THE STATE OF SOUTH CAROLINA

In The 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.

FINAL REPLY BRIEF OF APPELLANT

Burnet R. Maybank, III, SC Bar No. 3699
Rick Reames III, SC Bar No. 68327
Jim Rourke, SC Bar No. 79879
NEXSEN PRUET, LLC
1230 Main Street, Suite 700 (29201)
Post Office Drawer 2426
Columbia, South Carolina 29202
Telephone: (803) 771-8900
bmaybank@nexsenpruet.com
rreames@nexsenpruet.com
jrourke@nexsenpruet.com

John M. Allan
JONES DAY
1420 Peachtree Street NE
Suite 800
Atlanta, Georgia 30309
Telephone: (404) 581-8012
jmallan@jonesday.com

Attorneys for Appellant Lowe's Home Centers, LLC

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bmaybank@nexsenpruet.com
rreames@nexsenpruet.com
jrourke@nexsenpruet.com

John M. Allan
JONES DAY
1420 Peachtree Street NE
Suite 800
Atlanta, Georgia 30309
Telephone: (404) 581-8012
jmallan@jonesday.com

Attorneys for Appellant Lowe's Home Centers, LLC

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I. INTRODUCTION

Lowe's undisputedly operates a retailer line of business where it makes traditional retail sales of home improvement products and building materials to customers. But Lowe's also operates a $5 billion contractor line of business where it regularly enters into contracts with customers to affix items of tangible personal property ("TPP") to customers' real property ("Installation Contracts"). Accordingly, the Administrative Law Court ("ALC") rightfully found, "Lowe's is both a contractor and a retailer" (ALC Order pp. 8-10, 18, R. pp. 9-11, 19); *i.e.*, a "dual business" as recognized by S.C. CODE ANN. REGS. § 117-324 (the "Dual Business Regulation").

This appeal focuses on Lowe's' contractor line of business and distills to two issues: (1) what was the taxable retail sale for purposes of Lowe's' Installation Contracts, and (2) what were the gross proceeds subject to sales tax. Although Lowe's is a contractor and a retailer, it operates as a contractor for purposes of its Installation Contracts. The taxable retail sale was the sale to Lowe's of the materials used to perform the real property improvements. S.C. CODE ANN. §§ 12-36-110(1)(a), (1)(c). The proceeds subject to tax were the cost price Lowe's paid. *Id.* § 12-36-90.

In the Initial Brief of Respondent ("Department's Brief"), the Department contends, "There are three distinct transactions at issue: (1) when Lowe's buys materials tax free (at wholesale) from its vendors; (2) when Lowe's withdraws materials for use in an installation contract; and (3) when a Lowe's customer pays the retail price for the materials plus installation." (Department's Brief p. 1). The Department's auditor said the taxable retail sale occurred at point (3). (*See* Lowe's' Initial Brief pp. 12-13). In its Final Determination and during the contested case hearing, the Department concluded the taxable retail sale occurred at point (2). (Department's Brief p. 1). The Department's Brief now contends that the retail sale occurred at point (3). (*Id.* pp. 20-30). Notably, this marks the ***third*** time in this case that the Department has changed its construction of the relevant laws. The Court should reject the Department's shifting, erroneous positions.

The evidence shows that Lowe's' Installation Contracts are real property improvement contracts. A key, undisputed fact is the contracts explicitly state that Lowe's retains title to all materials until after they become incorporated into the customers' real property and "[a]ny surplus materials upon completion of the Installation Services shall remain the property of Lowe's." (*See, e.g.*, Joint Ex. 34 p. 4, R. p. 903; 4/20/16 T. p. 41 lines 2-9, p. 45 line 9 – p. 46 line 20, R. pp. 76, 80-81). Also, the General Manager for the Policy Section within the Department's Office of General Counsel admitted that Lowe's was "making improvement[s] to real property" and "providing contracting services." (6/7/16 T. p. 41 line 13 – p. 42 line 4, R. p. 381). Lowe's "[was] the final user – consumer of the building materials." (*Id.* p. 65 line 25 – p. 67 line 1, R. p. 387). The foregoing, and other evidence, shows that the taxable retail sale was the sale to Lowe's of the materials used under the Installation Contracts. (*See* Lowe's' Initial Brief pp. 25-29). Because the taxable retail sale was the sale to Lowe's, both South Carolina law (*e.g.,* S.C. CODE ANN. REGS. §§ 117-314.1 & 117-314.2) and common sense provide that the amount subject to tax was the price Lowe's paid to acquire the materials. You would never purchase an item from a store and pay sales tax on a price some other person might be charged in a different transaction. The same is true here.

Because Lowe's is a dual business, the Dual Business Regulation required it "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 ANN. REGS. § 117-324 (emphasis added). The Department belabors the fact that Lowe's purchased the materials at issue as if they were "at wholesale" to claim Lowe's seeks to have its cake and eat it too: "to be able to buy materials in bulk at discounted rates", and make those purchases at wholesale, but be taxed as a contractor. (Department's Brief pp. 1-2, 34-41). But the amount of sales tax Lowe's paid to the state would have been the same even if it did not purchase all materials as if they were at wholesale.

For example, assume Lowe's purchased flooring from a vendor for $100. "There is a certain amount that [Lowe's] know[s] [is] going to be retail sales and a certain amount that's going to be related to real property improvements." (*See* 4/20/16 T. p. 94 line 4 – p. 95 line 2, R. pp. 129-130). Because Lowe's initially did not know the specific flooring that would be sold versus used, it would have extended its resale certificate to purchase all flooring from the vendor. If Lowe's later entered into an Installation Contract to affix flooring in a customer's home, it would pay tax on its $100 cost at the time it used the flooring. If, however, Lowe's paid sales tax to its vendor at the time it first purchased the flooring, Lowe's would still have paid tax on the $100 cost. Lowe's would not have paid the vendor sales tax on $140 (the 40% mark up to the shelf/retail price). When Lowe's uses materials to make real property improvements, it pays the same amount of tax to the state regardless of whether it purchased the items from its vendor using a resale certificate (*i.e.*, at "wholesale"). The only difference is the timing.

The Department complains that Lowe's receives an alleged unfair advantage because it "buy[s] materials in bulk at discounted rates." (Department's Brief pp. 1-2) ("Lowe's is asking for treatment that no contractor in South Carolina receives"). The evidence, including Department testimony, shows other contractors receive similar volume discounts. *Infra* p. 25.

II. ARGUMENT

A. THE ALC (AND NOW THE DEPARTMENT) ERRED AS A MATTER OF LAW IN INTERPRETING THE APPLICABLE STATUTES AND REGULATIONS TO DETERMINE THAT THE INSTALLATION CONTRACTS INVOLVE A TAXABLE RETAIL SALE OF TPP BY LOWE'S TO CUSTOMERS

1. The Department's Inconsistent Positions Suggest Ambiguity that Must Be Construed in Lowe's' Favor

The Department asserts that the language of the applicable statutes and regulations is "plain and unambiguous". (Department's Brief p. 19). It also asserts that even if the relevant statutes and

regulations are ambiguous, its construction of those laws "is entitled to deference and should not be overruled absent compelling reasons." (*Id.*). But the Department has construed the laws in this case inconsistently without explaining its inconsistency. The Department's auditor testified that, "without ever seeing or reviewing the contracts," she determined that the Installation Contracts were "two separate transactions": a taxable retail sale of TPP by Lowe's to the customer, and a nontaxable sale of installation services by Lowe's for items owned by the customer. (4/20/16 T. p. 191 line 3 – p. 192 line 7, p. 197 lines 3-14 & p. 219 lines 12-17, R. pp. 226-227, 232, 254; Joint Ex. 29 p. 4, R. p. 817).[1] In the Final Determination and contested case hearing, the Department rejected the auditor's position. Indeed, the Department's General Manager for the Policy Section, McCormack, testified that Lowe's "[was] the final user – consumer of the building materials" used to perform an Installation Contract. (6/7/16 T. p. 65 line 25 – p. 67 line 1, R. p. 387). He stated the construction that an Installation Contract "was a sale and installation and not a withdrawal for use [wa]s – [wa]s incorrect" and wrong "as a matter of law." (*Id.* p. 52 line 22 – p. 53 lines 22 & p. 63 lines 15-19, R. pp. 383-384, 386). The Department's Final Determination ultimately took the position that "pursuant to sections 12-36-90(1)(c) and 12-36-110(1)(c), the withdrawal for use of these items by the taxpayer should be characterized as retail sales and included in the taxpayer's gross proceeds of sales subject to the tax." (Joint Ex. 32 p. 3 of 8, R. p. 859; ALC Order p. 14, R. p. 15). Now, contrary to the Installation Contracts and testimony from the Department, the Department's Brief asserts that the taxable retail sale was the sale of TPP to Lowe's' customers. (Department's Brief pp. 3, 20-30). The Department's Brief states that McCormack has "been

[1] The Department asserts that the auditor ultimately reviewed the Installation Contracts and her subsequent review "cemented" her position that Lowe's sold TPP to customers under its contracts. (Department's Brief p. 26 n.10). But the auditor testified that the undisputed facts that the contracts were lump sum and title did not transfer to the customer until after items were affixed and converted to real property were "irrelevant." There was nothing that could be put in the Contracts to change her position. (4/20/16 T. p. 219 line 20 – p. 221 line 14, R. pp. 254-256).

employed with the Department for approximately thirty-six years" and his work "has been focused primarily in the area of sales tax." (Department's Brief p. 13). Yet, the Department's Brief rejects his interpretation without reason.

Even before the Department adopted its latest construction in the Department's Brief, the ALC recognized the Department's inconsistent positions:

> 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. . . . [T]he 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.

(ALC Order pp. 29-30, R. pp. 30-31) (emphasis added).

The Department's shifting positions suggest ambiguity that must be construed in favor of Lowe's. The laws at issue, *e.g.*, Retail Sale Statute and Gross Proceeds Statute, are tax imposition statutes. Ambiguity, especially in the case of general tax administration and not a credit or exemption, must be resolved in favor of the taxpayer. *Alltel Commc'ns, Inc. v. S.C. Dep't of Revenue*, 399 S.C. 313, 321, 731 S.E.2d 869, 873 (2012) ("'In the enforcement of tax statutes, the taxpayer should receive the benefit in cases of doubt.'") (quoting *S.C. Nat'l Bank v. S.C. Tax Comm'n*, 297 S.C. 279, 281, 376 S.E.2d 512, 513 (1989)). Moreover, the Department's varying interpretations are compelling reasons to reject its request for deference. *See, e.g.*, *I.N.S. v. Cardoza-Fonseca*, 480 U.S. 421, 446 n.30 (1987) ("An agency interpretation of a relevant provision which conflicts with the agency's earlier interpretation is 'entitled to considerably less deference' than a consistently held agency view."); *United Housing Found., Inc.*

v. Forman, 421 U.S. 837, 858 n.25, 95 S. Ct. 2051, 2063, 44 L. Ed. 2d 621 (1975) (giving "no special weight" to the Securities and Exchange Commission's interpretation of a statute because it "contradict[ed]," without explanation, the Commission's earlier interpretation); *Malcomb v. Island Creek Coal Co.*, 15 F.3d 364, 369 (4th Cir. 1994) (same).

2. Lowe's Is a Contractor for Purposes of its Installation Contracts

The ALC and the Department agree that Lowe's acts as a contractor when it performs real property improvements related to its Installation Contracts. (ALC Order p. 10, R p. 11) ("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"); (6/7/16 T. p. 41 line 13 – p. 42 line 4, R. p. 381) (Lowe's was "making improvements to real property" and "providing contracting services"). The ALC, however, bifurcated the Installation Contracts into two parts and concluded that Lowe's acted as a retailer for part of the transaction (allegedly selling TPP to customers) and, thereafter, acted as a contractor for the other part of the transaction (installing the materials involved in the project). (ALC Order pp. 25-26, R. pp. 26-27). On the other hand, the Department insists that Lowe's cannot be treated as a "true contractor" for tax purposes during these transactions primarily because of the size of Lowe's' retail business and representations that it is a retailer. (Department's Brief pp. 1, 28-33). In reaching these conclusions, the ALC's Order, and the Department's Brief, ignore substantial evidence showing that Lowe's acts solely as a contractor for all purposes (including tax) when it performs the Installation Contracts.

South Carolina's laws regarding who can qualify as a contractor are broad. *See* S.C. CODE ANN. REGS. § 117-314.2; S.C. CODE ANN. § 40-11-20(4), (8), (9). The Department's auditor even admitted that Lowe's "fits within this definition" when it installs real property improvements at customers' homes. (4/20/16 T. p. 163 line 23 – p. 164 line 20, R. pp. 198-199). The Department has admitted that nothing in South Carolina's sales tax code or regulations says a retailer "cannot

be a contractor . . . as defined under the statute and as established under the regulations." (4/20/16 T. p. 227 lines 14-24, R. p. 262). In fact, the Department's Sales and Use Tax Manual recognizes that a retailer may "serve[] as a contractor or subcontractor in the traditional sense for some transactions." (Joint Ex. 63, Chapter 16, p. 7, R. p. 1746). Additionally, the Dual Business Regulation provides that taxpayers, like Lowe's, may be a retailer for some transactions and a contractor for others. *See* S.C. CODE ANN. REGS. § 117-324. The undisputed evidence shows Lowe's is a contractor for purposes of its Installation Contracts because (1) the contracts establish that Lowe's is a contractor; (2) Lowe's holds itself out as both a retailer and a contractor; (3) the Department's guidance supports a determination that Lowe's is a contractor; and (4) persuasive authority from other jurisdictions support that Lowe's is a contractor.

a. ***Lowe's' Installation Contracts show Lowe's acts as a contractor when performing real property improvements.***

The Installation Contracts contain terms and conditions that establish customers are purchasing real property improvements from a contractor, not TPP from a retailer. (Joint Exs. 34 & 35, R. pp. 899-910; 4/20/16 T. p. 41 lines 2-9, R. p. 76). The ALC (and now the Department) erred as a matter of law in disregarding the terms of the contracts in incorrectly determining that Lowe's acted in its capacity as a retailer selling TPP to its Installation Contract customers. Basic principles of contract law require that "the intention of the parties and the meaning [be] gathered primarily from the contents of the writing itself, or, as otherwise stated, from the four corners of the instrument, and when such contract is clear and unequivocal, its meaning must be determined by its contents alone." *McPherson v. J.E. Sirrine & Co.*, 206 S.C. 183, 204, 33 S.E.2d 501, 509 (1945).

Here, the contract speaks for itself – the parties to the contract understand that Lowe's is acting as a contractor and the contract is entered into for the purposes of real property

improvements, rather than a sale of TPP. *First*, the contracts provide that Lowe's will subcontract the installation services. (Joint Ex. 34 p. 4, R. p. 903; Joint Ex. 35 p. 4, R. p. 909). In light of its role as general contractor, the agreements provide that Lowe's is "responsible to Customer for obtaining any and all licenses and building permits which are legally required to perform the Contract." (*Id.*). Additionally, Lowe's "warrant[s] that the Installation Services will be performed . . . in a good and workmanlike manner" and "bears the risk" for the contract being performed to the customer's satisfaction and "in compliance with all applicable safety rules and all existing building codes, zoning ordinances and other laws." (*Id.*; 4/20/16 T. p. 43 line 18 – p. 44 line 11, R. pp. 78-79). *Second*, the contracts are lump-sum contracts. They state that Lowe's is required to provide both the materials and labor necessary to complete the real property improvement for one fixed, lump-sum price. (Joint Ex. 34 p. 4, R. p. 903; 4/20/16 T. p. 43 line 18 – p. 44 line 11, R. pp. 78-79). *Third*, and most significantly, the contracts explicitly state that Lowe's retains title to all materials used to perform the real property improvements until after they are incorporated into the customers' real property and "[a]ny surplus materials upon completion of the Installation Services shall remain the property of Lowe's and shall be returned to Lowe's by the Installer." (*E.g.*, Joint Ex. 34 p. 4, R. p. 903; 4/20/16 T. p. 41 lines 2-9, p. 45 line 9 – p. 46 line 20, R. pp. 76, 80-81).

The Department's Brief does not address *McPherson* or the terms of the contracts. Instead, it focuses on two sentences found in a separate form that was attached to one of the Installation Contracts in error. That separate form states, "Lowe's is a supplier of materials only. Lowe's does not engage in the practice of engineering, architecture, or general contracting[.]" (Joint Ex. 35, p. 6, R. p. 910). Will Lowe testified for Lowe's during the contested case hearing. His undisputed testimony explained that the form containing the above language was a preprinted project estimate form that did not relate to Installation Contracts, was never signed by customers, and was

erroneously included in the contract file. (6/7/16 T. p. 128 line 7 – p. 129 line 11, R. p. 402-403). Lowe inquired about the purpose of the form and discovered it was an old form that was used prior to the time Lowe's began its contractor line of business in the mid-1990s; the form was specifically used to provide quotes to contractors, builders, and customers that were making large purchases. (4/20/16 T. p. 36 line 19 – p. 37 line 6 & p. 71 lines 12-15, R. pp. 71-72, 106; ALC Order p. 4, R. p. 5; 6//7/16 T. p. 130 line 12 – p. 131 line 20, R. p. 403). This language in an unrelated form does not have any bearing on the clear language of the Installation Contracts themselves.

b. *Lowe's holds itself out as a contractor.*

Lowe's holds itself out to the public not only as a retailer, but also as a contractor working with subcontractors to provide real property improvements. Lowe's' Form 10-K states, "We offer installation services through independent contractors in many of our product categories, with Flooring, Millwork and Cabinets & Countertops accounting for the majority of sales." (Joint Ex. 20 p. 7, R. p. 615). Likewise, the "About Lowe's" section of Lowe's' website states, "Lowe's offers more than 50 interior and exterior installation services, such as appliances, flooring and blinds." (Joint Ex. 22 p. 2, R. p. 723). The website also provides a list of services, including "Installation services provided through independent contractors, primarily in Flooring, Kitchens & Appliances and Millwork." (Joint Ex. 23 p. 2, R. p. 726). Another page discusses the Lowe's Installation Team and lists the license numbers and certifications held by or on behalf of Lowe's in multiple states, including South Carolina. (Joint Ex. 24, R. pp. 728-729). Thus, the ALC recognized that Lowe's offers Installation Contracts for just about every home improvement there is, from built-in "appliance[s] 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." (ALC Order p. 4, R. p. 5; *see also* 4/20/16 T. p. 37 line 14 – p. 38 line 1, R. pp. 72-73).

c. *The Department's own guidance supports that Lowe's acts as a contractor for purposes of its Installation Contracts.*

The Department has indicated in guidance that taxpayers are not retailers with respect to their real property improvement contracts and are instead acting as contractors. *See* Private Letter Ruling 07-4 (S.C. Dep't of Revenue (July 13, 2007)). Private Letter Ruling 07-4 provides that sales of TPP by a taxpayer are subject to tax, while sales of TPP which become part of real property by the same taxpayer would ***not*** be subject to tax. *Id.* (emphasis added). The Department's Brief does not address Letter Ruling 07-4, nor does the ALC's Final Order.

Moreover, the test set forth in the Department's Sales and Use Tax Manual supports Lowe's' position. In its brief, the Department refers to a portion of its policy set forth in its Sales and Use Tax Manual. (Department's Brief pp. 32-33). However, the Department does not quote the part of its policy that states "the determination as to whether a person is a retailer making sales and installations or a contractor may require a review of the various agreements or contracts between the taxpayer and his customers." (Joint Ex. 63, Chapter 16, p. 6, R. p. 1745).

After ignoring the part of the policy that is most favorable to Lowe's, the Department erroneously concludes that the factors weigh against Lowe's' position that it is a contractor. (Department's Brief pp. 32-33). In so doing, the Department ignores several additional favorable factors like Lowe's advertising itself as both a retailer and a contractor, and testimony (including from the Department's own witness) regarding customers' perception and understanding that they are entering into a contract for the installation of real property improvements. (Joint Exs. 34 & 35, R. pp. 899-911; 4/20/16 T. p. 41 lines 2-9, R. p. 76); (6/7/16 T. p. 45 lines 12-15, p. 46 lines 10 – p. 48 line 21, R. p. 382) ("I was buying improvement to real property.").

The Department does concede that Lowe's' contractor licenses in South Carolina help establish that Lowe's acted as a contractor pursuant to its Installation Contracts. (Department's

Brief p. 33). But in an attempt to undermine this favorable factor for Lowe's, the Department mischaracterizes the length of time Lowe's was licensed by the SCLLR during the Audit Period. (*Id.*). Specifically, the Department asserts that Lowe's did not have a general contractor's license for "most of the installation contracts at issue." (*Id.* p. 21). While a license is not required to fall within the meaning of a contractor, Lowe's in fact held licenses throughout the entire Audit Period. Craig Price explained in his trial testimony that licenses held by individuals qualified Lowe's as a contractor throughout the Audit Period. (4/20/16 T. p. 44 line 12 – p. 45 line 5, p. 117 lines 5-25, R. pp. 79-80, 152).[2] The Department is careful to say Lowe's only held a SCLLR-issued *General Contractor license* for the last two months of the Audit Period. (Joint Ex. 33 p. 1, R. p. 891). The Department ignores that Lowe's held a SCLLR-issued Residential Builder license dating back to 2002; thus, prior to holding the General Contractor license, Lowe's held the Residential Builder license all other months in the Audit Period. (Joint Ex. 33 pp. 2-8, R. pp. 892-898). S.C. CODE ANN. § 40-59-20 defines "Residential Builder" as "one who constructs, superintends, or offers to construct or superintend the construction, repair, improvement, or reimprovement of a residential building or structure which is not over three floors in height and which does not have more than sixteen units in any single apartment building". Lowe's' improvements to customers' residences via its Installation Contracts fit squarely within the definition of Residential Builder.

d. *Persuasive authority from other jurisdictions supports that Lowe's acts as a contractor for purposes of the Installation Contracts.*

The Department does not dispute that the Installation Contracts at issue in this case contain the same terms as contracts used by Lowe's in other jurisdictions. (*See* Lowe's' Initial Brief p. 34). Nor does it dispute that Lowe's has confronted the same controversy relating to its Installation

[2] *See also* South Carolina Contractor's Licensing Board Frequently Asked Questions, available at https://llr.sc.gov/clb/faq.aspx (noting a qualifying party is an individual who has been issued a certificate to qualify an entity for a license by passing the examination in a license classification or sub-classification).

Contracts in Oklahoma, Kansas, and Indiana. (*Id.*). These jurisdictions have each agreed that, although Lowe's is a "recognized retailer", it acts as a contractor when affixing TPP to customers' real property pursuant to Installation Contracts. *See Matter of Lowe's Home Ctrs.*, LLC, No. 115,254, 2017 WL 1369944, at *23 (Kan. Ct. App. Apr. 14, 2017) (affirming the Kansas Board of Tax Appeals' decision "that Lowe's was acting as a contractor when it installed built-ins into customer's homes"); *Lowe's Home Ctrs., LLC v. Indiana Dep't of State Revenue*, 23 N.E.3d 52, 55 (Ind. T.C. 2014) (agreeing that Lowe's was a contractor for purposes of the Installation Contracts; rejecting the Department's position that under an Installation Contract Lowe's was a retailer, selling TPP to customers), cert denied (2015).[3] *Accord In the Matter of the Sales Tax and Use Tax Protest of Lowe's Home Ctrs., LLC a/k/a Lowe's Home Ctrs., Inc.*, Okla. Tax Comm'n Order, Case No. P-09-195-H , p. 45 (Feb. 26, 2015), *aff'g In the Matter of the Sales Tax and Use Tax Protest of Lowe's Home Ctrs., LLC a/k/a Lowe's Home Ctrs., Inc.*, A.L.J. Findings, Conclusions and Recommendations, Case No. P-09-195-H (July 7, 2014) (holding that Lowe's, "[a]s a 'Contractor,'" was the final consumer or use of the materials incorporated into the customer's real property, pursuant to the terms of the Installation Contracts).[4] This persuasive authority rebuts the Department's characterization of Lowe's as manipulating the system in order to "[have its] cake and eat[ ] it too." (Department's Brief p. 1). Rather, in each jurisdiction where it operates, Lowe's carefully analyzes and applies the law to avoid wrongfully shifting sales tax onto its customers and the threat of consumer class actions. (6/7/16 T. p. 60 line 21 – p. 61 line 5,

[3] In addition to these cases, early in the history of Lowe's' contractor business, the Maryland Department of Revenue sent Lowe's "notice that in the state of Maryland [on] these transactions, you're serving as a contractor". (4/20/16 T. p. 75 line 19- p. 76 line 1, R. pp. 110-111). Ohio and Utah sent similar notices. (*Id.* p. 76 lines 2-7, R. p. 111).

[4] The Department moved to strike the copy of the Oklahoma decision Lowe's submitted as Attachment 1 to Lowe's Initial Brief. (*See* Department's Motion to Strike) This Court should deny the Department's motion. (*See* Appellant's Objection to the Department's Motion to Strike).

R. p. 385-386) (testimony from Department witness, agreeing that retailers "have to be careful. They can't collect a tax if it's not owed. If they do[,] they open themselves up to liability.").

The Department asserts that this authority should be entirely ignored by the Court because the statutory scheme in each of the other states "is far different from the statutory scheme in South Carolina." (Department's Brief p. 34). Lowe's' Initial Brief outlines the important similarities between the laws in each jurisdiction. (Lowe's' Initial Brief pp. 31-33). For instance, South Carolina, Kansas, Indiana, and Oklahoma all impose sales tax on sales of TPP at retail. And, each of the states have similar definitions that tie a retail sale of TPP to a transfer of property. (*Id.*) The Department's attempts to distinguish South Carolina law from the other three jurisdictions fail.

As an initial matter, the Department asserts that "*none*" of the other states contain language similar to the withdrawal language in S.C. Code Ann. § 12-36-110(1)(c), which provides that a retail sale includes "the withdrawal, use, or consumption of tangible personal property by anyone who purchases it at wholesale." (Department's Brief p. 34). Contrary to the Department's assertion, the Kansas Department of Revenue provides, "In general, when a contractor-retailer withdraws merchandise from inventory to install for another, the contractor-retailer must accrue sales tax on the cost of the materials." Kansas Information Guide, KS-1525, available at https://www.ksrevenue.org/pub1525.html.

Next, the Department states three other points of alleged distinction; each of which is a red herring. (*See* Department's Brief p. 34) (stating (1) Kansas, Indiana, and Oklahoma do not have a regulation like Section 117-309.17; (2) the Indiana case involved a regulation that distinguished between time and material and lump sum contracts, and (3) unlike in Kansas, Indiana, and Oklahoma, Lowe's is legally responsible for sales tax in South Carolina). It is irrelevant that the other three states do not have language regarding how to tax withdrawals by retailers, because that

section is irrelevant to taxation of contractors, as Lowe's explained in its initial brief. (Lowe's' Initial Brief pp. 41-42). Similarly, the fact that Indiana had a regulation that distinguished between time and material and lump-sum contracts is irrelevant to Lowe's' reason for citing the decision, which is that multiple jurisdictions have ruled that Lowe's should be taxed as a contractor. Finally, Lowe's' reason for citing to its prior cases was to provide authority for the position that Lowe's has been found to act as a contractor for tax purposes, not for the proposition of who bears the incidence of tax and whether Lowe's should somehow be able to pass on tax to its customers.

3. The Installation Contracts Are Retail Sales Under Either S.C. CODE ANN. §§ 12-36-110(1)(a) or (1)(e)

The ALC concluded that the customer, not Lowe's, is the final purchaser of the TPP used to perform the real property improvements via the Installation Contracts and it is the sale of TPP by Lowe's to customers that constituted the taxable retail sale under the general definition of the Retail Sale Statute. (ALC Order pp. 25-26, R. pp. 26-27). The Department conveniently adopts the same construction in its brief. (Department's Brief p. 21).[5] The ALC and Department are wrong.

As detailed in Lowe's' Initial Brief, in determining whether the Installation Contracts were construction contracts, this Court must consider the nature and characteristics of the contracts.[6] In *Springs Industries, Inc.*, the court held that when determining whether a contract is a construction contract, it is appropriate to look to the nature and characteristics of the agreement. No. 99-ALJ-17-0153-CC, 11/09/1999. In that case, the fact that the contracts charged a lump-sum price and made references to a "contractor" supported that they were construction contracts. *Id.* p. 6.

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[5] The Department spends 10 pages of its brief on its new position that a retail sale occurs when Lowe's sells TPP to Installation Contract customers. (*See id.* pp. 20-30). It relegates its previous withdrawal theory to a mere 2 pages of its brief. (*See id.* pp. 30-32).

[6] (Lowe's' Initial Brief p. 26) (citing *Springs Indus., Inc. v. S.C. Dep't of Revenue*, 99-ALJ-17-0153-CC (S.C. Admin. Law Ct. Nov. 9 1999), *aff'd S.C. Dep't of Revenue v. Springs Indus., Inc.*, No. 2003-UP-029 (Ct. App. 2003)).

Neither the ALC Order nor Department's Brief address *Springs Industries*. And, neither discuss how the nature and characteristics of the Installation Contracts somehow establish that they are sales of TPP rather than sales of real property improvements (*i.e.*, construction contracts). They cannot. The contracts make clear that they are lump-sum contracts for real property improvements. They provide that Lowe's (i) is the general contractor and will subcontract the installation services; (ii) is responsible for performing tasks typically performed by a general contractor; and (iii) warrants the work and bears the risk for the contract being performed. The contracts expressly provide that Lowe's retains title to all materials used to perform the contracts until after they are installed and converted to real property. *See supra* p. 8.

Based on the foregoing, the Department previously concluded that the contracts were sales of real property improvements, and not TPP, to Lowe's customers. (Joint Ex. 32 p. 3 of 8, R. p. 859; ALC Order p. 14, R. p. 15; 6/7/16 T. p. 45 line 7 – p. 46 line 12, p. 47 line 8 – p. 48 line 21, p. 62 line 25 – p. 63 line 19, p. 73 lines 11-18 & p. 111 lines 15-23, R. pp. 382, 386, 389, 398). The Department's Brief largely ignores the clear testimony of its General Manager for the Policy Section that the Installation Contracts were real property improvements. (*See* Department's Brief pp. 14 & 34 n.14) (ignoring testimony about his experience entering into an Installation Contract and understanding that he was purchasing a real property improvement).

Without citing any authority, the Department asserts that "Lowe's actions determine the true nature of the installation contracts." (*Id.* p. 21). Even assuming this were the standard, the evidence shows that the contracts were construction contracts, not sales of TPP. The first action the Department points to is Lowe's' alleged failure to hold its SCLLR-issued General Contractor license for the entire Audit Period. (*Id.*). As noted, Lowe's was licensed throughout the entire Audit Period. (*See* Lowe's Initial Brief p. 10, 21-22, 33; *supra* p. 11). Lowe's' action of obtaining

its SCLLR-issued Residential Builder and General Contractor licenses supports that the Installation Contracts were real property improvement contracts (in Lowe's' capacity as a builder/contractor), not sales of TPP to customers (in Lowe's' capacity as a retailer).

The next action the Department points to is Lowe's' compliance with the Dual Business Regulation; namely, Lowe's purchased at wholesale *all* materials – including materials that were used to perform the Installation Contracts – by extending a resale certificate. (Department's Brief p. 22). In complying with the Dual Business Regulation, Lowe's did not misuse its resale certificate as the ALC and Department contend. The Department itself has promulgated a regulation that expressly provides that companies, like Lowe's, making both retail sales and withdrawing for use from the same goods may use resale certificates to comply with the Dual Business Regulation. S.C. CODE ANN. REGS. § 117-305.4 (2017) ("Educational and medical institutions and food service companies should not provide their suppliers a resale certificate, Form ST-8A, unless they will be re-selling the product or are doing so to comply with the provisions of SC Regulation 117-324."). Even assuming Lowe's' compliance with the regulation was incorrect, the Department's remedy should have been to charge Lowe's sales tax on the cost price it paid to acquire the materials. In any event, Lowe's' adherence to the Dual Business Regulation does not show that Lowe's acted as a retailer for purposes of the Installation Contracts or that the Installation Contracts were retail sales of TPP. Adherence to the regulation merely shows that Lowe's is a dual business – a retailer and a contractor that purchased materials some of which were sold in traditional retail sales and some of which were used to perform real property improvements. For practical purposes, the regulation authorized Lowe's to purchase all items by extending a resale certificate and later report and remit the appropriate tax once a particular item was sold or used.[7]

[7] The Department's assertion that the Court would need to find that the sale of materials from vendors to Lowe's "is simultaneously both a retail sale and a wholesale sale" (Department's Brief p. 2) lacks merit. The Dual

Finally, the Department's Brief joins with the ALC Order in relying on the erroneous rationale that the primary objective of the Installation Contracts was to facilitate a retail sale of TPP to customers. (Department's Brief p. 25; ALC Order pp. 20-21, R. pp. 21-22). Neither the ALC nor the Department cite any authority in support of this rationale. Lowe's is not aware of any.

Because the Installation Contracts are real property improvement/construction contracts, the retail sale occurred under (l)(a) or (l)(e) of the Retail Sale Statute and sales tax attached at the time Lowe's purchased the materials to be used in performing the contracts. (Lowe's Initial Brief p. 26) (citing *Springs Indus., Inc.*, 99-ALJ-17-0153-CC, 11/09/1999).

B. THE GROSS PROCEEDS SUBJECT TO TAX ARE BASED UPON LOWE'S' COST TO ACQUIRE THE MATERIALS USED TO PERFORM THE INSTALLATION CONTRACTS

The ALC and Department are wrong in concluding that the gross receipts subject to tax are the retail selling price of materials used to fulfill the Installation Contracts. Lowe's properly paid tax on its cost price of the materials used to perform the real property improvements.

1. Several States Recognize that Taxpayers Who Operate as Contractors and Retailers Should Pay Tax on the Cost Price of Materials They Use to Perform Construction Contracts

Contrary to the Department's assertion, Lowe's' position (*i.e.*, purchasing all items as if they were at wholesale and then paying tax on the cost price upon use) does not lead to an "absurd" result. (Department's Brief p. 3). Like South Carolina, several other states have statutes, regulations, and/or guidance that allow dual businesses to purchase materials at wholesale and pay tax on the cost price of materials upon withdrawal and use to perform real property

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Business Regulation specifically authorizes purchases at wholesale followed by subsequent reporting of items sold versus used. The Department's claim that if the Court accepts Lowe's position then every item purchased by Lowe's (even items sold in traditional sales) would be subject to sales tax upon Lowe's cost price from the vendor (Department's Brief p. 29) also fails. It is undisputed that in retail transactions, Lowe's "remit[s] sales tax on the store's retail price of the item". (4/20/16 T. p. 87 line 18 – p. 88 line 6, R. pp. 122-123).

improvement/construction contracts. North Carolina law states: "A retailer-contractor that purchases tangible personal property . . . to be installed or applied to real property to fulfill the contract may ***purchase those items exempt from tax*** under a certificate of exemption . . . provided the retailer-contractor also purchases inventory or services from the seller for resale." N.C. GEN. STAT. § 105-164.4H(b)(1) (emphasis added). The statute also states: "When the property is withdrawn from inventory and installed or applied to real property, use ***tax must be accrued and paid on the retailer-contractor's purchase price of the property***." *Id.* (emphasis added).

Additional states with similar provisions include:

- Alabama: "Dual businesses in Alabama shall obtain a sales tax license and ***purchase*** all of the items they sell and withdraw for use ***at wholesale***, tax-exempt. . . . ***State and local sales taxes are due*** on withdrawals at the time and place of the withdrawal from inventory and shall be computed ***on the cost of the property to the business making the withdrawal.***" ALA. ADMIN. CODE § 810-6-1-.56(2) (emphasis added).[8]

- Arkansas: "A business holding a sales tax permit should ***purchase*** all materials used in its construction, repair, and retail business ***exempt from sales tax*** as sales for resale. Any materials used in the performance of non-taxable services are not taxed to the customer; however, the business must self-assess, report, and ***pay sales tax as a withdrawal from inventory (stock) on the purchase price of the materials***." ARK. REGS. GR-21(D)(1) (emphasis added).

- Colorado: "Some contractors . . . also may be retail merchants of building supplies or construction materials which were ***purchased tax free*** for resale. . . . If the contractor bills with a lump sum contract, all supplies and materials are ***taxable on the contractor's cost.***" 1 COLO. CODE REGS. § 201-5:SR-10(3) (emphasis added).

- Idaho: "If the majority of [a contractor's] business is in retailing, contractors may want to ***buy all materials without tax*** by giving the supplier a [resale certificate]. When they sell goods at retail, they collect sales tax. If materials are installed into

[8] Alabama's regulation contains language similar to the South Carolina Dual Business Regulation. *Compare* S.C. CODE ANN. REGS. § 117-324 ("This ruling applies only to those who actually carry on a retail business having a substantial number of retail sales and does not apply to contractors, plumbers, repairmen, and others who make isolated or accommodation sales and who have not set themselves up as being engaged in selling) *with* ALA. ADMIN. CODE § 810-6-1-.56(3) ("Contractors, plumbers, repairmen, and others who make isolated or accommodation sales and who have not set themselves up as being engaged in selling do not qualify as a dual business."). The Alabama regulation applies to contractors as long as they engage in a sufficient number of retail sales. *See Vision Southeast Cos. v. Ala. Dep't of Revenue*, No. S. 14-1006, 2015 WL 11237324, *4 (Ala. Tax Tribunal Dec. 7, 2015). The same is true for the South Carolina Dual Business Regulation. (*But see* ALC Order p. 24, R. p. 25).

real property, they ***owe use [tax] on the cost of the goods***. Idaho State Tax Commission, available at https://tax.idaho.gov/i-1013.cfm#sub26 (emphasis added); *see also* IDAHO ADMIN. CODE R. § 35.01.02.012.09(b).

- Iowa: "[A] sale by a contractor–retailer of building supplies, materials and equipment which provides for installation of the merchandise is considered a construction contract and ***tax shall be paid*** by the contractor–retailer based ***upon the cost of materials at the time the materials are withdrawn from inventory for use in a construction contract*** performed in Iowa." IOWA ADMIN. CODE R. § 701-219.4(423) (emphasis added).

- Kansas: "Each retailer whose principal line of business is the retail selling of tangible personal property to the final user or consumer, but who also performs contractor services, may ***purchase material exempt from sales tax*** for resale purposes. When the retailer engages in a construction project as a contractor and removes material from inventory to perform the project, the retailer shall report and ***pay the proper sales tax on the cost of the material on the retailer's sales tax return***. KAN. ADMIN. REGS. § 92-19-66(c) (emphasis added).

- Michigan: "Contractor ***purchases*** building materials ***exempt from sales tax*** claiming a resale exemption. Contractor eventually removes the materials from retail inventory and uses the materials to perform a construction contract. Contractor is ***liable for use tax based on the purchase price of the materials consumed in the construction***." Michigan Revenue Administrative Bulletin, 2016-18, p. 4 (Sept. 20, 2016) (emphasis added).

- Minnesota: "If you are primarily a retailer ***do not pay sales tax on your purchases***. If any items purchased exempt for resale are later used in a construction contract, you must report the ***cost of the items as use tax purchases when you file your return***." Minnesota Department of Revenue, available at https://revenue.state.mn.us/guide/contractor-retailer-sales-tax-guidelines (emphasis added).

- Missouri: "Dual operators should ***present a resale exemption certificate when purchasing materials*** for inventory that may be used either for resale or contract jobs. When materials are removed from inventory for use in a contracting job, the dual operator should ***pay sales tax*** if purchased in-state or use tax if purchased out-of-state ***based on the original purchase price of the material***." MO. CODE REGS. 12 § 10-112.010(3)(B) (emphasis added).

- North Dakota: "If a contractor or subcontractor also is engaged in retail trade and part or all of the machinery, equipment, material or supplies used in carrying out contracts is taken from stock which was ***purchased for resale***, the contractor or subcontractor must ***pay use tax on the purchase price*** of the machinery, equipment, materials or supplies used." North Dakota Sales Tax-Contractors Guideline, available at https://www.nd.gov/tax/data/upfiles/media/contractors_1.pdf (emphasis added).

- Virginia: "A person who is a using or consuming contractor . . . may also be engaged in the business of selling tangible personal property to customers. [A] contractor may ***purchase the tangible personal property under a resale exemption*** certificate. If such a person . . . removes from his sales inventory for use in the performance of any contract any tangible personal property purchased under a resale certificate, he ***must include the cost to him*** of such tangible personal property ***on his dealer's return and pay the tax***. 23 VA. ADMIN. CODE § 10-210-410 (emphasis added).

- Wisconsin: "A contractor who acts as both a consumer and retailer . . . [may] [g]ive an exemption certificate claiming resale to suppliers and ***purchase the materials without tax***. . . . If the materials are used in a real property activity, the contractor ***must report a use tax based on the purchase price of the materials***[.]" Wisconsin Dep't of Revenue Publication 207, p. 45 (emphasis added).[9]

These laws undermine the contention that Lowe's' position could have never been intended by a legislature. They are also consistent with the policy stipulated in *Colonial Stores, Inc. v. South Carolina Tax Commission*, 253 S.C. 14, 168 S.E.2d 774 (S.C. 1969), where the Department (i) authorized a taxpayer to purchase promotional merchandise free of sales tax because segregation of sales and use tax between the items acquired as promotional merchandise and those held for resale would be impractical; and (ii) allowed the taxpayer to pay tax to the Department based on the cost price of materials used by the taxpayer because they would have otherwise been subject to tax at the time of purchase. (Lowe's' Initial Brief p. 31).

2. Section (1)(c) of the Gross Proceeds Statute Cannot Apply to Special Order Materials

As stated in Lowe's Initial Brief, 40% of the materials used in the Installation Contracts were "Stock Materials" that were withdrawn from existing inventory. The remaining 60% of materials used were "Special Order Materials" that were not resale, were never placed in

[9] Other states allow taxpayers to purchase at wholesale and then pay tax upon withdrawal and use. *See* California Sales and Use Tax Manual § 1206.10, available at https://www.cdtfa.ca.gov/taxes-and-fees/manuals/am-12.pdf; Illinois Compliance Alert 2015-14 (June 2015), available at https://www2.illinois.gov/rev/research/publications/compliancealerts/Documents/ca-2015-14.pdf; 103 KY. ADMIN. REGS. 26.070; OHIO ADMIN. CODE § 5703-9-14(E); South Dakota Contractor's Excise Tax Guide, July 2019, available at https://dor.sd.gov/media/wl2p3fkl/contractors-excise-tax-guide.pdf; TENN. COMP. R. & REGS. §1320-5-1-.08(1).

inventory, and were ordered from a vendor to fit the specific needs of a particular customer. (Lowe's Initial Brief pp. 11-12). Special Order Materials do not fall within the definition of "wholesale sale": sales of "tangible personal property to licensed retail merchants, jobbers, dealers, or wholesalers for resale." S.C. CODE ANN.§ 12-36-120.[10]

Section (1)(c) of the Gross Proceeds Statute states, "Gross proceeds of sales . . . includes . . . the fair market value of tangible personal property previously ***purchased at wholesale which is withdrawn*** from the business or stock and used or consumed . . . by ***any person withdrawing it.***" S.C. CODE ANN. § 12-36-90 (Emphasis added). Under the plain language of the statute, it does not apply to materials used or consumed by a taxpayer that are not purchased for resale or maintained in/withdrawn from stock. The Department does not dispute that Special Order Materials are excluded from the statutory definition of "wholesale sale" and fall outside section (l)(c) of the Gross Proceeds Statute.

3. The Department's Interpretation of "Fair Market Value" Violates South Carolina Law

The Department's Final Determination interpreted that the retail sale was "the withdrawal, use or consumption of the TPP by Lowe's in making the improvement to the real property for their customer" under section (1)(c) of the Retail Sale Statute. (Joint Ex. 32 p. 3 of 8, R. p. 859; 6/7/16 T. p. 15 lines 2-10, p. 51 lines 4-12, R. pp. 374, 383). Section (c) of the Gross Proceeds Statute states that the term "[g]ross proceeds of sale" includes "the fair market value of tangible personal property previously purchased at wholesale which is withdrawn from the business or stock and used or consumed in connection with the business or used or consumed by any person withdrawing it." S.C. CODE ANN. § 12-36-90(1)(c). Even if the items used under the Installation Contracts were

[10] *Colonial Stores* is especially on point with respect to the Special Order Materials. Colonial Stores bought promotional merchandise Colonial Stores at wholesale for use and then paid tax based on its cost price. *See supra* p. 20. Likewise, Lowe's clearly bought Special Order Materials for use in Installation Contracts and not for resale.

taxable under section (1)(c), the Department is wrong in its claim that fair market value should be determined using a 40% markup from Lowe's' acquisition cost to the "retail price." (Joint Ex. 32 p. 6 of 8, R. p. 862; 4/20/16 T. p. 151 lines 14-24 & p. 314 line 9 – p. 316 line 3, R. pp. 186, 349-351). This interpretation violates the Gross Proceeds Statute and South Carolina law.

The Department has admitted that "[t]he definition of 'fair market value' is well settled law." (Joint Ex. 32 p. 6 of 8, R. p. 862). South Carolina law has long recognized, "Fair market value is that price which a willing buyer will pay a willing seller, neither being under compulsion to buy or sell and both being fully informed of all uses to which the property is adopted and for which it is capable of being used." (*Id.*) (*quoting Haus. Auth. of City of Charleston v. Olasov*, 282 S.C. 603, 608, 320 S.E.2d 478, 481 (Ct. App. 1984)). Both Crider (testifying for Lowe's) and van Bulck (testifying for the Department) agreed that the controlling standard for determining the gross proceeds subject to tax for a taxable retail sale under section (1)(c) is fair market value. (4/20/16 T. p. 128 line 24 – p. 129 line 17, R. pp. 163-164); (*id.* p. 285 lines 9-14, R. p. 320). Crider was the only expert witness qualified by the ALC – based on his education, certifications, and experience as an educator and professional appraiser – to opine on the "generally accepted meaning of fair market value" (*Id.* p. 127 line 20 – p. 128 line 13, R. pp. 162-163). He testified on cross-examination that to determine fair market value, "you must identify appropriate buyers and sellers" for the willing buyer/willing seller analysis. (*Id.* p. 142 lines 10-15, R. p. 177). The Department has conceded that for this analysis, Lowe's is the willing buyer. (*Id.* p. 237 lines 1-8, R. p. 272) (Crawford testifying for the Department that for purposes of "fair market value", the "purchaser . . . is Lowe's" and "[n]ot the customer."); (6/7/16 T. p. 123 lines 4-13, R. p. 401) (McCormack testifying that "[t]he deemed sale is to Lowe's"; the "buyer in this case being Lowe's. The willing buyer."). The Department took Crider's testimony out of context. (Department's Brief p. 16). He

testified as a general matter that the party who enters into the Installation Contract with Lowe's is a Lowe's customer; he did not testify, however, that the Lowe's customer is the "willing buyer" for purposes of determining fair market value. (*See* 4/20/16 T. p. 144 lines 12-16, R. p. 179).

The Department relies on van Bulck's testimony regarding "levels of trade" and "inventory at rest versus inventory that is moving" to contend that fair market value is retail price. (Department's Brief pp. 17-18, 39-40). van Bulck's testimony is contrary to South Carolina law. The Department admitted there is no case law saying fair market value is the retail or shelf price:

> Q: [T]here is not a single reported court case that says that fair market value is the retail prices of items that they would sell off the shelf.
> A: Nothing that specifically says that. It just says fair market value.

(6/7/16 T. p. 89 lines 10-16, R. p. 393).

S.C. CODE ANN. REGS. § 117-309.17 (2012), "Withdrawals from Stock, Merchants," does not support the Department's interpretation. Section 117-309.17's title shows, and the Department's testimony confirms, that the regulation applies only to withdrawals by ***retailers.*** (Lowe's Initial Brief pp. 41-42). Furthermore, the Department's interpretation of Regulation 117-309.17 is inconsistent with *Colonial Stores, LLC*. The Department cherry-picked a quotation from the decision that is actually *dicta*. (Department's Brief p. 39). Moreover, the quotation, which states "goods . . . purchased for ***resale*** but later withdrawn from stock and used by the taxpayer . . . is the 'reasonable and fair market value' of the tangible property withdrawn", 253 S.C. at 17-18 (emphasis added), is not applicable here. Specifically, the property withdrawn ultimately became a real property improvement, meaning it was ultimately acquired for use, not for resale as TPP. Further, the case does not say that fair market value must be something other than cost price.

C. The Department's Final Determination Violates Equal Protection

The Department's insistence that large retailers cannot possibly be treated as contractors for tax purposes confirms that the Department is singling out companies that appropriately use volume purchases to achieve price concessions while acting in dual capacities as both contractors and retailers. This is a classic example of treating similarly situated entities differently for purposes of the tax code, and there is no rational basis to explain this disparate treatment. *See, e.g.*, *Ed Robinson Laundry & Dry Cleaning, Inc. v. S.C. Dep't of Revenue*, 356 S.C. 120, 124, 588 S.E.2d 97, 99 (2003) (applying rational basis review). Instead, the Department's Brief asserts that Lowe's is asking for treatment that ***no*** contractor in South Carolina receives because contractors ***always*** pay full price. (Department's Brief pp. 41-45). This argument lacks merit and is not supported by any evidence. *See S. Bell Tel. & Tel. Co. v. Spartanburg*, 285 S.C. 495, 497, 331 S.E.2d 333, 335 (1985) (voiding local business license tax because "[t]he city has advanced no reasonable basis for the differential treatment"); *S. Bell Tel. & Tel. Co. v. Aiken*, 279 S.C. 269, 273, 306 S.E.2d 220, 222 (1983) (invalidating local tax under Equal Protection Clause because "the record lacks sufficient evidence that would support an express finding of a rational basis" for classification).

The Department mischaracterizes S.C. CODE ANN. REGS. §§ 117-314.1 & 117-341.2 as "providing that contractors are required to purchase materials at retail price and to pay tax on that higher retail price at the time of purchase." (Department's Brief p. 26). These sections simply address the incidence of tax (who is responsible) and the timing for payment. They state the general rule that sales of building materials to contractors, or sales of building materials for use in adding to, repairing, or altering real property are subject to sales tax by the contractor at the time of purchase based on the price paid. S.C. CODE ANN. REGS. §§ 117-314.1 & 117-314.2. The sections do not say that contractors are not entitled to discounts and must pay tax on a "higher retail price." It simply is not the case in practice that all contractors pay full retail or shelf prices. During the

contested hearing, multiple witnesses testified that some contractors may purchase items at discounts. In fact, Department witnesses, including Crawford and Krull, testified that some contractors "buy at discount." (4/20/16 T. p. 157 line 12 – p. 158 line 8, R. pp. 192-193). (*See also id.* p. 233 lines 14-25, R. p. 268) (discussing an audit meeting where it was suggested that "Lowe's deserved discounts just like other contractors received"). Krull even testified about having her contractor buy items at Lowe's in order to receive the benefit of his discount. (*Id.* p. 263 lines 7-13, R. p. 298) (stating she would have her contractor pay "because he got a . . . five or ten percent discount"). *See also* https://www.lowes.com/l/Pro/pro-benefits.html (discussing Lowe's' "pro"/contractor benefits; stating "Large product inventories save you time and money, so you can get what you need all at once with volume discounts."). The Department's regulations even contemplate that "customary discounts" should be excluded from gross proceeds. S.C. CODE ANN. REGS. § 117-309.17.

Due to high-volume purchases, Lowe's may receive a larger discount than some smaller contractors. Even if the Department thinks Lowe's discounts are too large or unfair, it does not have the authority to treat Lowe's differently from other contractors by subjecting it to a 40% mark-up. The Department cannot and has not asserted a legitimate government purpose for this disparate treatment among taxpayers in the construction industry by arbitrarily treating contractors who also engage in a retail line of business differently from contractors that do not.

III. CONCLUSION

For the reasons set forth in the Initial Brief of Appellant and above, Lowe's respectfully requests that this Court reverse the Administrative Law Court's Final Order.

Dated: June 29, 2021

Burnet R. Maybank, III, SC Bar No. 3699
Rick Reames III, SC Bar No. 68327
Jim Rourke, SC Bar No. 79879
NEXSEN PRUET, LLC
1230 Main Street, Suite 700 (29201)
Post Office Drawer 2426
Columbia, South Carolina 29202-2426
Telephone: (803) 771-8900
bmaybank@nexsenpruet.com
rreames@nexsenpruet.com
jrourke@nexsenpruet.com

John M. Allan
JONES DAY
1420 Peachtree Street NE
Suite 800
Atlanta, Georgia 30309
Telephone: (404) 581-8012
jmallan@jonesday.com

Attorneys for Appellant

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THE STATE OF SOUTH CAROLINA
In the Court of Appeals

APPEAL FROM THE ADMINISTRATIVE LAW COURT

S. Phillip Lenski, Administrative Law Judge

Case No. 14-ALJ-17-0552-CC
Appellate Case No. 2021-000031

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

v.

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

CERTIFICATE OF COUNSEL

The undersigned certifies that this **Final Reply Brief of Appellant** complies with Rule 211(b), SCACR.

Columbia, South Carolina
June 29, 2021

Burnet R. Maybank, III (Bar No. 3699)
Rick Reames III, (Bar No. 68327)
Jim Rourke (Bar No. 79879)
NEXSEN PRUET, LLC
1230 Main Street, Suite 700 (29201)
Post Office Box 2426
Columbia, South Carolina 29202-2426
PHONE: 803.771.8900
bmaybank@nexsenpruet.com
rreames@nexsenpruet.com
jrourke@nexsenpruet.com

John M. Allan
JONES DAY
1420 Peachtree Street, NE, Suite 800
Atlanta, Georgia 30309
PHONE: (404) 581-8012
jmallan@jonesday.com
Attorneys for Appellant Lowe's Home Centers, LLC