decided to assess tax on the presumed
 17 markup. Is that correct?
 18 A: They were trying to come to the -- I believe
 19 they were trying to come to what they normally
 20 sell the items for, yes.
 21 Q: But they -- they came up with the assessment.
 22 You didn't do the assessment. They did the
 23 assessment.
 24 A: No, I did not do the assessment.
 25 Q: Okay. And they were the ones who decided to

1 impose the negligence penalty. Is that
 2 correct?
 3 A: Well either they or their supervisors, I guess.
 4 Yes.
 5 Q: Okay. I'm going to read just little excerpts,
 6 and I invite you read along if you'd like.
 7 This is from the transcript. Let's first start
 8 with Ms. Crawford's testimony. Let's go to
 9 218.
 10 A: You said 218?
 11 Q: Yes, sir. Starting at the end of line 20. As
 12 I understand your testimony that you just gave,
 13 you consider home improvement contracts as two
 14 separate transactions. There's a retail sale
 15 of tangible personal property to the customer
 16 followed by an installation service by Lowe's
 17 of these goods that belong to the customer.
 18 And her response was, that's correct. And then
 19 down on line 12 I say, so you made the -- and
 20 she says, yes. You've made the decision to
 21 segregate the transaction into two separate
 22 transactions without every seeing a contract.
 23 And her response is, that's exactly right. And
 24 then lets go to page 221, line 11. So from
 25 your point of view is there anything that could

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1 be put in the contract that would change your
 2 position? And her response is, I don't think
 3 so. And then let's go to page 230, line 10.
 4 So the trigger is not the withdrawal, it's the
 5 sale of tangible personal property to a
 6 customer. That's currently what the
 7 Department's position is. And she says, yes.
 8 And then I go on, page 231, line 16, I plead,
 9 help me, what is the Department's position?
 10 And she says, the Department's position it's --
 11 it's a retail sale. Now her testimony is
 12 completely inconsistent with your testimony is
 13 it not?
 14 A: Well I can understand where she's coming from
 15 but I think the tax is based on the withdrawal,
 16 use or consumption because that is a retail
 17 sale by definition.
 18 Q: And under her position when you bought the
 19 installed dishwasher from Lowe's you would have
 20 owed sales tax on that would you have not?
 21 A: Again, if you consider it a sale and
 22 installation, the transaction would have been
 23 subject to the tax but I would not have owed it
 24 because, again, I'm not legally liable. They
 25 can pass the tax on but, again, I'm not legally

14 (Pages 53 to 56)

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1 liable.
 2 Q: So her position was legally wrong was it not?
 3 A: Like I said I can understand where it's coming
 4 from because you -- you're -- if you go by the
 5 statute on the withdrawal, use or consumption
 6 and you go by the regulation based on what you
 7 normally sell it for, you should essentially
 8 come to the same position. Because if you're
 9 selling that dishwasher for \$500 and you're
 10 separately stating out the installation labor
 11 and -- or you're -- it's -- my testimony is
 12 you're withdrawing, using and consuming that
 13 dishwasher and you normally sell it for \$500,
 14 that should be the basis for the tax. So I can
 15 understand where -- where she's coming from
 16 with the confusion.
 17 Q: But it's wrong, is it not?
 18 A: I -- I think the position is that the tax is
 19 based on the withdrawal, use or consumption;
 20 yes.
 21 Q: Had Lowe's collected sales tax from its
 22 customers, that would be a wrongful collection
 23 of sales tax would it not?
 24 A: Well again, the law doesn't say that they can't
 25 pass that tax on. The -- that doesn't refuse

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1 them to tax and tax on just like the contractor
 2 I mentioned earlier that I used. He passed the
 3 tax on to me as part of his cost. That's how
 4 he did that. Like I said, I'm not sure that's
 5 a -- a -- an illegal act if they pass that tax
 6 on because it is a retail sale.
 7 Q: So you're -- the Department's position is a tax
 8 -- a transaction that is not subject to sales
 9 tax, Lowe's could still charge the customer for
 10 sales tax on that transaction even though as a
 11 matter of law it is not owed?
 12 A: I'm just saying that that's part of their cost.
 13 If they say that that's part of their cost then
 14 they can, you know --
 15 Q: They could bury it in their cost but they
 16 couldn't charge it as a sales tax could they?
 17 A: No. It's -- it's -- it's an expense item
 18 essentially what it is. They can --
 19 Q: Okay.
 20 A: -- charge it. It's just whether they --
 21 whether they -- it's not really the tax on the
 22 transaction that we're dealing with.
 23 Q: So had Lowe's charged you sales tax on your
 24 installed dishwasher and it was listed on the
 25 transcript as sales tax that they collected and

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1 remitted to the Department, that would be wrong
 2 as matter of law wouldn't it?
 3 A: I think the transaction, it would be subject to
 4 tax as a withdrawal for use. Again, them
 5 passing an expense on to me I don't think it's
 6 necessarily wrong.
 7 Q: But they can't collect it as a tax can they?
 8 MS. WOOTEN: Objection Your Honor. Asked and
 9 answered.
 10 MR. SMITH: I don't believe he's answered the
 11 question. I'm trying to get an answer.
 12 MS. WOOTEN: I believe he's asked the same question
 13 three times and Mr. McCormack has given him an
 14 answer. He may not agree with the answer but
 15 he's answered his question.
 16 THE COURT: I'm not -- I -- I -- I'm going to have
 17 to agree. I don't -- I don't -- he's provided
 18 a response but I don't know that it has been
 19 responsive to the question. So I am going to
 20 allow him to ask the question again. And Mr.
 21 McCormack, I would ask, Mr. McCormack, that you
 22 answer the question.
 23 MS. WOOTEN: Thank you.
 24 Q: So the question, Mr. McCormack, is whereas they
 25 could incorporate the tax that they paid as

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1 part of their cost and charge it as a cost to
 2 you, they cannot charge you separately sales
 3 tax and remit it to the Department if you don't
 4 owe the sales tax, can they?
 5 A: They -- again, they can -- the taxable
 6 transaction is when they withdraw from
 7 inventory and it's based on fair market value.
 8 And so the transaction between me and the
 9 customer, what I'm paying them is not what is
 10 the transaction that's taxable. It's when they
 11 withdraw that it is taxable. All I'm saying is
 12 that the -- you know, if they built it into
 13 their cost or they line-itemed their cost just
 14 like the contractor that I dealt with that
 15 improved my house did that, then they can -- I
 16 don't know if there's anything wrong with that
 17 in saying this is -- these are all our costs
 18 and performing this job for you. But the legal
 19 transaction that is subject to the tax is a
 20 withdrawal, use or consumption.
 21 Q: And -- and you've read about class actions that
 22 have been filed on behalf of consumers against
 23 retailers for collecting taxes where taxes
 24 aren't owed. That happens doesn't it?
 25 A: Yes.

15 (Pages 57 to 60)

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1 Q: And so retailers have to be careful. They
2 can't collect a tax if it's not owed. If they
3 do they open themselves up to liability. Is
4 that correct?
5 A: No -- yes, I understand that.
6 Q: Okay. And so again, had Lowe's followed the
7 directive of Ms. Crawford, they would be
8 opening themselves up to class-action liability
9 would they not?
10 A: I don't think she said in her testimony about
11 adding the tax on. I think she just said what
12 she thought the tax was due on.
13 Q: Well then let's see what Ms. Krull said if
14 there was any confusion on that point. She is
15 the supervisor of Ms. Crawford. Is that
16 correct?
17 A: From what I understand, yes.
18 Q: Let's go to page 255, line 8, so is it the
19 Department's position that it is a sale of
20 tangible personal property to the customer?
21 Answer, it is a retail sale of tangible
22 personal property. Let's go to 257, line 12,
23 but if I contract with Joe the contractor --
24 big contractor with a warehouse full of stuff
25 that he's buying in stores I owe no sales tax,

1 says, yes proceeds from the sale. And I finish
2 my sentence, of tangible personal property.
3 And says, we don't have to go and figure out
4 what fair market value is because that's what
5 they charge the customer. Question, so
6 everything that we've spent this morning on C
7 is, and she responds, was a waste of time.
8 That was the Department's position six weeks
9 ago. This is a waste of time, this is it, it's
10 what they charge a customer and the customer
11 owes the tax. Now what you're telling me today
12 is that everything that the Department said on
13 April 20 was wrong as a matter of law. Is that
14 correct?
15 A: What I'm saying is, is that the idea that it
16 was a sale and installation and not a
17 withdrawal for use is -- is incorrect; that it
18 is a withdrawal, use or consumption based on
19 fair market value. But looking at her point
20 here I think the last point that you made is
21 fair market value is that the statute -- excuse
22 me, the regulation defines what fair market
23 value is and so I can see where she could look
24 at that as a, quote, waste of time, because the
25 regulation which has been approved by the

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1 but if I go to Lowe's and have the exact same
2 work done, sign the same contract, I owe sales
3 tax. Is that the Department's position? And
4 she says, the Department's position is that
5 when you go to Lowe's and you purchase
6 something that you want installed in your
7 house, that the cost of the item is a sale of
8 tangible personal property. The installation
9 labor is exempt from that sale. And so my
10 question, so the answer's yes, if I have Joe
11 the contractor no tax, Lowe's the contractor
12 tax? Answer: Right, Lowe's is acting as a
13 retailer. Let's go further in case there's any
14 misunderstanding. Question, so -- and I was
15 pointing at this B versus C at the time, it's
16 the proceeds from the sale --
17 MS. WOOTEN: I'm sorry to interrupt. Can you tell
18 me where you are.
19 MR. SMITH: Line 15, I'm sorry.
20 MS. WOOTEN: On what page?
21 MR. SMITH: 259, --
22 MS. WOOTEN: Thank you.
23 MR. SMITH: -- line 15. I'm sorry.
24 MS. WOOTEN: That's okay.
25 Q: So it's the proceeds from the sale, and she

1 General Assembly says it's what you normally
2 sell it for.
3 Q: Mr. McCormack, she was relying on a completely
4 different statutory section than what you're
5 relying on was she not?
6 A: The -- she was calling it a sale and
7 installation, yes.
8 Q: Okay.
9 A: But -- but again, you know, I can see where the
10 division is that you've got a regulation that
11 says what you normally sell it for so.
12 Q: Okay. This question I suspect is in the
13 Judge's mind, whose testimony should we believe
14 is the Department's position? What is the
15 Department's position, B, C? How is Lowe's
16 possibly supposed to know what the Department's
17 position was?
18 A: Well I think that the -- what you do is you
19 have a statute which says that a -- the only --
20 allows the only mechanism for someone to
21 purchase something at wholesale is that of a
22 retailer. It does not allow that mechanism for
23 a contractor. So, it only allows a retailer in
24 this -- relative to these facts to purchase
25 something at wholesale. Then the statute says

16 (Pages 61 to 64)

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1 that that is based on -- then the statute
 2 allows the only mechanism for the retailer to
 3 make a choice, am I selling it or am I using
 4 it? In this case they're using it as a
 5 withdrawal, use or consumption. That statute
 6 therefore puts it on fair market value. So
 7 allowing that mechanism, the regulation
 8 therefore defines that as what you normally
 9 sell it for. So I think what you rely on is
 10 the statute and that they are -- because
 11 they're in the -- and one of the key things in
 12 the statute is in the definition of sale and
 13 retail. When it defines a retail sale to
 14 include the withdrawal, use or consumption
 15 something previously purchased at wholesale is
 16 by anyone. So anyone that does that and then,
 17 you know, purchases it wholesale then uses it
 18 is subject to the tax is -- makes that a retail
 19 sale. And therefore you get down to item C
 20 under 12-36-90 as being the fair market value
 21 and then you get to the regulation 117.309.17
 22 which has been approved by the General
 23 Assembly. It's saying that value is what they
 24 normally sell it for.
 25 Q: Okay. For purposes of going forward we will

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1 assume then since you're the last one that
 2 testified for the Department that your position
 3 is the Department's position, so it's C. We'll
 4 accept that. So under C Lowe's is not the
 5 seller, it is the deemed purchaser of the
 6 building materials. Is that correct?
 7 A: Well I guess you could say they're the deemed
 8 seller and the deemed purchaser in that
 9 situation because they're -- they're purchasing
 10 it from themselves. So it's a deemed sale to
 11 --
 12 Q: They're selling it to themselves?
 13 A: It's a deemed sale to themselves, I guess you
 14 could call it that.
 15 Q: Okay so they are the final user -- consumer of
 16 the building materials?
 17 A: Yes.
 18 Q: No further sale is contemplated?
 19 A: Yes.
 20 Q: There's no resale to a retail customer that's
 21 contemplated?
 22 A: Yes.
 23 Q: And there's no further markup that's
 24 contemplated?
 25 A: Well, it's just -- it just -- it states there

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1 fair market value.
 2 Q: Okay. But Lowe's now is the se- -- the buyer.
 3 It's not going to mark it up anymore. It's --
 4 it -- it owns it. Is that correct?
 5 A: Under the deemed sale it's based on fair market
 6 value.
 7 Q: Okay. One other thing. You read Dr. Van
 8 Bolk's testimony.
 9 A: Yes.
 10 Q: Okay. Well, and he gave an opinion based on
 11 his reading of the regulation that in this
 12 particular case fair market value should be the
 13 retail value and not the acquisition cost. You
 14 read that?
 15 A: I believe so, yes.
 16 Q: Okay. And on page 314, line 18, so -- this is
 17 my question, so you're assumption for your
 18 opinion customer received tangible personal
 19 property when he paid the invoice at the cash
 20 register. Answer, he knows how much it was,
 21 the amount is certain, the date is certain and
 22 the item is certain. Question, okay, and
 23 you're assuming the customer is the final end
 24 user of the tangible personal property and not
 25 Lowe's? And he answers, it could be a

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1 customer, it could be the installer that works
 2 for the customer. And then down on line 16 of
 3 315, well these assumptions that you just gave
 4 me are inconsistent with your experience
 5 dealing with a contractor are there not? And
 6 his answer is, if they are they are. I can't
 7 help it. So the basis of Dr. Van Bolk's entire
 8 opinion was that the homeowner is the retail
 9 customer, not Lowe's. He was focusing on the
 10 wrong level of trade was he not?
 11 A: I don't know whether he actually answered that.
 12 He said it could be the customer, it could be the
 13 installer that works for the customer which
 14 would be Lowe's.
 15 Q: Oh so you think he was being unclear on that?
 16 A: Well he didn't -- he didn't answer that -- that
 17 question there.
 18 Q: All right. I think the testimony will stand on
 19 its own, but if he were believing a taxable
 20 event was the customer signing the installation
 21 contract that would be a wrong assumption,
 22 wouldn't it?
 23 A: The taxable event would be the withdrawal, use
 24 or consumption which is that if you're talking
 25 about level of trade that's -- that -- at that

17 (Pages 65 to 68)

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1 point that's the level of trade which is a
 2 retail sale by definition. The General
 3 Assembly has said the level of trade is the
 4 retail trail [sic]. It just happens to say it's
 5 a deemed retail sale.
 6 Q: And Mr. McCormack, I'm absolutely clear on what
 7 your opinion is on that. To -- to move it
 8 along I'm asking specific questions and if you
 9 can answer those questions I know that's your
 10 opinion, but if Dr. Van Bolk were to base his
 11 opinion on the assumption that the customer's
 12 signing of the installation contract is the
 13 taxable event that would be wrong would it not?
 14 A: The -- the signing of it is not the taxable
 15 event.
 16 Q: Thank you. An exhibit that came out during the
 17 April 20 hearing, I think it's -- Nicky, was
 18 this 64?
 19 MS. WOOTEN: Yes, it was.
 20 Q: Okay. It's (c) 64, but I'll give you this one,
 21 which is a news story.
 22 MR. SMITH: Your Honor, I have loose one here, so if
 23 you --
 24 THE COURT: Okay. Thank you.
 25 Q: Are you familiar with that news story?

1 investigate the sales tax issue with Lowe's.
 2 Now you -- you read Mr. Price's testimony at
 3 the first hearing. Is that correct?
 4 A: Um.
 5 Q: Director of Sales Tax for Lowe's? He was the
 6 person --
 7 A: Yes. I believe so, yes.
 8 Q: Okay. He -- he testified that he was told
 9 during the first audit that the Department
 10 considered permanent home improvements to be
 11 taxable retail sales of tangible personal
 12 property which is apparently entirely
 13 consistent with what Mr. Brazell was telling
 14 News 19 around that same time. As far as you
 15 know is there any reason to dispute that?
 16 A: As far -- I can't answer one way or the other
 17 what was discussed between --
 18 Q: Okay.
 19 A: -- the auditor and the -- and the Director of
 20 Tax at that time.
 21 Q: If the auditor and if Mr. Brazell were telling
 22 the world and telling Lowe's that sales of
 23 permanent home improvements were subject to
 24 sales tax to the customers they were wrong were
 25 they not?

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1 A: I think something -- I can remember reading
 2 something in the deposition I think there was
 3 discussion about this I think but I can't
 4 remember --
 5 Q: Okay. Take a moment and read it.
 6 A: -- what was the discussion.
 7 Q: Have you read it?
 8 A: Yes.
 9 Q: Okay. You were with the Department at the
 10 time. Do you remember when this was on the
 11 news after 2005?
 12 A: No, I don't recall this one.
 13 Q: This probably came out during the first audit
 14 that we're talking about. And it deals -- the
 15 controversy was someone who bought an installed
 16 dishwasher from Lowe's. Same story that you
 17 did. And Lowe's told the customer as they
 18 apparently told you that permanent home
 19 improvements were not subject to sales tax in
 20 South Carolina. And the Department's official
 21 spokesman, Danny Brazell, went on camera and
 22 told News 19, it's just not true, when you talk
 23 home improvement, no, there's nothing that gets
 24 an exception. And he adds, it looks like some
 25 customers just got lucky; and he promised to

1 A: Well I'm not sure that's -- I'm not sure that's
 2 what Mr. Brazell meant because later on he
 3 says, there's nothing wrong with telling a
 4 customer they don't owe sales tax. The
 5 retailer would have to pay the tax. He's not
 6 saying what the -- the tax is on I think. I
 7 think he's just saying -- you know, the
 8 transaction I just think he is saying there's
 9 tax due on the transaction -- on a transaction
 10 involving that home improvement.
 11 Q: Well he says, when you talk home improvements,
 12 no, there's nothing that gets an exemption.
 13 A: Well I could read that many ways because like
 14 I said if -- if I -- if there's nothing that
 15 gets an exemption I -- tax is going to be due
 16 when the -- when the -- when the person doing
 17 the home improvement either purchases or
 18 withdraws it from inventory, depending on what
 19 type of taxpayer they are. So I think, like I
 20 said, that's -- I don't think he's speaking in
 21 technicalities there. I think he's just
 22 speaking in -- in generalities that tax is
 23 going to be due on that material. It's just a
 24 matter of what -- what transaction you're
 25 talking about taxing. Because he's a

18 (Pages 69 to 72)

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1 spokesman. He's not a -- a technical tax
 2 person trying to explain things in a very
 3 technical way. He's just trying to make the
 4 point that the tax is due on -- on the
 5 material. It's just he doesn't say what
 6 transaction.
 7 Q: Did you consider yourself lucky when you didn't
 8 pay sales tax on your deal?
 9 A: No, because I knew they were paying tax on it
 10 anyway.
 11 Q: Okay. So anyway, if in fact the Department
 12 told Lowe's at the end of the first audit that
 13 they should have treated installed sales as
 14 sales of tangible personal property to
 15 customers and collect sales tax from customers,
 16 that advice would have been wrong would it have
 17 not?
 18 A: Yes. I would disagree with that advice.
 19 Q: Okay. Does it surprise you -- I mean that was
 20 eleven years ago, this audit goes back eight
 21 years, that the Department today still doesn't
 22 know exactly that -- or can't agree among
 23 itself as to the basis on why a tax is owed
 24 here?
 25 A: Well like I said, I think because you -- you

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1 know, in my example earlier I think you come to
 2 the same position. I think that that would be
 3 the reason for any kind of confusion there,
 4 because if you're paying the tax on basically
 5 what you normally sell it for then, you know,
 6 you should come to the same conclusion as far
 7 as the basis upon which the tax is due because
 8 the withdrawal is on fair market value which is
 9 defined at what you normally sell it for
 10 allowing for customer discounts. And the --
 11 Q: Okay.
 12 A: If you're doing a sale and installation then
 13 it's whatever you sell it for, which is what
 14 you normally sell for, would come the -- should
 15 come to the same answer. So, I could
 16 understand the confusion there but I think by
 17 law it's on the withdrawal, use or consumption
 18 of the tangible personal property based on fair
 19 market value.
 20 Q: Okay. There's a second fundamental belief that
 21 Lowe's and the Department disagree on. It is
 22 your belief that the sales tax on the fair
 23 market value is higher than the tax on the
 24 gross proceeds of sale between the manufacturer
 25 and Lowe's.

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1 A: Well, again, it goes back to the Colonial
 2 Stores case where they -- they talked about
 3 something -- tax being due on something in cost
 4 but then they talked about being a different
 5 valuation method on something that was
 6 withdrawn from inventory that was previously
 7 purchased at wholesale.
 8 Q: I understand and you believe that difference,
 9 it's higher?
 10 A: Yes.
 11 Q: In this case 40 percent higher?
 12 A: The -- I believe is based on what they normally
 13 sell an item for. So I believe that that's
 14 what they were trying to get to when they --
 15 when they did the markup.
 16 Q: Okay. Well let's first look at the Graystone
 17 case. And you're familiar with this case.
 18 Is that correct? It's something -- it's a core
 19 principal on which the Department is basing its
 20 assessment on Lowe's. Is that correct?
 21 A: Again, like I said I don't know whether it's a
 22 core principal on Lowe's but you could, I
 23 believe, apply to other stores, but it's a
 24 issue that deals with, if I remember correctly,
 25 withdrawal for use.

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1 Q: Correct. In this case Graystone Catering
 2 managed an Embassy Suites Hotel. And Embassy
 3 Suites, when you stay there, they offer free
 4 breakfast buffet. And so when customers would
 5 go in they would pay for the room and they'd be
 6 assessed a seven percent occupancy tax on their
 7 room rate and they'd get their free breakfast
 8 and they'd leave. And the Department came
 9 after Graystone Catering and said, well in
 10 addition to that occupancy tax we're going to
 11 assess sales tax on the breakfast that you
 12 didn't charge for because, and they said,
 13 Graystone does not bill separately for the
 14 food, therefore the last transaction occurred
 15 when the food and drink items were withdrawn
 16 from inventory. And that was the basis for the
 17 tax was it not?
 18 A: Yes. They -- they -- when they withdraw it
 19 from inventory that's the basis for the tax.
 20 Q: And they were relying on 12-36-90(c)?
 21 A: Yes.
 22 Q: Okay. And so under your theory then, what they
 23 should have assessed the tax on would have been
 24 what the retail price of the breakfast would
 25 have been to the customers had they charged for

19 (Pages 73 to 76)

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1 it. Is that correct?
 2 A: Can you repeat that question?
 3 Q: What the tax, from your point of view, would
 4 have been is on the retail price of the
 5 breakfast if they didn't charge for, but had
 6 they charged at retail what the customers would
 7 have paid.
 8 A: What they normally sell the breakfast for, yes.
 9 Q: Okay. That's what it should have been from
 10 your interpretation?
 11 A: Yes.
 12 Q: It would not be on the wholesale cost that
 13 Graystone Catering paid. Is that correct?
 14 A: No. Like I said, as long as they're buying the
 15 food -- once they buy it at wholesale then it's
 16 based on the withdrawal for use in this case.
 17 Q: Okay. Well let's look at page 2 here.
 18 Graystone argues by paying seven percent based
 19 upon the room rate plus five percent based on
 20 the wholesale cost of the food and beverages it
 21 is paying taxes twice on the same goods. And
 22 the Court upheld that assessment on the
 23 wholesale cost. And the Court went further and
 24 said, you can avoid having to pay the tax on
 25 the wholesale cost by billing the customers and

1 Department said, yes you do because that's a
 2 deemed retail sale of the goods when you
 3 withdrew it because you didn't bill for it.
 4 And so the assessment at cost was upheld. Was
 5 the court wrong?
 6 A: Well the -- the controlling case here is
 7 Colonial Stores, so if the -- if the tax was
 8 based on their cost of the food then that would
 9 be wrong because it's based on their withdrawal
 10 for use and the Colonial Stores case would be
 11 the controlling case --
 12 Q: Okay so --
 13 A: -- since it was with the Supreme Court.
 14 Q: Am I correct then that the Department's
 15 position is inconsistent with and contrary to
 16 the Court of Appeals' interpretation of this
 17 statute in the Graystone case?
 18 A: I think our position is consistent with the
 19 Supreme Court and Colonial Stores. Again if
 20 the -- if this tax was based on the wholesale
 21 cost of the -- the items in this particular
 22 Graystone case then that would be -- that would
 23 be wrong.
 24 Q: Okay so I guess the Department's been ignoring
 25 the Court of Appeals' ruling in this case?

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1 collecting tax on the retail price, but since
 2 you didn't do that we're going to assess you on
 3 your costs. This is the Court of Appeals
 4 interpreting this statute and they measure fair
 5 market value as the acquisition cost paid by
 6 Graystone Catering. Is that correct?
 7 A: Could you point out where you're reading?
 8 Q: Yes, sir. That (indicating) sentence.
 9 A: Okay.
 10 Q: Was the Court wrong?
 11 A: Well like I said, I don't whether the -- I
 12 don't know whether the misstatement here or
 13 they're stating the facts of what Graystone
 14 Catering is stating but the -- the -- the tax
 15 is due on the withdrawal for use from inventory
 16 based on fair market value.
 17 Q: Which was determined in this case to be the
 18 cost was it not?
 19 A: I don't know whether they're making a
 20 determination there or whether they're making a
 21 statement of fact there.
 22 Q: Well the challenge was against the assessment
 23 at all. Graystone Catering said, we shouldn't
 24 have to pay a second tax on the cost that we
 25 incurred in buying breakfast goods. And the

1 A: I'm thinking that the Department is looking at
 2 the controlling case which would be the Supreme
 3 Court case.
 4 Q: Okay. Now ... Then let's talk about Colonial
 5 Stores. Does it appear however that in your
 6 reading and reliance on Graystone Catering you
 7 may have misread it?
 8 A: I don't know if I testified on Graystone
 9 Catering or not.
 10 Q: Yes, you did, sir. And it's listed by us
 11 jointly as one of the primary principles
 12 underlying the assessment.
 13 A: Well, I don't recall that.
 14 Q: Okay. So let's talk about Colonial Stores.
 15 You claim that this stands for a tax on the
 16 withdrawal for use by a retailer as based on
 17 its fair market value which the Court said can
 18 be a different value than cost. Now was it
 19 your testimony, your understanding that in
 20 Colonial Stores, Colonial bought these premium
 21 merchandise and never sold them at retail?
 22 A: The -- I believe that they -- I think they --
 23 in most cases they did but I think they did --
 24 might have sold something because they were
 25 using -- I think they used a provision that

20 (Pages 77 to 80)

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1 allows them to purchase at wholesale and then
 2 resell it so they could have been -- some of it
 3 could have been sold.
 4 Q: Okay. So they were both --
 5 A: I think in most cases they were just giving
 6 them away.
 7 Q: So they were doing both. They were selling it
 8 at retail and then they would also give it away
 9 in exchange for books of stamps that the
 10 customers would collect over time. Is that
 11 correct?
 12 A: I believe that might have been the case, yeah.
 13 Q: And the court upheld again an assessment on
 14 cost in this case?
 15 A: Let me see.
 16 Q: It's at the top of page 2. It says, Colonial
 17 when and is it -- as it exchanged premium
 18 merchandise for save-a-stamps included its
 19 return and payday use tax on the cost to it of
 20 the premium merchandise exchanged. This latter
 21 is the tax it seeks to recover. It was trying
 22 to recover the tax it paid on its cost. And
 23 the Court upheld the assessment at cost.
 24 A: And they -- they considered it a use tax they
 25 were -- they were buying so they paid tax when

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1 they bought it it appears, because that would
 2 be the only way to pay a use tax.
 3 Q: Well you pay a use tax when you use it don't
 4 you?
 5 A: No. That's a sales tax.
 6 Q: Okay. I didn't expect to go in this direction
 7 with this. A use tax is imposed on the use or
 8 consumption in the state of tangible personal
 9 property purchased at retail for storage and
 10 use in this state. Is that -- so it's at --
 11 when you use it is when the use tax kicks in.
 12 A: Right. Yes.
 13 Q: Okay.
 14 A: But this is not a -- a withdrawal for use is
 15 not a use tax.
 16 Q: I understand. In that case, when Colonial
 17 withdrew its materials or its premium products
 18 and gave them away to customers that was deemed
 19 a use tax and taxed at cost, was it not?
 20 A: It basically said that both parties regarded
 21 such as a use tax as evidenced by the following
 22 and so then they talked about that they pay tax
 23 on the premium merchandise. So they considered
 24 it a use tax at that time, yes.
 25 Q: Okay. And apparently what you're focusing

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1 everything on is about halfway down on page 2
 2 where you say a different rule of valuation
 3 applies where goods are purchased for resale
 4 but later withdrawn from stock and used by the
 5 taxpayer. In such case the withdrawal is in
 6 effect treated as a sale at retail and the
 7 basis of valuation for tax purposes is the
 8 reasonable of fair market value of the tangible
 9 personal property withdrawn. That's what
 10 you're basing everything on is that dictum. Is
 11 that correct?
 12 A: Basing it on the fact that they -- they draw a
 13 distinction between -- because before that they
 14 say that both parties regarded the premium
 15 merchandise as being acquired for use by
 16 Colonial rather than for resale and hence
 17 subject to use tax is further evidenced by the
 18 fact the tax was paid and collected on the
 19 basis of the cost of the merchandise. Then it
 20 says, a different valuation method applies
 21 where goods are purchased for resale.
 22 Q: Okay.
 23 A: So they basically -- what we're relying on is
 24 the fact that they court recognized that when
 25 you buy something at -- for resale and then you

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1 -- instead of reselling it you use it, that a
 2 different valuation method applies, that being
 3 the reasonable fair market value. So, that's
 4 the point that we're relying on.
 5 Q: Okay. It doesn't say necessarily it's higher
 6 or lower than cost, it just says it can be
 7 different. Is that correct?
 8 A: It says -- it just says the reasonable fair
 9 market value, yes.
 10 Q: Okay. And again as we clarified in the last
 11 hearing, fair market value is a term that is
 12 not defined in the tax code?
 13 A: In the sales tax code.
 14 Q: Yes.
 15 A: I can tell you where it's defined somewhere
 16 else in the code.
 17 Q: Yes. In property tax. Is that correct?
 18 A: It may be. Like I said you may be right. I
 19 don't know.
 20 Q: Okay.
 21 A: I'd have to look at it again.
 22 Q: And it did -- also in Colonial it talks about
 23 a procedure that the Department allows when
 24 segregation of sales and use tax are
 25 impractical. In this case as you said, some of

21 (Pages 81 to 84)

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1 the items they sold at retail, some of the
2 items they gave away in return for stamps. And
3 so the Department authorized them -- under
4 those circumstances they didn't have to pay tax
5 on the items they gave away at the time they
6 bought it. They would simply for all purposes
7 buy the items using the resale certificate
8 whether or not they were going to resell them.
9 That's a Department regulation, is it not?
10 A: Well there's a statute and I don't think that
11 deals with resale certificates. It's a -- it's
12 a different provision --
13 Q: Uh-huh.
14 A: -- that is not a resale certificate.
15 Q: Okay. But it's just when it's hard to
16 segregate how you're going to use the materials
17 you -- the Department allows retailers to
18 purchase tax exempt or tax free and then
19 collect it as they utilize it in the future?
20 A: Well, no. This provision typically is not used
21 for -- for retailers but it is a provision that
22 is in the statute not nec- -- is not the
23 Department allowing, it's a provision of the
24 statute.
25 Q: Okay. Are you familiar with the term ad

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1 valorem tax?
2 A: Yes. Well at least I think I know what it
3 means.
4 Q: Okay. Well literally it's a tax whose amount
5 is based on the fair market value of a
6 transaction of property is it not?
7 A: Well basically it's a property tax from what I
8 understand.
9 Q: Well the great source of all information,
10 Wikipedia -- I didn't know where else to look.
11 It's probably in Black's Law Dictionary too.
12 I was -- but an ad valorem tax, Latin for
13 according to value, is a tax whose amount is
14 based on the value of a transaction or of the
15 property. So it can be a property tax but in
16 this case if you're charging a sales tax at
17 fair market value that's an ad valorem value or
18 an ad valorem tax, is it not?
19 A: I would not consider that an ad valorem tax
20 from what I -- from what I've understood. Like
21 I said because usually in -- I always
22 understood it being a tax on property, and this
23 being a transaction tax on -- on -- on the sale
24 which by definition in this case is a
25 withdrawal, use or consumption. So I don't

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1 know whether I would know about Wikipedia in
2 saying it's on the transaction would be
3 correct.
4 Q: Well as a matter of policy though a sales tax
5 is a transaction tax and 99 percent of the time
6 or 95 percent of the time it's on the gross
7 proceeds. So it's the amount that's
8 transferred, you're going to tax that amount.
9 But if you're basing the tax on fair market
10 value that's an ad valorem tax, is it not?
11 A: Well --
12 Q: By definition.
13 A: By definition fair market value is part of --
14 is gross proceeds. So, you know, I think it's
15 the way of the General Assembly saying that the
16 tax on the transaction of the withdrawal for
17 use is based on the fair market value of the
18 property.
19 Q: Did you read the trial testimony regarding the
20 concept of lower costs or market?
21 A: I remember that yes, but I don't remember it in
22 detail.
23 Q: Okay. In fact it was the Department's deemed
24 expert that spent a great deal of time talking
25 about in valuing inventory at the retailer's

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1 level of trade. The value is at most cost but
2 can be less due to depreciation and
3 obsolescence. So fair market value starts at
4 cost and works down. You remember that
5 testimony?
6 A: I think he was talking about the inventory as
7 a whole there though if I remember correctly,
8 wasn't he?
9 Q: He was talking about valuing at the retailer's
10 level of trade, yes. And that -- and his
11 entire experience -- and he's valued retail
12 inventories throughout his career, he's filled
13 out sales tax returns for contractors
14 throughout his career. He has never valued
15 inventory items at more than their cost. You
16 remember that testimony?
17 A: That I don't remember.
18 Q: Okay. Isn't that what Colonial Stores' Court
19 meant when it said that fair market value of
20 items subject to deemed retail sales could be
21 different from cost? It could be less than
22 cost could it not?
23 A: I do not -- I do not read it that way, no.
24 Q: And Graystone of course confirmed that
25 apparently the maximum amount would be the cost

22 (Pages 85 to 88)

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1 because that's what they upheld.
 2 A: Again, I can't say wha- -- Graystone on that.
 3 Like I said -- to me, like I said, it seems
 4 like he's stating a point of fact but I think
 5 based on the statute and based on Colonial's I
 6 would say based on fair market value is what
 7 they normally sell it for and that's what the
 8 regulation which was approved by the General
 9 Assembly states.
 10 Q: We're going to talk about that in a minute too
 11 but there is not a single reported court case
 12 that says that fair market value is the retail
 13 prices of items that they would sell off the
 14 shelf.
 15 A: Nothing that specifically says that. It just
 16 says fair market value.
 17 Q: Okay. Well we do have a court case that
 18 specifically says fair market value means cost.
 19 A: Again, I don't know whether I would agree that
 20 it says cost. I think -- I think that's
 21 stating a fact. I don't know whether they're
 22 specifically saying that's what they --
 23 Q: All right. Let's go to another code section.
 24 And any time you want to take a break I know
 25 you've been on the stand for a while and if you

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1 -- are you okay?
 2 A: I'm fine right now. Appreciate that though.
 3 THE COURT: If you want to take a recess we can do
 4 that but --
 5 MS. WOOTEN: Can we take a short five minute recess
 6 please?
 7 MR. SMITH: I -- I think it's time.
 8 MS. WOOTEN: Yes, please.
 9 THE COURT: That would be just fine.
 10 MS. WOOTEN: Please. Thank you.
 11 THE COURT: Let's take 10.
 12 (A break was taken from 11:17 a.m. until 11:39 a.m.)
 13 THE COURT: Okay. We're back on the record.
 14 MR. SMITH: Your Honor, we have tried to work with
 15 the state people to lower the temperature here
 16 and we've been unsuccessful so my -- my counsel
 17 and I would like to jointly petition for
 18 permission to remove the jackets. It is warm.
 19 THE COURT: Yes. Certainly. It is a little warm in
 20 this room and so if anybody would be more
 21 comfortable removing their jackets that would
 22 be just fine.
 23 THE WITNESS: I'm fine.
 24 THE COURT: Provided you've got something on
 25 underneath it. Otherwise I'm going to have to

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1 ask you keep your jackets on.
 2 MR. SMITH: Thank you, Your Honor.
 3 Q: Okay. So we went to a new code section here
 4 which is the 110(c), and this is the triggers
 5 of events that trigger retail sales or retail
 6 -- what are deemed retail sales under South
 7 Carolina law. And I know Ms. Wooten asked you
 8 about both (a), when retail sales triggered
 9 when building materials are sold to a
 10 construction contractor and we talked about
 11 that briefly; And (e), sales, it doesn't have
 12 to be the building materials, but sales of any
 13 kind of contractors [sic] for use in the
 14 performance of construction contracts; and then
 15 we have the withdrawal or use. Now one of the
 16 things that we talked about with Ms. Crawford
 17 last time was that if you choose (a) or (e) you
 18 can't choose (c). Their mutually exclusive
 19 because these (indicating) would occur before
 20 that (indicating). Do you agree with that?
 21 A: I think if you're a con- -- if you're a true
 22 contractor then you would come under (a) and
 23 (c), and so -- but if you're a retailer --
 24 excuse me, (a) and (e), but if you're a
 25 retailer you're going to come under (c).

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1 Q: Okay. So you -- you -- you can't be both. So
 2 it's one or the other. So you're either
 3 treated as a contractor or you're not.
 4 A: Well, I don't think it's that simple. I think
 5 the transaction is treated as a sale to a
 6 contractor or sale to retailer. The -- the
 7 retailer can then be serving as a contractor
 8 when they withdraw for use.
 9 Q: So other than Lowe's, to your knowledge, has
 10 the Department ever applied (c) to a contractor
 11 before?
 12 A: A true contractor? Not that I'm aware of, no.
 13 When -- if you buy --
 14 Q: Well any contractor as defined under the
 15 statute, has (c) ever been applied to a
 16 contractor other than Lowe's?
 17 A: If you're a retailer then (c) would apply. And
 18 so that would apply to anybody that's a
 19 retailer and also withdraws material to use in
 20 a contract as a contractor.
 21 Q: Okay. Are you aware -- because Ms. Crawford
 22 was not and Ms. Krull was not. Are you aware
 23 of anyone who performs contracting services
 24 other than Lowe's to which the Department has
 25 tried to apply (c) to?

23 (Pages 89 to 92)

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1 A: I believe there's someone that they're trying
2 to apply (c) to.

3 Q: Now?

4 A: I -- I think that they've dealt with that
5 before, yes. They've dealt with it on -- on
6 other occasions, yes. But I can't name any
7 particular one. I believe they've done that,
8 yes.

9 Q: Okay. Do you recall -- you read the -- did you
10 read -- I know we asked you about Dr. Van Bolk
11 and you read -- I guess you skimmed over his
12 testimony. Did you also read Mr. Cryder's
13 testimony who was our expert witness as well?

14 A: Yes.

15 Q: They both agree on this principal, in fact I
16 think Mister -- Dr. Van Bolk described it as
17 beautifully stated: for ad valorem tax
18 purposes, fair market value is not the retail
19 value to the taxpayer but the current wholesale
20 value adjusted for the fair market. Thus the
21 taxpayer's costs may be adjusted upward,
22 downward or remain the same to reflect the
23 wholesale market as it determined the fair
24 market value of the tangible personalty in the
25 taxpayer's possession at that economic moment

1 as a -- as a -- as an ad valorem tax. I think
2 it's a -- the measuring of the -- the basis for
3 the tax in this particular case on the
4 particular transaction which they define as a
5 retail sale.

6 Q: So do you disagree with the two experts or do
7 you agree with them?

8 A: I'm not saying I agree or disagree because I
9 don't recall all the specifics of their
10 testimony.

11 Q: Okay. I'm going to step back for just a moment
12 to code section 90 just to focus on (c). (c)
13 can only apply by its terms if items were
14 previously purchased at wholesale. Is that
15 correct?

16 A: Yes.

17 Q: And withdrawn from the business or stock; that
18 would be from the inventory would it not?

19 A: Well it just says no, withdrawn from the
20 business. As long as it's part of the business
21 then it's -- then it can be withdrawn.

22 Q: And it doesn't have to be an inventory item?

23 A: It doesn't say that because it --

24 Q: So if they bring home a stapler from the office
25 is that a retail sale?

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1 in time. Do you -- are you -- do you recall
2 both experts agreeing that that principal is
3 correct?

4 A: I don't recall specifically that one. I
5 remember that was an issue but I don't recall
6 exactly what they said because I know there was
7 issues on -- seems like my memory was there
8 were issues on whether they were talking about
9 as inventory as a whole versus the individual
10 transaction. It seemed like there was some
11 discussion on that so I -- but I don't recall
12 the specifics.

13 Q: But the principal that I just read would be
14 applicable to any ad valorem tax. Where you
15 measure fair market value, you don't look at
16 the retail value to the taxpayer but you look
17 at the current wholesale value which is
18 consistent with what Graystone Catering did.

19 A: But again, I don't think sales tax in my view
20 is an ad valorem tax.

21 Q: Even when it's measured on fair market value?

22 A: I think that -- that is what they're saying is
23 the retail sale and that is what they're saying
24 gross proceeds is by definition so I don't
25 think that's what -- I would not look at that

1 A: If someone brings home a stapler from the
2 office?

3 Q: Yes.

4 A: Yeah, if they -- if they purchased it at
5 wholesale and then they took it out of -- in
6 that case, inventory they took it out of
7 business then it's -- it's a retail sale under
8 110 like we talked about earlier. Because this
9 -- this -- the concept of a withdrawal for use
10 as we call it and the -- and the basis upon
11 which it's taxed is applies to all retailers.
12 Your -- your example of someone taking an
13 office equipment supply place, buying it
14 wholesale and then taking some of that stuff
15 home is -- is an example of that. Or even if
16 they take the equip- -- the stapler out of
17 inventory and they -- they use it in the office
18 part of the office supply store it's taxable.
19 It -- it applies -- it can apply to about any
20 retailer who purchases something at wholesale
21 and instead of selling it uses it.

22 Q: Okay. But it has to be -- in order for (c) it
23 has to be previously purchased at wholesale?

24 A: Yes.

25 Q: That is an absolute requirement?

24 (Pages 93 to 96)

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- 1 A: Right.
 2 Q: Okay. I was more diligent than I thought. And
 3 this (indicating) is the statutory definition
 4 of a wholesale sale?
 5 A: Yes.
 6 Q: And the one thing we know about wholesale sale,
 7 it is -- does not include sales to users and
 8 consumers not for resale. Is that correct?
 9 A: Right.
 10 Q: So if a -- someone is a user consumer who has
 11 purchased items and does not intend to resell
 12 them then it is not a wholesale sale. Is that
 13 correct?
 14 A: It is a sale to the user consumer and the --
 15 then it's going to be a -- a wholesale sale.
 16 So they -- they -- if they're not reselling it
 17 then it's -- you're right, it's not a wholesale
 18 sale.
 19 Q: Okay. So that -- we agree. If it's not -- if
 20 it's a sale that's not for resale it cannot be
 21 a wholesale sale no matter what.
 22 A: It's got -- it's got to be for -- to the user
 23 consumer. That's the key thing.
 24 Q: And not for resale.
 25 A: And not for resale, yes.

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- 1 Q: Got it. Okay. Now you have read the testimony
 2 that 60 percent of the building materials that
 3 were used and consumed by Lowe's in the
 4 performance of installation contracts were
 5 special order sales. Is that correct?
 6 A: Yes.
 7 Q: You don't dispute that.
 8 A: I have nothing to dispute it with.
 9 Q: Okay. So those are items that were bought to
 10 be consumed by Lowe's in the performance of
 11 installation contracts. Never entered the
 12 inventory, was never intended to be resold. It
 13 was bought for the specific purpose of
 14 performing an installation contact. Do you
 15 understand that?
 16 A: I understand what you're saying. I don't -- I
 17 don't think I agree with it.
 18 Q: Okay. What don't you agree with that?
 19 A: Well it's -- it's resold by definition as a
 20 withdrawal for use. In other words that they
 21 -- when they buy it at wholesale, as the charts
 22 showed earlier, you've got -- they're reselling
 23 it either by an ordinary sale, the dishwasher,
 24 or by withdrawing it for use. That is a retail
 25 sale. So the original sale was a wholesale

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- 1 sale because the -- the withdrawal of the
 2 inventory or withdrawal from the business is a
 3 retail sale by definition.
 4 Q: Okay. Let me see if I follow this logic then.
 5 Even though it is not purchased to be resold
 6 you're -- because you deemed it is withdrawn to
 7 be -- to perform it's going to be wholesale
 8 even if it's not for resale.
 9 A: What I'm saying is that specifically says that
 10 a withdrawal for use by anyone purchasing it at
 11 wholesale who -- that that is a retail sale by
 12 itself. If you notice the defini-- the term is
 13 sale at retail.
 14 Q: Yes, sir.
 15 A: So because it's a sale at retail, when they
 16 purchase it tax free then they can -- they can
 17 -- it's resold in one of two ways, a ordinary
 18 sale as the chart showed earlier or it's resold
 19 as a deemed sale and therefore it is a
 20 wholesale sale because it is resold.
 21 Q: To itself.
 22 A: Exactly.
 23 Q: Okay. So that's your theory? And when Lowe's
 24 sold it to itself, what were the gross proceeds
 25 of that sale?

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- 1 A: The gross proceeds -- if you look at that 12-
 2 36-90, gross proceeds is the fair market value
 3 of the tangible personal property purchased at
 4 wholesale which is withdrawn from the business
 5 or stock and used or consumed by -- with --
 6 with -- in connection with the business or used
 7 and consumed by the person withdrawing it. So
 8 that's the gross proceeds.
 9 Q: All right. Well let's see what the cases say
 10 about that. We talked about some of this. You
 11 brought with you at your deposition and I
 12 thanked you -- every case that you could find
 13 which included revenue rulings and things like
 14 that that dealt with this issue. And we went
 15 through all of them. Some of which really
 16 didn't deal with it but some did. So let's
 17 talk about some of them. The first one is the
 18 Sand Dunes Resort.
 19 MR. SMITH: I only have one copy.
 20 MS. WOOTEN: That's fine.
 21 Q: This is the Sand Dunes Resort versus South
 22 Carolina Department of Revenue. It had a bunch
 23 of issues involved but the ones that we focused
 24 on was with the resort. When customers checked
 25 in and went to the resort they got caps, Sand

25 (Pages 97 to 100)

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1 Dunes' caps, and golf balls and t-shirts and
 2 stuff like that that were given to them as part
 3 of the -- the package. And so in that case the
 4 Department deemed under withdrawal part 1(c) of
 5 12-36-90 that that was a taxable event. That
 6 was the same code section we talked about here.
 7 Is that right? Do you remember that case?
 8 A: Yeah. It's been awhile since I read it but I
 9 think it dealt with the -- if I remember
 10 correctly, the -- the caps were -- I don't know
 11 if they withdrew the caps or whether they
 12 bought the caps.
 13 Q: Well, they bought the caps and they gave them
 14 away.
 15 A: Right.
 16 Q: So that was deemed a withdrawal for use. In
 17 fact --
 18 A: Yeah, I see.
 19 Q: -- generally (c) always deals with property
 20 being given away either to the employees or for
 21 promotional purposes.
 22 A: I'm just trying to remember whether they --
 23 whether they paid tax to begin with or not but
 24 I see here where they -- they -- they withdrew
 25 it from inventory.

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1 Q: Okay. And this case was decided about a year
 2 after the Graystone Catering case. Is that
 3 right?
 4 A: Again, I don't remember the year of the
 5 Graystone Catering case.
 6 Q: That was '97 and this was '98.
 7 A: Yes.
 8 Q: Okay. And then the tax was imposed by the fair
 9 market value. Do you know if that was
 10 mentioned in it's cost? Would deemed cost and
 11 fair market value be the same thing?
 12 A: I don't remember one way or the other on this
 13 case. I think like I said -- it just said --
 14 I don't think it states how -- what the basis.
 15 I think it just says withdrawal for use fair
 16 market value. But I don't think it defines
 17 fair market value in this -- in this particular
 18 case if I remember correctly.
 19 Q: It doesn't. If it were something other than
 20 cost don't you think it would have said
 21 something particularly after the Graystone
 22 Catering case was decided the year before?
 23 A: No, I don't think that's unusual. They're just
 24 saying what the fair market value is.
 25 Q: Well does the case specifically cite the

1 Graystone Catering case? It says, the
 2 controlling case in this issue is the Graystone
 3 Catering case, on page 8.
 4 A: Yeah, I think they're -- if I remember
 5 correctly they may be speaking of the fact that
 6 this controlling because the -- there was no --
 7 the last consideration paid was the -- the sale
 8 -- sale to -- in other words, that it was being
 9 used by them. It wasn't being -- there was no
 10 charge to the customer -- separate charge for
 11 the customer. So I think that's what it's
 12 talking about there that that was the key thing
 13 here in -- in the same way there was no charge
 14 for the customer as a cap. There was no charge
 15 to the customer -- separately stated charge for
 16 -- for food in the Graystone Catering case. I
 17 think that's what they're relying on in this
 18 case.
 19 Q: And so it was taxed on something following
 20 Graystone Catering, would it be a cost?
 21 A: It says fair market value.
 22 Q: Okay. But it doesn't say that that's any
 23 different from cost does it?
 24 A: No. But again there's a regulation that speaks
 25 to the fact that that's what you normally sell

1 it for.
 2 Q: Okay. Well then let's go to another decision
 3 since that one's not clear. This is South
 4 Carolina Revenue Ruling 15-1 which we talked
 5 about. And this dealt with kayaks and
 6 paddleboards, which a popular thing to do in
 7 South Carolina, and the companies that buy them
 8 and sell them -- resell them. And there are
 9 companies that buy them and then conduct tours.
 10 And there are companies that buy them and rent
 11 them. I think the question was the companies
 12 who were buying the paddles [sic] and the kayaks
 13 tax exempt for resale in some cases were
 14 keeping them and renting them and the tax was
 15 collected at that and in some cases they were
 16 using them for tours. And the question was,
 17 how did you tax the paddleboards? And the
 18 Department ruled that they would tax it at what
 19 they paid for them, at their cost, even though
 20 they bought it tax exempt. Is that correct?
 21 Q: I don't think that the Department ruled that
 22 specifically that. I think what the Department
 23 said was there was a regulation, 117-318.4,
 24 which gave them the -- which gives someone who
 25 is both renting something and then using the

26 (Pages 101 to 104)

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1 same thing they're renting gives them an
2 alternative. It says the tax is based on the
3 fair rental value but in the alternative
4 instead of paying the tax on each time you
5 withdraw it from their inventory and each time
6 you withdraw it paying on fair rental value,
7 gave them the option to pay the tax up front
8 when they bought so they would no longer pay on
9 withdrawals but they would still pay on the --
10 when they rented it out.
11 Q: And that would be at what they paid for it. Is
12 that correct?
13 A: In that particular case, yes.
14 Q: Okay. And then we have private letter ruling
15 95.4. And this is very close to the Graystone
16 Catering case. This was a Delaware corporation
17 that supplied food and food management services
18 to public and private institutions such as
19 private businesses and hospitals. And there
20 were three separate transactions: one, they
21 would sell the food directly to customers; two,
22 they would withdraw from inventory as part of
23 their management and provide it. And the
24 question was, when it was withdrawn from
25 inventory what was the basis of taxing it. Do

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1 you recall that case?
2 A: Yeah. I'd have to read -- read it again but I
3 can recall --
4 Q: Okay. Well take a moment to read it because
5 we're going to talk about their thinking in
6 this case.
7 A: Okay.
8 Q: Okay. So this essentially deals with a food
9 management service to a hospital. That's what
10 we're looking at. And there are three
11 transactions, two of which involve withdrawals
12 under subsection (c). The hospital withdraws
13 some food to serve to its patients as part of
14 its hospital stay and it also sells some food
15 at retail to people who come into the
16 cafeteria. So it is both a retailer and a
17 consumer of food provided by the food
18 management service. And what the Department
19 ruled is that it should collect tax from
20 customers when it's selling at retail to the
21 customers on the gross proceeds of the retail
22 sale. But on the food that it withdrew to
23 serve to hospital patients it was the user and
24 consumer of the food and was charged on its
25 fair market value. Now under your thinking the

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1 fair market value should be -- be marked up
2 retail price that it would sell it to its
3 retail customers. Am I correct?
4 A: At what it normally sells the -- the food for,
5 yes.
6 Q: So what was the finding of the Tax Commission?
7 If you look at footnotes 1 and 2 on the bottom
8 of page 3, it says on the first tran- -- or
9 transaction 2, the hospital will report retail
10 sales based on gross proceeds of sales of food
11 in the cafeteria and withdraws for use to
12 patients based on the property's fair market
13 value (i.e., the amount paid by the hospital to
14 ABC for food cost reimbursed under the terms of
15 the contract [sic]. And then on the third
16 transaction it says, the hospital will report
17 retail sales based on the gross proceeds of
18 sales of food in its cafeteria and withdraws
19 for use to patients based on the property's
20 fair market value, i.e., the amount paid by the
21 hospital to outside vendors for food costs.
22 Except for withdrawals for use, the fair market
23 value is the cost that the hospital incurred in
24 getting the food that it served to its patients
25 not the marked up retail value. Is that

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1 correct?
2 A: Well, that's what we said there and as I
3 mentioned in our deposition I thought that was
4 -- we made a mistake there and that was
5 incorrect.
6 Q: Okay. So they were wrong too on this subject?
7 Well let's go one final ruling, private letter
8 ruling 07-4. And this deals with a sign
9 company but I'll let you take a moment to read
10 it.
11 A: Okay.
12 Q: This was a company that designed and
13 manufactured and sold and in some cases
14 installed signs. Do you remember that?
15 A: Yes.
16 Q: And the question was, was it a retailer or
17 signs or was it a contractor? And the Court
18 rul- -- well in this case it was private letter
19 ruling, found that it was selling tangible
20 personal property at retail so it was a
21 retailer like Lowe's. But it also says, it's
22 on page 7 starting at the second paragraph,
23 based on the above and the facts that were
24 above, XYZ is selling tangible personal
25 property at retail. However, we must consider

27 (Pages 105 to 108)

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1 the application of the tax with respect to
2 tangible personal property which becomes part
3 of real property. And they address regulation
4 117-314.2 which we talked about earlier that
5 defines building materials as anything -- any
6 other tangible personal property which becomes
7 part of real property. And on page 8 it signs
8 -- or cites a South Carolina Supreme Court case
9 of Paris Mountain Water Company, and it comes
10 to the conclusion that if a tangible personal
11 property becomes part of real property such as
12 concrete used for the foundation of a
13 standalone sign then such tangible personal
14 property is considered used and consumed by XYZ
15 and not sold by XYZ. So a retailer can be a
16 contractor in this case, they're a retailer
17 when they're selling tangible personal property
18 but they also are a contractor when they're
19 consuming materials that become a part of real
20 property. That's principal number one. Do you
21 agree with that? Is that correct?
22 A: You're saying that basically it says that when
23 they buy the concrete that they're using and
24 consuming concrete, they're not reselling
25 concrete?

1 itself and so it -- they -- they're -- they
2 don't come under the withdrawal provision
3 because they don't buy it at wholesale.
4 They're buying it at retail because they are
5 using and consuming that. They're -- they're
6 buying the stuff to make the sign with at
7 wholesale but they're -- and then they're
8 selling it because they're considered a
9 retailer but they're paying tax on the concrete
10 because they -- they're just users or consumers
11 of the concrete. They're not -- they're not
12 also selling concrete as Lowe's is also selling
13 these building materials to others without
14 installing them.
15 Q: So -- so let me see if I follow that then. How
16 is the sign company different from Lowe's? Now
17 Lowe's on the installation contracts is in fact
18 all of that is being incorporated into real
19 property. Is that correct? All the building
20 materials on the installation contracts become
21 part and parcel of the customer's real
22 property.
23 A: Yes.
24 Q: Lowe's is a retailer like the sign company was
25 a retailer. Lowe's also makes home

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1 Q: Correct. And if you look on page 10 it says,
2 since some tangible personal property used in
3 the transaction becomes a part of the real
4 property such as the concrete used for
5 foundations and standalone signs then such
6 tangible personal property is considered used
7 and consumed by XYZ and not sold by XYZ. As
8 such, the sales to or purchases by XYZ of such
9 tangible personal property are subject to tax.
10 Which means that even though they're a
11 retailer, the materials that they buy then
12 become incorporated into real property are
13 deemed sales of building materials to
14 construction contractors. You can be both.
15 Isn't that the conclusion there?
16 A: I think the conclusion is that telling the
17 taxpayer that you're not reselling the
18 concrete, that you're using and consuming the
19 concrete. And therefore you're -- you pay tax
20 when you buy the concrete.
21 Q: Yes.
22 A: And so I think the -- and the point there is
23 when you -- you buy that concrete that you pay
24 tax on it. They're not buying concrete for
25 resale. They don't sell concrete just by

1 improvements or permanent real property
2 improvements like the sign company does. And
3 according to this when the sign company buys
4 materials for resale they're taxed one way;
5 when it buys materials that are incorporated
6 into real property they're taxed under this
7 (indicating). Isn't that what it says?
8 A: It says that they're -- they should pay tax
9 when they buy those things because they --
10 they are using and consuming those things.
11 They are not also buying them at wholesale in
12 order to resell concrete and then use concrete.
13 They are just purely using the concrete at that
14 point.
15 Q: But we don't know that. We don't know if
16 they're using all of their concrete. They're
17 a retailer. They're buying concrete -- they're
18 buying everything tax exempt and they're asking
19 how to be treated. And it says if it's being
20 sold as tangible personal property you're taxed
21 one way. If it's being incorporated into real
22 property it's taxed a different way. Isn't
23 that what it says?
24 A: No, I think we know that they -- they weren't
25 reselling concrete.

28 (Pages 109 to 112)

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1 Q: Really?
 2 A: Yeah.
 3 Q: Okay.
 4 A: I wrote it.
 5 Q: I see. Now Lowe's then, under your ruling,
 6 when it buys materials for use in installation
 7 contracts should be paying the tax like a
 8 contractor does at the time it buys the
 9 materials.
 10 A: No, I'm not saying that.
 11 Q: Well I mean if it is -- we -- we talked
 12 earlier. It is a construction contractor under
 13 the statute. It is buying building materials.
 14 So under this rule and of course under the
 15 ruling that you wrote here dealing with the
 16 sign company, what the decision was is if
 17 you're buying materials for real property
 18 improvement you should pay the tax that [sic]
 19 you buy it.
 20 A: No. The -- the -- the -- I -- the issue is if
 21 you're buying things in order to sell them and
 22 use them then you come under (c) because you --
 23 you pay -- you don't pay taxes when you
 24 purchase it because that's a wholesale purchase
 25 but then you pay tax when you either sell it,

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1 sell the dishwasher, or you withdraw it from
 2 inventory to use it to make it an improvement
 3 to real property you pay tax on fair market
 4 value there. Because otherwise you're reaching
 5 an absurd conclusion because you're -- you're
 6 basic theory there is, okay, they're a
 7 contractor, these are building materials, so
 8 that means that when Lowe's buys all of its
 9 dishwashers they pay tax on the -- all
 10 dishwashers at their cost even if they sell
 11 them. And that's not the case, because you
 12 have to look at the statute as a whole and say,
 13 again, the General Assembly set forth a
 14 mechanism for a retailer who is both selling
 15 and using to purchase at wholesale and then to
 16 pay tax on the sale or the -- on the withdrawal
 17 whereas they did not set that mechanism for a
 18 contractor. The contractor has to buy
 19 everything tax paid.
 20 Q: Now according to you then on the -- on the sign
 21 company, you -- as you said they're a retailer.
 22 They buy at wholesale these materials for signs
 23 they sell as tangible personal property, but if
 24 they're buying materials not for resale then
 25 they're taxed at their cost like their

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1 concrete. That is if you buy the material
 2 solely for purposes of performing an
 3 installation.
 4 A: If you're buying things for use, your own use,
 5 without reselling it, you're only going to be
 6 using this item, then you pay tax when you buy
 7 it. Which is no different than when you buy
 8 the -- Lowe's or anybody other retailer buys
 9 the cash register. They're not in the business
 10 of reselling cash registers. They -- they buy
 11 the cash register at retail and they pay the
 12 tax on what they paid for it.
 13 Q: Okay. But we talked about the 60 percent which
 14 are special order sales which are buying for
 15 pur- -- for sole use to be incorporated into an
 16 installation, not as tangible personal property
 17 for sale, and you're treating Lowe's
 18 differently under those circumstances than
 19 you're treating this sign retailer. And that
 20 is because Lowe's is directed by the Department
 21 to purchase the materials without paying the
 22 tax at the time.
 23 A: I -- I disagree. I think from my reading of
 24 the testimony, one -- somebody for Lowe's -- I
 25 can't remember which one, stated that the

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1 special order sales, that they do sell those
 2 items without installing them. That I can buy
 3 a -- a -- a -- window and have it specially made
 4 and I don't have to have Lowe's install it. I
 5 can have my own person install it.
 6 Q: That's true but that's not the subject of any
 7 of any of what we're talking about here today.
 8 We're only talking about installations here.
 9 Is that correct?
 10 A: No. What -- but you were asking about what's
 11 the difference between this ruling and Lowe's,
 12 and my point was that Lowe -- this ruling right
 13 here, they're buying the concrete. They're not
 14 buying the concrete to resell. They're buying
 15 the concrete to use. No different than Lowe's
 16 buys a cash register to use. In the case of
 17 Lowe's special order sales they will sell those
 18 to people without installing them and they will
 19 sell them to install them. And so under the
 20 regulations, which were approved by the General
 21 Assembly, they buy those at -- at wholesale and
 22 then they pay tax when they sell them and then
 23 they -- they pay tax -- or they pay tax when
 24 they withdraw them for use to use in that --
 25 when they're installing or have somebody

29 (Pages 113 to 116)

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1 installing on their behalf. That was my only
2 point.
3 Q: Now Lowe's could, when it's doing special order
4 sales, pay the supplier the tax at the time it
5 buys it such as a construction material, but
6 for the Department's regulation on dual
7 businesses. You will not let them do that,
8 will you?
9 A: Well I think that -- to me the statute sets
10 forth this -- again, this concept because it --
11 it provides a mechanism for contractors to buy
12 every- -- everything tax paid. They have no
13 choice. But in the case of a retailer, someone
14 who's also a retailer and may be using
15 something, it -- it -- that's the only
16 mechanism with respect to the -- the issues
17 we're facing here today, that you can buy
18 something at wholesale and then pay tax either
19 when you sell it or when you use it. And so in
20 my mind the -- the regulation is addressing the
21 mechanism set forth by the General Assembly.
22 Q: Okay. We've been hearing a lot about the
23 regulation. Now you -- you will acknowledge
24 there's not a single court decision, there's
25 not a single revenue ruling that supports your

1 contractor because you think that's absurd.
2 A: Is there a question?
3 Q: Is that your testimony?
4 A: I'm saying that it's absurd because you have to
5 look at the -- you're -- you're forgetting the
6 one rule of construction about looking at the
7 statute as a whole. And because Lowe's is not
8 going to buy everything -- all the building
9 materials tax paid under 12-36-110(1)(a), the
10 General Assembly has set forth a mechanism for
11 retailers that are also in this case acting as
12 contractors when they withdraw from inventory.
13 The only mechanism they've set forth is to
14 purchase at wholesale and then to either pay
15 when they sell or to pay when they withdraw.
16 And so -- and then -- so that's where the dual
17 business regulation comes up 117-324. And then
18 because it says fair market value 117-309.17
19 applies in the case of the withdrawal.
20 Q: Now you've acknowledged the net result is that
21 Lowe's performing the exact same transaction is
22 another construction contractor who may buy the
23 materials at the same cost as Lowe's, who may
24 store them in the same manner as Lowe's and may
25 do the exact same transactions as Lowe's,

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1 position. You disagreed with all of them. But
2 you do refer to your regulation. That's --
3 you're hanging your hat on the regulation. Is
4 that correct?
5 A: Well, I'm saying that the regulations are
6 approved by the General Assembly and therefore
7 -- and have the full force and effect of law.
8 And so ...
9 Q: Now you remember our principals that we talked
10 about at the very beginning. Let's see if I
11 can find it again. The Department of Revenue
12 cannot impose interpretations of tax laws that
13 are inconsistent or in conflict with statutes
14 passed by the legislature. And you agreed with
15 that, correct?
16 A: Yes. I did.
17 Q: The Department of Revenue has no authority to
18 create its own tax laws or to repeal or alter
19 tax laws enacted by the legislature. Do you
20 agree with that?
21 A: Yes.
22 Q: So we have the statute that says that sales of
23 building materials to contractors is a retail
24 sale, but you're deeming that not applicable to
25 the sale of building materials to Lowe's as a

1 Lowe's will pay tax at a 40 percent higher rate
2 than its competitor contractor as a result of
3 the Department's interpretation as promulgated
4 in this regulation. Isn't that correct?
5 A: Well what I'm saying is they're -- they're
6 paying it --
7 Q: First of all answer the question please and
8 then you can explain it.
9 A: I'm saying they're paying it at a different
10 value because they're different entities.
11 One's just solely a contractor, one is a
12 retailer. And I'm also saying that, you know,
13 the -- the statute says when you're a retailer
14 and you withdraw or use or consume something
15 instead of selling it, you pay on fair market
16 value. And therefore the definition of fair
17 market value is defined as what you normally
18 sell it for, which in my mind is -- is a
19 reasonable definition of fair market value and
20 that's all a regulation has to do. It has to
21 be reasonable, and the General Assembly
22 approved it as reasonable.
23 Q: Now you keep mentioning the General Assembly
24 approved it. Was there any feedback from the
25 General Assembly when this was published?

30 (Pages 117 to 120)

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1 A: The -- as far as -- like, what do you mean
 2 feedback?
 3 Q: Well you publish it for 120 days and if no one
 4 says anything it just goes into effect.
 5 A: Right.
 6 Q: Okay. That's what happened.
 7 A: One of the methods. That's one of the methods,
 8 yes.
 9 Q: Is that what happened here?
 10 A: I believe so, yes.
 11 Q: Okay. So the General Assembly's never weighed
 12 in on it one way or another. They just didn't
 13 say anything.
 14 A: Well it could have gone to committee, so that
 15 -- that depends on what the committee might
 16 have done.
 17 Q: Okay. The regulation however does conflict
 18 with the statutory definition of contractor.
 19 It does conflict with the regulation dealing
 20 with building materials and how they're dealt
 21 with on sales to contractors of building
 22 materials. It does run counter to the Court of
 23 Appeals' decision in Graystone Catering. It
 24 does conflict with every revenue ruling that
 25 we've addressed that deals with withdrawals and

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1 it's not supported by any case authority or
 2 ruling anywhere. Now how is that consistent
 3 with the law?
 4 A: Well, first of all I don't -- I don't agree
 5 that it's inconsistent. The -- first of all
 6 the -- it says fair market value. If the -- in
 7 the statute, if the General Assembly had wished
 8 to put it at cost they could have said, items
 9 with the -- you know, the cost of items with --
 10 previously purchased at wholesale and
 11 subsequently withdrawn and used and consumed.
 12 But they didn't say cost. So they must have
 13 meant something different than cost. And --
 14 and so they placed fair market value. Fair
 15 market value is -- generally the concept is a
 16 willing buyer and willing seller. Well, I mean
 17 what's more willing buyer and willing seller
 18 than what the person will sell it for? If they
 19 put that dishwasher on the floor for \$500 then
 20 that's what the willing buy- -- willing seller
 21 is willing to go for and they know that the
 22 customers are willing to buy that for that
 23 \$500. So by saying -- taxing it at the -- at
 24 what they normally sell it for it seems to me
 25 that it's reasonably related to that concept of

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1 willing buyer and willing selling at the retail
 2 sale.
 3 Q: Okay.
 4 A: And that -- also that they're acting as a -- a
 5 contractor on -- not when they purchase it but
 6 when they withdraw it from inventory. That's
 7 what the statute is set up. It is set up a
 8 situation where they're -- they're a contractor
 9 when they're withdrawing it from inventory to
 10 use or consume in these installed sales.
 11 Q: The buyer in this case being Lowe's. The
 12 willing buyer.
 13 A: The deemed sale is to Lowe's, yes.
 14 Q: Okay. But you don't look at what the willing
 15 buyer paid the willing seller for these
 16 materials.
 17 A: You're looking at what --
 18 Q: You're looking at some fantasy person further
 19 up the chain on a different level of trade as
 20 to what they might pay on a piecemeal basis and
 21 a different point in time. You're looking at
 22 a different level of trade, are you not?
 23 A: No. I think you're looking at the retail sale
 24 because the withdrawal for use is a retail
 25 sale, so you look --

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1 Q: To Lowe's. To Lowes.
 2 A: Retail sale to Lowe's if you want to look at it
 3 that way but it's a retail sale by statute and
 4 that the -- the level of trade seems to me to
 5 be what is it normally sold for, which is what
 6 the regulation deals with. And on an
 7 individual basis.
 8 Q: One other principal -- tax principal, absent
 9 legislative -- express legislative authority,
 10 similarly situated taxpayers performing similar
 11 or identical transactions should be taxed
 12 similarly. True or false?
 13 A: True. But I don't believe we have similar
 14 taxpayers here that you're usually talking
 15 about. You're talking about -- you're trying
 16 to draw a distinction between a -- a -- you're
 17 trying to say that a true contractor who does
 18 not make retail sales and a retailer who does
 19 contracting work are similarly situated
 20 taxpayers --
 21 Q: Yes I do.
 22 A: -- and I don't agree
 23 Q: That is precisely the point that we're talking
 24 about here.
 25 A: Yeah.

31 (Pages 121 to 124)

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1 Q: That is I think the case. Is -- is there a
 2 statutory distinction between contractor and a
 3 true contractor, a term manufactured by the
 4 Department. I think you've summarized the
 5 case. That's all I have for now.
 6 THE COURT: Thank you. Ms. Wooten?
 7 MS. WOOTEN: Nothing further.
 8 THE COURT: Nothing further?
 9 MS. WOOTEN: Yes.
 10 THE COURT: All right. So can McCormack be excused?
 11 MS. WOOTEN: I'm sorry. Yes, yes Your Honor.
 12 THE COURT: All right. Any objection to Mr.
 13 McCormack being excused?
 14 MR. SMITH: No.
 15 THE COURT: All right. Thank you Mr. McCormack.
 16 Thank you very much.
 17 MR. MCCORMACK: Thank you Your Honor.
 18 THE COURT: You can return to your seat now.
 19 Anything else from the Department?
 20 MS. WOOTEN: No, Your Honor. That's all of our
 21 witnesses.
 22 THE COURT: Okay. All right. Any rebuttal?
 23 MR. SMITH: We have a very, very brief rebuttal.
 24 THE COURT: Okay.
 25 MR. SMITH: On one item. I'm going to call Will

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1 Lowe.
 2 THE COURT: All right. And Mr. Lowe, sir, if you
 3 would just be sworn in before you take your
 4 seat sir.
 5 MR. LOWE: Sure.
 6 THE COURT: Thank you.
 7 MR. COURT REPORTER: Mr. Lowe, do you solemnly swear
 8 and affirm the testimony you're about to give
 9 will be the truth, the whole truth and nothing
 10 but the truth so help you God?
 11 MR. LOWE: I do.
 12 MR. COURT REPORTER: Thank you, sir.
 13 THE COURT: Please make yourself comfortable sir.
 14 MR. LOWE: Thank you.
 15 WILLIAM LOWE, having been duly sworn, testifies as
 16 follows:
 17 MR. LOWE - EXAMINATION BY MR. SMITH:
 18 Q: Mr. Lowe, this is your first appearance here,
 19 sir. Tell us who you are and what you do.
 20 A: I'm Will Lowe. I work in sales tax at Lowe's.
 21 I'm actually Director of Indirect Tax Audit and
 22 Compliance there.
 23 Q: And what does that mean?
 24 A: My primary responsibilities involve overseeing
 25 a team that files all the sales and use tax and

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1 environmental fee returns, and also is
 2 responsible for making the related payments.
 3 I also oversee a team that facilities all the
 4 sales and use tax audits as well.
 5 Q: And you've worked with Craig Price before?
 6 A: I have, yes.
 7 Q: How long have you been with Lowe's?
 8 A: In total I've been with Lowe's just over 20
 9 years. I actually started in the corporate
 10 accounting Department there. I left Lowe's
 11 briefly, came back in the tax Department and
 12 I've been there for just over 10 years this
 13 time.
 14 Q: Okay. Are you familiar with how Lowe's handles
 15 it's installed sales transactions for tax
 16 purposes?
 17 A: I am, yes.
 18 Q: Okay. And you were here for the first trial.
 19 A: Yes, I was.
 20 Q: Okay. We wanted to just address what appeared
 21 to be a statement that was made during the
 22 course of that and try to clarify it. Do you
 23 recall when Ms. Krull was testifying and I was
 24 questioning her, at the end she made a comment.
 25 The contracts say that Lowe's is not a

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1 contractor.
 2 A: I do recall that, yes.
 3 Q: Okay. Do -- do you have any understanding of
 4 what she was referring to there?
 5 A: I believe I know what she was referring to,
 6 yes.
 7 Q: Okay. It's -- let's go to (c) 35 in the book.
 8 And -- and this is just a file from one of the
 9 Lowe's special order sales installation
 10 contracts that we discussed at the hearing.
 11 And on the last -- in that file on the last
 12 page is a preprinted project estimate form.
 13 Are you familiar with that document?
 14 A: Yes, I am.
 15 Q: Okay. First of all, in your 20 years with
 16 Lowe's before this case came up had you seen
 17 that form before?
 18 A: I have not seen this form before until
 19 recently, no.
 20 Q: Okay. What is it?
 21 A: This is a project estimate form. This form is
 22 very old. It's been around for 30 years, maybe
 23 even before that. It was actually in use
 24 before Lowe's was involved in the sale of real
 25 property improvements, we were only selling

32 (Pages 125 to 128)

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1 materials. And what this form was intended for
 2 at the time was to provide an estimate to home
 3 builders, contractors, you know, customers more
 4 on the pro side when they were purchasing large
 5 quantities of materials.
 6 Q: Is it a document that's ever signed by a
 7 customer?
 8 A: It is not signed by the customer, no.
 9 Q: Is it part of the installation contract that
 10 Exhibit 35 is?
 11 A: No, it is not.
 12 Q: Okay. If you investigated as to why that lang-
 13 -- well at the bottom it has language and I
 14 think this is what Ms. Krull was referring to
 15 --
 16 MS. WOOTEN: Objection, Your Honor. They're
 17 speculating as to what Ms. Krull may or may not
 18 have meant during her testimony at the April
 19 hearing regarding this language if that's even
 20 what she was referring to. There's nothing in
 21 the testimony to say what she wa- -- what
 22 language she was referring to when she made
 23 that statement.
 24 MR. SMITH: She's absolutely right. We're
 25 speculating. That's a confusing document,

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1 we're explaining why it's there. I don't know
 2 what else she could be referring to so.
 3 THE COURT: All right. Well we'll -- we'll -- let's
 4 just -- let's not speculate --
 5 MR. SMITH: Okay.
 6 THE COURT: -- as to what Ms. Krull was referring
 7 to. Just address that.
 8 MR. SMITH: I'm just explaining this document.
 9 THE COURT: Just explain it.
 10 MR. SMITH: Okay.
 11 THE COURT: Thank you, sir.
 12 Q: But it does -- it makes the statements,
 13 supplier materials only, Lowe's does not
 14 engage in the practice of engineering,
 15 architecture, general contracting. Have you
 16 inquired about the history behind that
 17 language?
 18 A: I have.
 19 Q: Okay.
 20 A: Yes. I inquired about why this language was
 21 added and it -- it was added many years ago
 22 before the time that we were doing real
 23 property improvement sales. And the issue was
 24 Lowe's had contractors coming to use to
 25 purchase roofing trusses. And the contractor

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1 would supply a blueprint to us for those
 2 trusses. We would order those trusses from a
 3 manufacturer and sell those to the customer.
 4 And the roofing trusses were constructed based
 5 on the blueprints that were provided by the
 6 contractor. Later on, apparently some of these
 7 roofing trusses failed and the contractors
 8 tried to come back and blame Lowe's so this was
 9 put in there as protective measure at the time.
 10 Q: Okay. Are these forms supposed to be used for
 11 installation contracts?
 12 A: It -- it was not intended to be used for
 13 installation contracts, no.
 14 Q: Okay. Does the language in that form -- well,
 15 first of all a customer does not sign that does
 16 it -- do they?
 17 A: Correct.
 18 Q: Does it have any impact on the contractual
 19 relationship between the customer and Lowe's?
 20 A: No.
 21 Q: Okay. No further questions.
 22 THE COURT: I'm sorry. I'm in the middle of a note.
 23 I didn't see you. Okay. Thank you very much.
 24 MR. LOWE - EXAMINATION BY MS. WOOTEN:
 25 Q: Just -- just a few clarifying questions. If

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1 you'll refer to that -- that same document that
 2 Mr. Smith was asking you about.
 3 A: Yes.
 4 Q: This document is generated by Lowe's, correct?
 5 A: It is, yes.
 6 Q: And what is the date of this document?
 7 A: It looks like the date -- I see date estimated
 8 July 17th, 2010.
 9 Q: And do you recall the audit period that is
 10 involved in this matter?
 11 A: This matter, I believe it's August 1st, 2008 to
 12 July 31st, 2011.
 13 Q: So this document would have been generated
 14 during the audit period. Is that correct?
 15 A: Yes.
 16 Q: Okay. And do the inventory items on this
 17 document refer to the installation contract
 18 that is the beginning of this exhibit?
 19 A: I'm not sure to be honest.
 20 Q: Could you look at that for me please?
 21 A: Sure.
 22 Q: It appears to be, yes.
 23 Q: Thank you. That's all from the Department Your
 24 Honor.
 25 THE COURT: Anything from --

33 (Pages 129 to 132)

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1 MR. SMITH: Nothing further Your Honor.
 2 THE COURT: Mr. Lowe, sir, thank you very much.
 3 MR. LOWE: Thank you.
 4 THE COURT: Please have a seat.
 5 MR. SMITH: Nothing further from Lowe's.
 6 THE COURT: Okay. So no further rebuttal and
 7 nothing further from the Department, is that
 8 right?
 9 MS. WOOTEN: That's correct.
 10 THE COURT: All right. Well at this time if -- if
 11 the parties wish to make any kind of closing
 12 remarks I certainly will listen to them. I
 13 don't -- please don't feel like you need to do
 14 that. I'm going to ask the parties because of
 15 the complexity of the matter for some proposed
 16 orders in this case and -- and so I don't see
 17 necessarily a need for proposed orders;
 18 however, I am perfectly willing to listen to
 19 anything that you might want to present. If
 20 you want to offer anything?
 21 MS. WOOTEN: Just to clarify, I think you said you
 22 didn't see a necessity for proposed orders. Do
 23 you mean --
 24 THE COURT: No. I'm going to ask for proposed
 25 orders --

1 MS. WOOTEN: Sixty days from the date of receipt of
 2 transcript.
 3 THE COURT: So therefore 60 days from the day y'all
 4 receive the transcript then the Court will be
 5 looking for a proposed order from the parties.
 6 MS. WOOTEN: Sure.
 7 THE COURT: All right.
 8 MS. WOOTEN: Thank you very much.
 9 THE COURT: Thank you very much.
 10 MR. SMITH: Thank you Your Honor.
 11 THE COURT: All right. We're adjourned.
 12 (There being nothing further, the hearing concluded
 13 at 12:32 p.m.)

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1 MS. WOOTEN: Okay.
 2 THE COURT: -- but I was -- I didn't see a
 3 necessity for closing arguments --
 4 MS. WOOTEN: Okay. Thank you.
 5 THE COURT: --although I am perfectly prepared to
 6 listen to anything you want to say.
 7 MS. WOOTEN: The Department would prefer to do
 8 proposed orders in -- in lieu of closing. I'll
 9 defer to counsel.
 10 THE COURT: All right.
 11 MR. SMITH: Your Honor, in light of our struggling
 12 voices I think you've heard enough from us
 13 today. We -- we'll submit orders. That's
 14 fine.
 15 THE COURT: Okay. Thank you very much. And thank
 16 you very much for -- for everything. It was
 17 well presented. It was a lot of material and
 18 I'll consider everything. What -- what would
 19 be an appropriate amount of time for proposed
 20 orders? I know you will probably want to get
 21 the transcript obviously before you can get
 22 started on those but --
 23 MS. WOOTEN: I would say 45 to 60 days from the
 24 transcript would be our preference.
 25 THE COURT: Okay. So 60 days for an order?

34 (Pages 133 to 135)

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JOINT EXHIBIT 1

South Carolina Department of Revenue

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

August 8, 2011

File Number: 40038688-1
also: Various SC File#s (see attached list)
Tax Type: Sales Tax

Lowes Home Center, Inc.
P O Box 1111
N. Wilkesboro, NC 28659-1111

Dear Taxpayer:

Your Sales Tax tax returns for the period 08/01/2008 through 07/31/2011 have been assigned to me for examination. An appointment has been scheduled as follows:

Date and Time: Monday, September 12th at 10:00 AM

Locations: Hwy 268 East, N. Wilkesboro, NC 28659

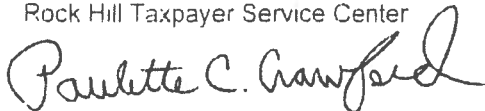
In order to expedite this examination, it would be greatly appreciated if all of the information requested below is available at the commencement of the audit.

- (1) Copies of your returns for the examination period.
- (2) All books and records used in preparation of your returns, including documentation supporting entries on the return.
- (3) Bank statements, along with cancelled checks and check register for the audit period.
- (4) All purchase invoices for the audit period, including invoices for inventory, supplies and fixed assets.
- (5) Copies of your South Carolina and federal income tax returns including the detailed depreciation schedules for the audit periods.
- (6) Copies of state or federal income tax audit reports for the audit periods if applicable.
- (7) Copies of certified or other financial statements for the audit periods.
- (8) Copies of resale certificates (ST-8A) or exemption certificates (ST-9) for your exempt sales.

The Department of Revenue has developed a Computer Assisted Auditing System for use when a taxpayer provides their records in an electronic format. Our software program can read virtually any file format or record type. Attached is a Computer Assist Audit System brochure, which provides more information. You are asked to complete and return the attached Computer Assisted Audit Questionnaire (form CAA-90) within ten (10) days from the receipt of this letter.

The Department of Revenue believes all taxpayers should be aware of their rights. I am enclosing a Tax Guide which summarizes the South Carolina Taxpayers' Bill of Rights. If scheduling of this audit poses an inconvenience, you may request up to a thirty (30) day delay from the date of this letter prior to the start of this examination. If you have any questions concerning our examination, please write or telephone me within ten days from the date of this letter.

Sincerely,
Rock Hill Taxpayer Service Center



Paulette C. Crawford, Auditor
Email: crawfop@sctax.org, (803)909-8766, Fax: (803) 324-8289
P. O. Box 12099, 454 S. Anderson Rd., Ste 202
Rock Hill, SC 29731

Lowes Home Centers, Inc.

6/21/2192

File #	Name	Store #	Street	City	Open date
40038688-1	Lowes Home Center, Inc.	Corp Hwy 268 E		N Wilkesboro, NC 28659	
1 002-17586-2	Lowes of Aiken	639 2470 Whiskey Rd		Aiken, SC 29803	2/1/1989
2 002-27931-3	Lowes of N Augusta	2207 1220 Knox Ave		N Augusta, SC 29841	12/14/2005
3 004-20086-7	Lowes of Anderson	383 3515 Clemson Blvd		Anderson, SC 29621	2/1/1989
4 007-20781-8	Lowes of Beaufort	207 Robert Smalls Pkwy		Beaufort, SC 29906	2/6/2002
5 007-20877-3	Lowes of Bluffton	1533 35 Malphrus Rd		Bluffton, SC 29910	5/2/2002
6 008-11892-1	Lowes of Summerville	358 1207 N Main St		Summerville, SC 29483	10/1/1993
7 008-19068-2	Lowes of Goose Creek	2464 520 Saint James Ave		Goose Creek, SC 29445	10/22/2006
8 010-46825-5	Lowes of Charleston	497 755 Northwoods Blvd		N Charleston, SC 29406	2/1/1989
9 010-46829-1	Lowes of Mt. Pleasant	539 1104 Market Center Blvd		Mt. Pleasant, SC 29464	2/1/1989
10 010-63424-5	Lowes Home Center	3125 Glenn McConnell Pkwy		Charleston, SC 29414	10/19/1998
11 010-63692-0	Lowes of James Island SC	770 Daniel Ellis Dr		Charleston, SC 29412-3034	11/16/1998
12 011-11182-4	Lowes of Gaffney	134 1601 W Floyd Baker Blvd		Gaffney, SC 29341	1/25/2006
13 016-15485-8	Lowes of Hartsville	2803 819 S 4th St		Hartsville, SC 29550	7/2/2007
14 018-15196-4	Lowes of N W. Charleston	99600 Dorchester Rd		Summerville, SC 29485	7/10/2009
15 021-19921-2	Lowes Home Center, Inc.	1120 2301 David H McLeod Blvd		Florence, SC 29501	2/1/1989
16 021-27415-8	Lowes of S Florence	1075 1701 Freedom Blvd		Florence, SC 29505	11/13/2000
17 023-49484-4	Lowes of Greer	1370 Wade Hampton Blvd W		Greer, SC 29650	2/1/1989
18 023-68022-3	Lowes of Simpsonville	3958 Grandview Dr		Simpsonville, SC 29680	4/1/1999
19 023-76584-6	Lowes of NW Greenville	1900 Poinsett Hwy		Greenville, SC 29609	3/24/2004
20 023-78149-0	Lowes of Greenville	386 1125 Woodruff Rd		Greenville, SC 29607	9/3/1992
21 024-09217-0	Lowes of Greenwood	518 513 Bypass 72 NW		Greenwood, SC 29649	2/1/1989
22 026-29889-0	Lowes of Myrtle Beach	410 1160 Seaboard St		Myrtle Beach, SC 29577	2/1/1989
23 026-45425-7	Lowes of N Myrtle Beach	603 214 US Hwy 17		N Myrtle Beach, SC 29597	3/1/1998
24 026-49554-2	Lowes of S Myrtle Beach	8672 Hwy 17 Bypass		Surfside, SC 29575	9/25/2000
25 026-53508-1	Lowes of Conway	2301 E Hwy 501		Conway, SC 29526	6/4/2003
26 028-10734-3	Lowes of Camden	11 Bay Ln		Camden, SC 29020	9/17/2003
27 029-12672-1	Lowes of N Lancaster	181 Fort Mill Hwy		Indian Land, SC 29707	4/24/2009
28 032-20463-1	Lowes of W Columbia	499 2829 Augusta Rd		West Columbia, SC 29464	2/1/1989
29 032-32939-2	Lowes of Lexington	5412 Sunset Blvd		Lexington, SC 29072	10/9/2000
30 032-41192-5	Lowes of SE Lexington Co	5570 Platt Rd		Lexington, SC 29073	10/12/2008

File #	Name	Store #	Street	City	Open date
31 036-07271-1	Lowes of Newberry		2911 Main St	Newberry, SC 29108	10/20/2004
32 037-09018-3	Lowes of Seneca	1635	195 Bilo Pl	Seneca, SC 29678	4/1/1992
33 038-14885-1	Lowes of Orangeburg	96	2896 North Rd Hwy 178	Orangeburg, SC 29115	2/1/1989
34 039-10542-2	Lowes Home Ctr Easley	469	6068 Calhoun Memorial Hwy	Easley, SC 29640	2/1/1989
35 039-18100-9	Lowes of Clemson	3071	608 Issaqueena Trail	Central, SC 29630	1/29/2010
36 040-44112-9	Lowes of N E Columbia	433	7441 Two Notch Rd	Columbia, SC 29223	2/1/1989
37 040-52592-1	Lowes of Irmo	385	390 Harrison Blvd	Irmo, SC 29063	11/1/1994
38 040-60740-5	Lowes of SE Columbia	1064	7420 Garners Ferry Rd	Columbia, SC 29209	8/21/2000
39 040-68513-3	Lowes of Richland County		10106 Two Notch Rd	Columbia, SC 29223	3/8/2006
40 040-72266-4	Lowes of N Richland Co	3026	1051 Sams Crossing Dr	Columbia, SC 29229	2/13/2009
41 042-31977-6	Lowes Home Ctr Inc	2595	120 E Blackstock Rd	Spartanburg, SC 29301	2/1/1989
42 042-49286-4	Lowes of Boiling Springs		170 Rainbow Lake Rd	Spartanburg, SC 29316	6/30/2004
43 042-49983-0	Lowes of Spartanburg	2548	2079 E Main St	Spartanburg, SC 29307	3/9/2005
44 043-13107-5	Lowes of Sumter	626	1251 Broad St	Sumter, SC 29150	2/1/1989
45 046-16096-4	Lowes of Rock Hill	416	1350 Springdale Rd	Rock Hill, SC 29730	2/1/1989
46 046-27806-2	Lowes of York		1010 E Liberty St	York, SC 29745	11/19/2003
47 046-30656-7	Lowes of Fort Mill	2442	1640 Hwy 160 W	Fort Mill, SC 29708	4/2/2007
48 046-32112-1	Lowes of N York Co		5288 Hwy 557	Clover, SC 29710	11/13/2008

South Carolina Department of Revenue
Audit Services

CAA-90

Rev 08-15-2003
(TM)-CAA-10

COMPUTER ASSISTED AUDIT QUESTIONNAIRE

Payer Information:

Name: Lowes Home Center, Inc.

FEI # : 56-0748358

Address: P O Box 1111

Lic. # : 40038688-1

City: N. Wilkesboro, NC 28659-1111

Date : August 8, 2011

1. Are any of your records computerized? YES ☐ NO ☐

2. Please indicate how the following records are maintained, the retention period, & storage media.

Record Type	Online Mths/Yrs	Archived Mths/Yrs	Storage Media (Note 1)	Manual Only †	Type Computer †		
					PC	Mainframe	Mini
Sales Invoices							
Purchase Invoices							
Purchase Orders							
Payment Vouchers							
Account Payable							
Accounts Receivable							
aging Reports							
Checks							
Other (Specify)							

Note 1. Please indicate the type of storage media: tape, 3480 or 3490 cartridge; diskette, CD, or other (please specify).

3. What type of computer do you use to maintain your records?

Manufacturer: _____ Model: _____ Size: _____

4. What software applications do you use to maintain your records?

Manufacturer: _____ Version: _____

5. Is any of the following information retained electronically within your accounting system?

a. Sales Tax Paid to Vendors? YES ☐ NO ☐ b. Use Tax Accrued? YES ☐ NO ☐

c. Description of Purchase? YES ☐ NO ☐ d. Sales Tax Collected? YES ☐ NO ☐

6. Have you changed your computer system in the last three years?

YES ☐ NO ☐

- a. If Yes, what was the date the system was taken out of service? _____/_____/_____
- b. Can these older history files be converted to run on the new system? YES ☐ NO ☐
7. Do you use EDI for business transactions? YES ☐ NO ☐
- a. Have you adopted ANSI EDI Standards? YES ☐ NO ☐
- b. If Yes, what areas? _____
8. Do you maintain a retention agreement with the IRS? YES ☐ NO ☐

If Yes, effective date of agreement. _____/_____/_____

9. PERSON(S) TO CONTACT

- a. Who is the person to contact to start our examination?

Name: _____ Title: _____

Address: _____ Telephone: (_____) _____

- b. What is the location of your records? _____

- c. Who is the person to contact regarding data processing information?

Name: _____ Title: _____

Address: _____ Telephone: (_____) _____

10. BUSINESS OPERATION

Give a general description of your business activities. _____

- b. Please furnish any additional information that will allow the auditor(s) to become familiar with your business prior to the start of the examination.

- c. Does your business maintain records for any related division, subsidiary, or affiliated company? YES ☐ NO ☐

If yes, please explain. _____

If you have any questions please call Paulette C. Crawford at (803)909-8766 or email at crawfop@sctax.org.

South Carolina Department of Revenue

Your Rights and Obligations as a South Carolina Taxpayer

Basic Rights and Obligations

- You have the right to apply for relief or assistance from the Taxpayer Rights' Advocate within the Department of Revenue. The Taxpayer Rights' Advocate is responsible for the resolution of taxpayer complaints and problems. Under certain conditions, the advocate may postpone until resolution any actions determined to cause you irreparable loss.
- You have the right to request and receive forms, instructions and other written materials in plain, easy-to-understand language.
- You have the right to prompt, courteous service from us in all your dealings with the Department of Revenue.
- You have the right to request and receive written information guides, which explain in simple and nontechnical language, appeal procedures and your remedies as a taxpayer.
- You have the right to receive notices which contain descriptions of the basis for and identification of amounts of any tax, interest and penalties due.
- You are required to provide complete and accurate information when you file your tax returns.
- You are required to keep records to prove the accuracy of your tax returns or to determine your tax liability if you did not file your return.
- You are required to file a return and pay your taxes when they are due.

Privacy & Confidentiality

- The Department of Revenue will not disclose to anyone the information you give us, except as authorized by law. You have the right to know why we are asking you for information, how we will use it, and what happens if you do not provide requested information.

The Audit Process

- When we notify you of a proposed change in your tax or to schedule an audit, we will advise you of your rights and responsibilities throughout the audit process and the steps to take to appeal if you disagree with the outcome. If you have any questions about your rights, please call us at one of the telephone numbers listed on the back of this brochure.

- If you move or your mailing address changes you are required to notify us of your current address.
- If we notify you that taxes are due, you are obligated to pay those taxes. If you don't think you owe the tax, you must file an appeal within the prescribed time.
- If you fail to file a return when required to, regardless of whether any tax is due, we will make an estimate of the amount due and issue a proposed assessment for that amount.
- If your failure to file a return or pay tax was due to written advice from us, we may, under certain circumstances, waive any penalties and interest.
- Generally, we must notify you that we think you owe taxes within three years of the date the taxes were due. We have more than three years to notify you if:
 - ☐ you committed fraud,
 - ☐ you failed to file a return,
 - ☐ you understated how much tax you owed by 20% or more,
 - ☐ the IRS is making an adjustment to your tax liability, or
 - ☐ you agree to waive the three-year deadline.
- If any of the above listed circumstances exist, the statute of limitations does not apply.
- If you are granted relief by the Taxpayer Rights' Advocate, all statutes of limitation are suspended during the relief period.
- If necessary, we may place a tax lien on your property. This generally means you will be unable to sell or borrow against your property until the debt is paid. These liens are generally filed in the courthouse of the county in which you reside or own property.
- We may also levy against your wages, bank account or other property you own. We may seize and sell your property to collect taxes you owe. Once you satisfy the tax debt which led to the lien being filed, we will record that the lien has been satisfied.
- If a lien has been filed in error, we will expunge the lien from public record and send a letter to you explaining the error.
- If we believe releasing or modifying a lien will facilitate the paying of the tax debt, we may, at our discretion do so.
- If we file a levy in error, you may request reimbursement of any bank charges you incur as a result of the levy. Your written request for reimbursement must be made within 90 days of the levy.
- If we have reason to believe that delay would hamper our ability to collect, we will take steps

most cases, penalties continue to accrue until the entire liability has been paid. You may request in writing that a penalty be abated. If you qualify under the Department's waiver guidelines, the Department of Revenue may abate the penalty.

- Interest will be charged to you for late tax payments. Interest will continue to accrue until the debt is paid.

Taxpayer Service

- The South Carolina Department of Revenue holds high the principles of the Taxpayers' Bill of Rights and will strive to insure your rights are protected in all dealings with us. We appreciate your comments and suggestions that may help us serve you better.
- We are here to help you. Please contact us by e-mail at www.sctax.org or by telephone to our contact center at (803) 898-5000. You may order forms and get answers to your income tax questions from a 24-hour automated telephone service. You may find information about South Carolina taxes on our website at www.sctax.org. Some helpful telephone numbers are listed on the back of this brochure.
- If you feel you are not getting proper assistance, you can call our Problems Resolution Office. A department specialist will work with you to help resolve problems you may be experiencing with the Department's administration of the tax laws.
- A taxpayer advocate is here to help you when all other steps fail. The taxpayer advocate takes an active and immediate interest in resolving your tax problem.

Where to call

Contact Center.....	(803) 898-5000
(Columbia)	
Problem Resolution Office.....	(803) 898-5873
Taxpayer Advocate.....	(803) 898-5444
Forms (24 hour service).....	1-800-768-3676
Columbia area.....	(803) 898-5320
Fax on Demand Forms	
(24-hour service).....	1-800-768-3676
Columbia area.....	(803) 898-5280
Refund Hotline (24-hour service).....	(803) 898-5300
Text Telephone.....	(803) 898-5656

Visit us on the Internet at: www.sctax.org

The Taxpayers' Bill of Rights may be found in Title 12, Chapter 58 of the

Introduction

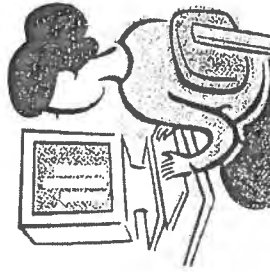
Technological advances, namely computer hardware and software applications, have given both businesses and government the ability to be more effective than ever before. Efficiency is of the highest importance in that time, money and personnel are elements that no one can afford to waste.

The volume and complexity of accounting records being produced by automated data processing systems has made

necessary the use of special auditing techniques to deal with such systems. The South

Carolina Department of Revenue (DOR) has over the past several years developed a Computer Assisted Audit System

(CAAS) that provides for efficient and accurate processing and analysis of taxpayers' electronic data



South Carolina
Department of Revenue

Computer Assisted Audit System

This brochure explains the methods DOR uses to incorporate modern technology into the audit function, and includes answers to frequently asked questions. The DOR is committed to using Computer Assisted Audit methods whenever possible and to promoting the effective use of modern technology in determining, accruing and paying proper tax. As computer technology increases, we will strive to keep pace with that technology and include it in our auditing techniques.

is not valid, the taxpayer must provide complete and accurate data before the audit can proceed.

3. Sample Methodology

In cases where a detailed review of all purchases or sales transactions is not feasible (large volume taxpayers), CAAS uses statistical methods in the selection of audit samples. This method is generally used for expense purchases and sales, but may be used in other areas. The field auditor and the taxpayer agree on what items will be included in the sample (account number selection, store locations, etc.). The resulting universe is broken down into dollar ranges. Our software is used to select a random sample of purchases or sales items from each stratum. A random sample means that every invoice in the group has an equal chance of being selected. The invoices that are selected from each stratum are then reviewed for tax treatment. If there is enough data in the electronic information to determine what the item is and its tax treatment, the hard copies may not need to be pulled for review. After the field auditor and the taxpayer agree on the tax treatment adjustments, the result from the statistical sample is projected using our software to calculate tax or credit due on the entire universe. The results are evaluated by our software to determine the validity of the sample.

Benefits of a Computer Assisted Audit

Quick – Computer assisted audits are completed faster than manual audits. Less time is needed by taxpayer personnel and by field auditors to

prepare audit information.

Efficient – More efficient auditing techniques for reviewing taxpayer's data are used in computer assisted audits. Data does not have to be re-entered by the field auditor into additional schedules.

Reliable – Computerized statistical sampling methods, as opposed to manual block samples, have proven to be more accurate in obtaining a dependable, representative sample.

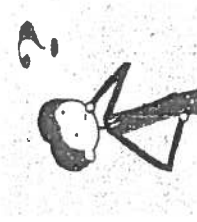
Less Paper – CAAS has the potential to do a 100% computerized audit. This reduces the amount of paper normally needed during an examination.

Questions and Answers

Will using CAAS alter the audit process?
No. Audit procedures remain the same. The difference between a computer assisted audit and a manual audit is that the information is submitted electronically, allowing the field auditor to examine a taxpayer's records quickly and more efficiently.

Why is CAAS more accurate?

CAAS uses scientific sampling methods to analyze data and provide an objective sample, which incorporates standard statistical sampling techniques, as well as generally accepted accounting principles.



JOINT EXHIBIT 2

South Carolina Department of Revenue
Audit Services

FS-93
Rev.
06/10/05-TM

Consent to Extend the Time to Assess Tax

Lowe's Home Centers, Inc.

File # 40038688-1
SSN/FEI # [REDACTED]

and the SOUTH CAROLINA DEPARTMENT OF REVENUE previously entered into a written agreement that extended the time for mailing the notice of assessment or refund any STATE tax due on any return(s) made by or for the above taxpayer(s) for the period(s) starting 08/01/2008 through 07/31/2011 may be assessed at anytime on or before June 30, 2012.

By executing this document the parties mutually agree to further extend the time for mailing the notice of assessment or refund of the above referenced tax for the period(s) starting 08/01/2008 through 07/31/2011 until September 30, 2012 in accordance with the provisions of Section 12-54-85(C)(4) of the 1976 South Carolina Code of Laws, as amended.

Lowe's Home Centers Inc.
(Name of taxpayer)

By: [Signature]
(Taxpayer, Partner, Officer of Corp., etc.)

Vice President - Tax
(Title)

6/20/12
(Date)

SOUTH CAROLINA DEPARTMENT OF REVENUE

By:

[Signature]
Paulette C. Crawford, Auditor
Audit Services

6-20-2012
(Date)

If this waiver is executed on behalf of a corporation, it will be signed by such officer or officers of the corporation as are empowered under the laws of the State in which the corporation is located to sign for the corporation.

DOR RESP LOWE'S 0011

South Carolina Department of Revenue
Audit Services

FS-93
Rev.
06/10/05-TM

Consent to Extend the Time to Assess Tax

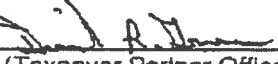
Lowe's Home Centers, Inc.

File # 40038688-1
SSN/FEI # 

and the SOUTH CAROLINA DEPARTMENT OF REVENUE previously entered into a written agreement that extended the time for mailing the notice of assessment or refund any STATE tax due on any return(s) made by or for the above taxpayer(s) for the period(s) starting 08/01/2008 through 07/31/2011 may be assessed at anytime on or before March 31, 2012

By executing this document the parties mutually agree to further extend the time for mailing the notice of assessment or refund of the above referenced tax for the period(s) starting 08/01/2008 through 07/31/2011 until June 30, 2012 in accordance with the provisions of Section 12-54-85(C)(4) of the 1976 South Carolina Code of Laws, as amended.

Lowe's Home Centers, Inc.
(Name of taxpayer)

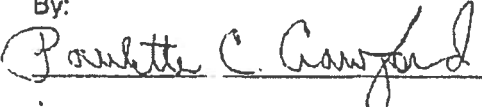
By: 
(Taxpayer, Partner, Officer of Corp., etc.)

Vice President - Tax
(Title)

3/13/12
(Date)

SOUTH CAROLINA DEPARTMENT OF REVENUE

By:



Audit Services

3/12/2012
(Date)

If this waiver is executed on behalf of a corporation, it will be signed by such officer or officers of the corporation as are empowered under the laws of the State in which the corporation is located to sign for the corporation.

DOR RESP LOWE'S 0012

South Carolina Department of Revenue
Audit Services

FS-43
Rev.
06/10/05-TM

Consent to Extend the Time to Assess Tax

Lowe's Home Centers, Inc.

File # 40038688-1
SSN/FEI # 

and the SOUTH CAROLINA DEPARTMENT OF REVENUE consent and agree to the following:

The amount of any State Sales Tax due ^{or refundable} on any return(s) made by or for the above taxpayer(s) for the period(s) starting 08/01/2008 through 07/31/2011 may be assessed at any time on or before March 31, 2012.

This agreement extends the time for mailing the notice of assessment or refund of the above tax pursuant to the provisions of Section 12-54-85(C)(4) of the 1976 South Carolina Code of Laws, as amended.

Lowe's Home Centers, Inc.
(Name of taxpayer)

By: 
(Taxpayer, Partner, Officer of Corp., etc.)

Vice President - Tax
(Title)

9/19/2011
(Date)

SOUTH CAROLINA DEPARTMENT OF REVENUE

By:


Paulette C. Crawford, Auditor
Audit Services

9-12-2011
(Date)

If this waiver is executed on behalf of a corporation, it will be signed by such officer or officers of the corporation as are empowered under the laws of the State in which the corporation is located to sign for the corporation.

DOR RESP LOWE'S 0013

JOINT EXHIBIT 3



SOUTH CAROLINA DEPARTMENT OF REVENUE

Audit Services

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

SID: 1384067 000
FEIN/SSN [REDACTED]
File#: 40038688-1
ACN: 06/21/2192

Period: 08/01/2008 thru 07/31/2011 (36 Mths)
Auditor: Paulette C. Crawford 6428
Auditor: Kimberly Hyatt
Interest & Penalty Date: 12/27/2012 County/Municipality Code:

Combined Billing Summary & Distribution Report

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

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

JOINT EXHIBIT 4



SOUTH CAROLINA DEPARTMENT OF REVENUE

Audit Services

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

SID: 1384067 000
FEIN/SSN: [REDACTED]
File#: 40038688-1
ACN: 06/21/2192

Period: 08/01/2008 thru 07/31/2011 (36 Mths)
Auditor: Paulette C. Crawford 6428
Auditor: Kimberly Hyatt
Interest & Penalty Date: 12/27/2012 County/Municipality Code:

Distribution Report [6320]

AS-54-DIST
Sales Tax
Total

G/L Code	Code	DLN	Tax	Interest	Penalty	Total	
27 34-2740	2615X		148.73	12.32	0.00	161.05	27
28 34-2721	2656		218.58	23.43	0.00	242.01	28
29 34-2721	2876		218.47	23.36	0.00	241.83	29
30 34-2721	2080		232.76	25.47	0.00	258.23	30
31 34-2730	5101		114.22	5.83	0.00	120.05	31
32 34-2730	5111		218.47	23.56	0.00	242.03	32
33 34-2730	5181		259.87	30.18	0.00	290.05	33
34 34-2730	5261		871.05	78.36	0.00	949.41	34
35 34-2730	5320		836.95	90.83	0.00	927.78	35
36 14-4701	SALE6		185,725.55	19,520.48	0.00	205,246.03	36
Total (36)			201,520.12	21,186.88	0.00	222,707.00	

WACH EXP01 TX

LOWE'S®

66-156
531

CHECK NO. 2260762

P O BOX 1111
NORTH WILKESBORO, NORTH CAROLINA 28658

WACHOVIA BANK, N.A.
CHAPEL HILL, NORTH CAROLINA

PAY

DATE

AMOUNT

TWO HUNDRED TWENTY TWO THOUSAND SEVEN
HUNDRED SEVEN AND 00/100 DOLLARS *****

12/13/12

***222,707.00

VOID AFTER 90 DAYS

TO
THE
ORDER
OF

SOUTH CAROLINA DEPT. OF
REVENUE
P.O. BOX 18323, OFFICE STE 475
SPARTANBURG SC 29318

[Handwritten Signature]
[Handwritten Signature]

DOR RESP LOWE'S 0101

LOWE'S®P O Box 1111
North Wilkesboro, NC 28658

▲ Detach Here ▲

Statement of Remittance

STORE	REF.NO.	INVOICE NO.	DATE	VOUCHER	GROSS AMOUNT	DISCOUNT	NET AMOUNT
		121212444	121212	BQSPVK	222,707.00	.00	222,707.00
File #							
40038688-1							
Fed ID							
							
Audit Control #							
06/21/2192							
CHECK NO.	DATE	VENDOR NO.		TOTAL GROSS		TOTAL DISC.	TOTAL AMOUNT
2260762	121312	0000065136 SOUTH CAROLINA		222,707.00			222,707.00

DOR RESP LOWE'S 0102