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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.

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I. STATEMENT OF ISSUES ON APPEAL

1. Did the Administrative Law Court ("ALC") err in concluding that the final agency determination (the "Final Determination") issued by the South Carolina Department of Revenue (the "Department") properly assessed additional sales tax and interest against Lowe's Home Centers, LLC ("Lowe's")[1] on the materials it used to complete its real property improvement contracts (the "Installation Contracts") during the tax period of August 1, 2008 through July 31, 2011 (the "Audit Period")?

    a. Did the ALC err in construing and applying S.C. CODE ANN. § 12-36-110 (2014) in concluding that the Installation Contracts were taxable retail sales of tangible personal property by Lowe's to customers under the general definition of "retail sale" instead of real property improvements?

    b. Did the ALC err in concluding that the "primary objective" of the Installation Contracts was to facilitate a retail sale of tangible personal property to customers and, as a result, recharacterizing the contracts as a taxable retail sale of tangible personal property by Lowe's (as retailer) to customers and a nontaxable sale of installation services by Lowe's (as contractor) for goods owned by the customer?

    c. Did the ALC err in disregarding the terms of the Installation Contracts in concluding that customers who entered into the contracts purchased tangible personal property instead of real property improvements?

    d. Did the ALC err in concluding that the taxable value of the materials used to perform the Installation Contracts was the retail selling price?

2. Did the ALC err in concluding that the issue of whether the Department erred in calculating the "fair market value" of the materials used to perform the Installation Contracts is moot?

3. Did the ALC err in concluding that Lowe's' claim that the Department's Final Determination results in it – as a contractor – being treated differently from (and less favorably than) other South Carolina contractors in violation of the Equal Protection Clause is moot?

---

[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.

II. STATEMENT OF THE CASE

A. INTRODUCTION

This appeal seeks clarification regarding the proper interpretation of certain South Carolina sales tax statutes and regulations. At issue is the following question: What sales tax responsibility did Lowe's have when, during the Audit Period, it incorporated items of tangible personal property ("TPP") into customers' real property in South Carolina to perform real property improvements via Installation Contracts?

It is undisputed that Lowe's operates ***two*** different lines of business. First, Lowe's owns and operates stores nationwide where it sells home improvement products and building materials to customers at retail. In addition to – and separate and distinct from – its retailing activities, Lowe's operates a nearly $5 billion line of business where it regularly enters into Installation Contracts with customers to perform real property improvements by permanently affixing items of TPP, such as flooring, cabinets, and roofing, to customers' real property. Thus, the ALC found that Lowe's is ***both a contractor and a retailer***. And, the Department and ALC both admitted that nothing in the South Carolina sales tax code or regulations prohibits a retailer from also acting as a contractor. Indeed, S.C. CODE ANN. REGS. § 117-324 (2012) expressly recognizes the concept of a "Dual Business": "***[o]perators 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." *Id.* (the "Dual Business Regulation") (emphasis added).

Furthermore, it is undisputed that the South Carolina sales tax statutes and regulations treat traditional retail sales of TPP differently from real property improvement contracts. For traditional retail sales, the *customer* is the final consumer and user of TPP, and the taxable retail sale is the sale of TPP to the *customer*. As a result, sales tax is due on the gross proceeds

the *customer* paid to acquire the property. However, for real property improvement contracts, because the TPP is incorporated into real estate and loses its character as TPP, the *contractor* is the final consumer and user of the TPP used to perform the improvement. The taxable retail sale is the sale of TPP to the *contractor*.[2] Thus, sales tax is due on the gross proceeds the *contractor* paid to acquire the property required for the project. The customer to the contract receives a nontaxable real property improvement, not TPP.[3]

Under S.C. CODE ANN. § 40-11-20 (2011) and S.C. CODE ANN. REGS. § 117-314.2 (2012), Lowe's was a "contractor" engaging in "general construction" when installing real property improvements for customers pursuant to its Installation Contracts. Under the contracts, title to the items of TPP remained with Lowe's until ***after*** they were incorporated into and became part of real property. In its capacity as a contractor, Lowe's was the end user and purchaser of the materials. As a contractor, Lowe's' purchases of materials used in the Installation Contracts were retail sales under S.C. CODE ANN. § 12-36-110 (2014) at either section (1)(a), encompassing the sale of building materials to construction contractors for resale or use in the form of real estate, or section (1)(e), addressing sales to contractors for use in the performance of construction contracts. As such, there were no retail sales of TPP to customers pursuant to the Installation Contracts. Therefore, customers who contracted for and received the real property improvements were not charged sales tax on those contracts because there was no transfer of TPP. Like other contractors performing real property improvements, Lowe's owed

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[2] A contractor is considered the final consumer of TPP because the TPP is converted to real property once it is installed. *See Hercules Contractors & Engineers, Inc. v. S.C. Tax Comm'n*, 280 S.C. 426, 435, 313 S.E.2d 300, 306 (Ct. App. 1984).

[3] *See 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). Charges to customers for building materials used to make a real property improvements are not subject to sales tax. *See* Private Letter Ruling 07-4 (S.C. Dep't of Revenue (July 13, 2007)).

tax on the gross proceeds it paid suppliers to procure the materials used in the Installation Contracts because it was the last to use the TPP before it was incorporated into and became part of real estate.

Generally, contractors pay sales tax on the amount paid to acquire TPP used to perform real property improvements at the time of acquisition. However, the Dual Business Regulation ***requires*** "dual businesses" that serve as retailers and contractors, like Lowe's, to purchase all TPP as if it were at wholesale and without paying sales tax upon acquisition. Thus, Lowe's remitted use tax on the cost paid to acquire the TPP at the time it used and consumed the property in the course of performing its Installation Contracts. The payment of use tax comes out of Lowe's' pocket as opposed to sales tax, which may be passed on to the consumer. If Lowe's had not complied with the Dual Business Regulation, it would have purchased identical property at the same cost price and remitted sales tax at the time of purchase. Just like other similarly situated high-volume purchasers, Lowe's receives discounts from vendors based on the volume of items it purchases. If Lowe's' adherence to the Dual Business Regulation was incorrect, the Department's remedy should have been to charge Lowe's sales tax on the cost price Lowe's paid to acquire the materials. However, both the Department and the ALC concluded that Lowe's, which merely complied with the Department's administrative guidance, should have to pay sales tax on a higher tax base than the original cost price.

B. PROCEEDINGS BELOW

The Department audited Lowe's' Installation Contracts to determine what was the taxable retail sale and the gross proceeds subject to sales tax. ***Without ever seeing or reviewing the Installation Contracts***, the auditor who completed the audit initially issued a proposed assessment based on the theory that the 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. But subsequently, the Department issued its Final Determination dated October 24, 2014, in which the Department concluded that the Installation Contracts were real property improvements and Lowe's was the final consumer and user of the items of TPP used to perform the contracts. The Department ultimately determined that, in accordance with S.C. CODE ANN. § 12-36-110(c) (2014), the taxable retail sale occurred in the form of 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 real property improvements. However, the Department claimed that Lowe's was not a "true contractor." It concluded that Lowe's underpaid sales tax because the gross proceeds subject to tax should be based on the "fair market value" of the materials under section 12-36-90(1)(c) (2014) as measured by a 40% markup from Lowe's' acquisition price to the retail pricing (i.e., the price Lowe's would have charged if it had sold the materials at retail to customers outside of an Installation Contract).

On November 21, 2014, Lowe's timely requested a contested case hearing to challenge the additional sales tax, interest, and penalties assessed in the Department's Final Determination. The ALC held a hearing in the matter on April 20, 2016, which was continued and completed on June 7, 2016.

In the contested case hearing, both the Department and Lowe's agreed that the taxable retail sale was the sale of TPP to Lowe's. The sole issue for the ALC to determine was the amount of gross proceeds subject to tax. Namely, whether (as Lowe's asserted) the company owed tax based on the cost it paid vendors to acquire the materials used in the Installation Contracts or whether (as the Department asserted) Lowe's owed tax based on "full retail".

The ALC issued a Final Order on December 11, 2020. In the Final Order, the ALC rejected the Department's interpretation in the Final Determination,[4] but upheld the Department's assessment against Lowe's of sales tax and interest on the independent basis that the Installation Contracts involved taxable retail sales of TPP by Lowe's to customers. (ALC Order pp. 19, 30, R. pp. 20, 31). The ALC concluded that Lowe's' Equal Protection claim was moot. (*Id.* p. 28, R. p 29). Finally, "acknowledg[ing] the complexity of the issues presented," the court declined to uphold all penalties. (*Id.* p. 30, R. p. 31).

Pursuant to Rule 203, SCACR, Lowe's timely served and filed a notice of appeal in this Court on January 8, 2021.

III. STATEMENT OF THE FACTS

The facts of this case are not in dispute.

A. LOWE'S' OPERATIONS

Lowe's is a limited liability company organized under North Carolina law with its principal place of business in Mooresville, North Carolina. (Joint Ex. 20 (Lowe's 2011 10-K) p. 1, R. p. 609; ALC Order p. 3, R. p. 4). The company operated between 40 and 42 store locations in South Carolina during the Audit Period. It did not own or operate a regional distribution center in South Carolina in the relevant period. (4/20/16 T. p. 34 lines 3-11 & p. 64 lines 11-13, R. pp. 69, 99; ALC Order p. 3 n.7, R. p. 4).

Lowe's primarily engages in "two categories of business": (1) traditional retail sales of home improvement products and building materials, which do not require contracts; and (2) residential real property improvements performed via Installation Contracts. (4/20/16 T. p. 35 line

[4] The Department's interpretation that the Installation Contracts were retail sales under S.C. CODE ANN. § 12-36-110(c) (2014) and should be taxed based on fair market value under S.C. CODE ANN. § 12-36-90(1)(c) (2014) is erroneous. *See infra,* pp. 41-46, Also, it violates Lowe's right to equal protection. *See infra*, pp. 46-50.

22 – p. 36 line 18, R. pp. 70-71; ALC Order pp. 3-4, R. pp. 4-5). Lowe's first began its contractor line of business in the mid-1990's. (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). During that time, Lowe's began to analyze how to treat its Installation Contract transactions for sales and use tax purposes in the various states where it operated. (4/20/16 T. p. 37 lines 3-8, p. 71 lines 12-19 & p. 75 lines 3-19, R. pp. 72, 106, 110).

Lowe's denied that the "primary reason a customer comes to Lowe's is to purchase [TPP]." Given the company's dual business lines, some customers go to Lowe's to make traditional retail purchases, while others go to purchase real property improvements. (4/20/16 T. p. 108 lines 8-16, R. p. 143) ("[T]hey have a need and the Lowe's associate is empowered to determine what that need is and we're going to satisfy the customer. It could be that all they need is a purchase of tangible personal property, it could be they want a new roof on their house.").

When a customer makes a traditional retail purchase of TPP, he selects the product, takes it to a checkout counter, and the cashier scans the item's barcode to register it into the point of sales system. The store's computer system calculates the sales tax based on the price of the item charged to the customer. The customer tenders payment of the item's price and the corresponding tax, at which point "title to the tangible personal property transfers to the customer." Lowe's remits sales tax to the Department based on the final price paid by the customer. The entire transaction is conducted over the counter without a contract. (4/20/16 T. p. 38 lines 2-22, R. p. 73; ALC Order pp. 3-4, R. pp. 4-5).

Installation Contract transactions are, however, "substantially different." When a customer purchases a home improvement, Lowe's and the customer enter into a single, written contract at a department service station (as opposed to a checkout counter) located in the store. At the service station, the parties define the scope of the project. Lowe's often charges a detail fee to send a

subcontractor to the customer's home to take detailed measurements. The customer selects the types of materials to be installed, and a description of the project is entered into Lowe's' computer system. A contract is generated, which contains: (a) the type and estimated quantity and estimated price of the property to be affixed to the customer's real estate; (b) the estimated cost of the labor to install the property; (c) the lump-sum price Lowe's will charge for furnishing the real property improvement; and (d) terms and conditions of the contract. A Lowe's employee signs the contract on behalf of Lowe's. The customer also signs the contract. He then proceeds to the checkout register, where the cashier processes the transaction and collects full payment for the Installation Contract. The customer is not charged sales tax. He leaves the store without title or possession of TPP; instead, he possesses a contractual right to receive a future real property improvement. When the customer accepts the installation as complete (by signing a Certificate of Completion), Lowe's pays the subcontractor. (4/20/16 T. p. 38 line 23 – p. 41 line 9 & p. 46 line 1 – p. 47 line 3, R. pp. 73-76, 81-82; ALC Order p. 4, R. p. 5). Lowe's remits use tax to the Department at the time it uses the materials to perform the Installation Contracts based upon the acquisition cost it paid to vendors. (4/20/16 T. p. 48 lines 2-16 & p. 79 line 14 – p. 80 line 1, R. pp. 83, 114-115; ALC Order p. 6, R. p. 7).

With respect to its Installation Contracts, Lowe's acts as a "contractor" or "general contractor." Accordingly, 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. For instance, the company's Form 10-K for the fiscal year ended February 3, 2012 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. Our Installed Sales model, which separates selling and project administration tasks, allows our sales associates to maintain their

> focus on project selling, while project managers ensure that the details related to installing the products are efficiently executed.

(Joint Ex. 20 (Lowe's 2011 10-K) p. 7, R. p. 615). Also, throughout the Audit Period, Lowe's was licensed with the South Carolina Department of Labor, Licensing and Regulation. Lowe's was initially licensed as a Residential Builder and then a General Contractor. (Joint Ex. 33 (Contractor Licenses), R. pp. 890-898; 4/20/16 T. p. 44 line 12 – p. 45 line 5 & p. 117 lines 5-11, R. pp. 79-80, 152).

The ALC rightfully found, "Lowe's is both a contractor and a retailer based on the evidence presented." (ALC Order pp. 8-10, 18, R. pp. 9-11, 19). It "[a]cknowledge[d] that nothing in the South Carolina statutes prohibits a retailer from also acting as a general contractor." (*Id.* at p. 25, R. p. 26). The Department agreed. (4/20/16 T. p. 227 lines 14-24, R. p. 262).

Lowe's' contractor business accounted for approximately 6% of total sales or nearly $5 billion during the Audit Period. (Joint Ex. 20 (Lowe's 2011 10-K) p. 7, R. p. 615). As part of that business, Lowe's competes with other contractors on price. (4/20/16 T. p. 55 line 5 – p. 56 line 22, R. pp. 90-91). If Lowe's is taxed on a markup of its cost to acquire TPP used under its Installation Contracts, it will have a cost disadvantage. (*Id.* at p. 56 line 23 – p. 58 line 2, R. pp. 91-93).

B. INSTALLATION CONTRACTS

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; 4/20/16 T. p. 37 line 14 – p. 38 line 1, R. pp. 72-73).

Nationwide, Lowe's uses a standardized form for its Installation Contracts. (4/20/16 T. p. 43 lines 4-17, R. p. 78; ALC Order p. 4 n.10, R. p. 5).[5] The Installation Contracts provide:

> Lowe's agrees to sell the goods and/or materials (the "Goods") ***and*** the services to install same (the "Installation Services") . . . for the stated ***total cash price*** (the "Price") and according to the specifications and other provisions of the Contract documents, including (a) this Contract form, (b) the Addendum, if and to the extent applicable, (c) and any attached sketches, material lists, floor plans, and/or specification sheets.

(Joint Ex. 34 p. 4, R. p. 903; Joint Ex. 35 p. 4, R. p. 909). Thus, the Installation Contracts are lump-sum agreements that require Lowe's to provide ***both*** the labor and materials necessary to complete the real property improvement for one fixed, lump-sum price. The customer pays the fixed, lump-sum amount before Lowe's begins performance of the real property improvement. (*Id.*; 4/20/16 T. p. 43 line 18 – p. 44 line 11, R. pp. 78-79). The estimated price shown on the Installation Contracts for the materials component of the project is not necessarily the retail price; "it can be any price [Lowe's] deem[s]." Also, the estimated price for the materials is not necessarily higher than Lowe's cost. (4/20/16 T. p. 88 line 16 – p. 89 line 7, R. pp. 123-124).

Further, the Installation Contracts provide that Lowe's will be the general contractor and subcontract the installation services:

> Customer authorizes Lowe's (a) to arrange for the Installation Services to be performed by an experienced independent contractor (the "Installer") (licensed when legally required), (b) to issue a work order to the Installer to perform the Installation Services, (c) to inspect the Installer's work, and (d) to pay the Installer after completion of the work and after receipt of a certificate, signed and dated by Customer, that the work has been satisfactorily completed (the "Certificate of Completion").

(Joint Ex. 34 p. 4, R. p. 903; Joint Ex. 35 p. 4, R. p. 909).

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[5] Representative copies were submitted during the contested case hearing (Joint Ex. 34 (Non-Special Order Contract), R. pp. 899-904; Joint Ex. 35 (Special Order Contract), R. pp. 905-910).

The agreements make Lowe's "responsible to Customer for obtaining any and all licenses and building permits which are legally required to perform the Contract." (*Id.*) Moreover, Lowe's "warrants that the Installation Services will be performed . . . in a good and workmanlike manner" and "bears the risk" for the contract "being performed in compliance with all applicable safety rules and all existing building codes, zoning ordinances and other laws." (*Id.*). Lowe's pays the installer after completion of the project and the customer signs a Certificate of Completion. If the installation does not meet the customer's satisfaction, Lowe's "bears the risk" and arranges for the work to be performed properly. (*Id.*; 4/20/16 T. p. 43 line 18 – p. 44 line 11 & p. 46 line 21 – p. 47 line 3, R. pp. 78-79, 81-82) ("The customer expected a tile floor and if the installer is walking into the customer's house and drops a box of tile and breaks every one, he's got to come back to the Lowe's store and get more tile. The customer bought a tile floor, not tangible personal property.").

Notably, the Installation Contracts provide that Lowe's retains title to all materials used to perform the real property improvements 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 and shall be returned to Lowe's by the Installer." (Joint Ex. 34 p. 4, R. p. 903; Joint Ex. 35 p. 4, R. p. 909). *See also* (4/20/16 T. p. 41 lines 2-9 & p. 45 line 9 – p. 46 line 20, R. pp. 76, 80-81) (discussing the terms and conditions and confirming that customers do not receive title until after the property is incorporated and the customers sign a Certificate of Completion).

The Installation Contracts contain clear terms and conditions. Customers know they are purchasing real property improvements, and not TPP. (Joint Exs. 34 & 35, R. pp. 899-910; 4/20/16

T. p. 41 lines 2-9, R. p. 76) (stating "[t]here is a contract and there's terms and conditions on that contract and I think the customer knows clearly what they're buying.").

C. Special Order Materials

The items of TPP used to perform the Installation Contracts are either "stock" or "special order." (4/20/16 T. p. 42 line 21 – p. 43 line 3 & p. 49 line 23 – p. 51 line 10, R. pp. 77-78, 84-86; ALC Order pp. 5-6, R. pp. 6-7). "Stock Materials" are withdrawn from "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." (ALC Order, p. 5, R. p. 6). "Special Order Materials" are items that "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 [S]pecial [O]rder [M]aterials for resale and the items are never placed into any store inventory [physically or for accounting purposes] for traditional retail purchases." (*Id.* at p. 6, R. p. 7; 4/20/16 T. p. 61 line 14 – p. 64 line 10, R. pp. 96-99).

Lowe's purchased both Stock Materials and Special Order Materials at cost, free of sales tax as "required" by the Dual Business Regulation. (4/20/16 T. p. 103 lines 14-21, R. p. 138) (testifying Lowe's used its resale certificate, including to buy Special Order Materials, "[b]ecause we're required to.") (*See also* 4/20/16 T. p. 59 lines 4-23, R. p. 94) ("Now, they're not for resale but we're still deemed, because of the reg, to purchase at wholesale."); (ALC Order p. 5, R. p. 6). Given its position as a high-volume home improvement company, Lowe's receives discounts from vendors based on the volume of items that it purchases. (4/20/16 T. p. 110 lines 3-6, R. p. 145).

During the Audit Period, only 40% of the materials used in the Installation Contracts at issue were Stock Materials. The remaining 60% were Special Order Materials ordered to meet

customers' specific needs. (4/20/16 T. p. 62 lines 11-20, R. p. 97; ALC Order p. 5, R. p. 6; Joint Ex. 37 (Summary of Inventory Versus Special Order Sales), R. pp. 918-919).

D. DEPARTMENT'S PROPOSED ASSESSMENT

In 2011, the Department initiated an audit of Lowe's' sales tax returns for the tax period of August 1, 2008 through July 31, 2011. (4/20/16 T. p. 170 lines 15-23, R. p. 205; Joint Ex. 1 (Audit Appointment Letter), R. p. 425). Paulette Crawford, a Department field auditor, completed the audit. With respect to the company's Installation Contracts, the auditor found that Lowe's remitted use tax on its cost to acquire the materials used to improve customers' real property. (4/20/16 T. p. 170 lines 15-19 & p. 190 line 20 – p. 191 line 2, R. pp. 205, 225-226; ALC Order p. 16, R. p. 17).

In the proposed assessment dated September 24, 2012, the auditor claimed that Lowe's underpaid sales tax because (1) it was not a "true contractor", and (2) the Installation Contracts were taxable retail sales of TPP to Lowe's customers with nontaxable sales of installation services. Based on this theory, the auditor determined that Lowe's should have remitted tax on the retail or shelf price of items used in performing Installation Contracts. The proposed assessment imposed $2,206,054.28 in additional sales tax, $360,580.69 in interest, and $290,593.35 in penalties, using a "40% markup from cost to retail pricing." (4/20/16 T. p. 191 line 3 – p. 192 line 7, R. pp. 226-227; Joint Ex. 29 (Proposed Assessment) p. 4, R. p. 817).

Significantly, the auditor testified that she made the decision to "segregate" the Installation Contracts into "two separate transactions" ***without ever seeing or reviewing the contracts***:

> Q: All right. During the audit, did you review any of the installed sales contracts of the taxpayer?
> A: No, we did not review any of those.
>
> * * *
>
> Q: Okay. So, you made the ---
> A: Yes.

Q: --- you made the decision to segregate the transaction into two separate transactions without ever seeing a contract?
A: That's exactly right.

(4/20/16 T. p. 197 lines 3-6 & p. 219 lines 12-17, R. pp. 232, 254). Due to the auditor's opinion that Lowe's could never be a "true contractor" because it was also a retailer, she stated that ***the contract terms were "irrelevant" and nothing could be put in the contracts to change her position***:

Q: Okay. So, the fact that the contract itself provides that it's a lump sum installation ---
A: Okay.
Q: --- home improvement contract and the title to the tangible personal property retained with Lowe's until it was affixed to the property and became a part of it, you deem that irrelevant?
A: I deem that irrelevant. . . .
Q: Okay. So, from your point of view, is there anything that could be put in the contract that would change your position?
A: I don't think so.

(4/20/16 T. p. 220 line 23 – p. 221 line 14, R. pp. 255-256).

E. DEPARTMENT'S FINAL DETERMINATION

Lowe's filed a protest of the proposed assessment on December 21, 2012. (4/20/16 T. p. 192 lines 8-21, R. p. 227; Joint Ex. 30 (Protest of Proposed Assessment), R. pp. 821-829). On October 24, 2014, the Department issued its Final Determination, which upheld the sales tax, interest, and penalties assessed against Lowe's relating to the Installation Contracts. But the Department's Final Determination rejected the auditor's viewpoint that the contracts were retail sales of TPP to customers. (Joint Ex. 32 (Final Determination) pp. 1 of 8 – 8 of 8, R. pp. 856-864). Instead, the Final Determination asserted that every Installation Contract "involved building materials that were previously purchased at wholesale and withdrawn from the business or stock" to complete real property improvements. (*Id.*; 6/7/16 T. p. 51 lines 4-12, R. p. 383). In concluding that Lowe's underpaid sales tax, the Final Determination maintained that Lowe's was not a "true

contractor", but interpreted 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 pp. 3 of 8, 5 of 8, R. pp. 859, 861; ALC Order p. 14, R. p. 15). The Department concluded that Lowe's owed tax on the "fair market value" of the withdrawn materials used to complete the Installation Contracts, which it determined was the 40% markup to the retailing price to customers. (Joint Ex. 32 p. 6 of 8, R. p. 862).

F. CONTESTED CASE HEARING

Craig Price testified at trial on behalf of Lowe's. Until retiring on March 18, 2016, Mr. Price served as the Director of Sales and Use Tax for Lowe's and was responsible for its sales and use tax compliance in the approximately 45 states that charge sales tax, plus Canada, along with local jurisdictions. His duties included: (i) ensuring that the tax calculations at Lowe's' points of sale were accurate for every type of transaction; (ii) making sure that any taxes collected were timely and properly remitted to the appropriate taxing jurisdiction; and (iii) responding to tax audits from various jurisdictions. (4/20/16 T. p. 30 line 21 – p. 32 line 9, R. pp. 65-66).

The Department's witnesses included John McCormack, General Manager for the Policy Section within the Department's Office of General Counsel, and Paulette Crawford, a Department field auditor. (6/7/16 T. p. 4 line 1 – p. 5 line 22, R. pp. 371-372; 4/20/16 T. p. 147 lines 10-20, R. p. 182).

Mr. McCormack testified that in determining what constitutes a retail sale subject to sales tax, the Department "look[s] at the imposition section, which in the case of the sales tax is code section 12-36-910"; "look[s] at the definitional sections: the – the definition of tangible personal property, the definition of sale at retail"; and then also "look[s] at the – the transaction itself." (6/7/16 T. p. 12 line 23 – p. 13 line 14, R. pp. 373-374). In "look[ing] at all those things together,"

the Department concluded, in the Final Determination and in the hearing, that the retail sale in this case occurred under section 12-36-110(1)(c) (2014). (*Id.* at p. 15 line 2 – p. 17 line 15, R. pp. 374-375).

With respect to its position that the Installation Contracts were real property improvements, the Department testified the transactions were different from traditional retail sales. (*Id.* at p. 15 line 15 – p. 17 line 15, R. pp. 374-375). It further testified that Lowe's was "making improvement[s] to real property" and "providing contracting services." (*Id.* at p. 41 line 13 – p. 42 line 4, R. p. 381). Also, Lowe's "[was] the final user – consumer of the building materials". "There's no resale to a retail customer that's contemplated." And, "no further markup [wa]s contemplated." (*Id.* at p. 65 line 25 – p. 67 line 1, R. p. 387). When testifying about his own experience entering into an Installation Contract for a built-in dishwasher, Mr. McCormack stated: "I was buying improvement to real property" and not TPP; the transaction "[wa]s not considered a sale to me. It's considered a deemed sale to Lowe's itself" because "they're [sic] the last consumers of the tangible personal property." (*Id.* at p. 45 lines 12-15, p. 46 lines 10 – p. 48 line 21, R. p. 382). Accordingly, he testified that the original position taken in the proposed assessment that an Installation Contract "was a sale and installation and not a withdrawal for use is – is incorrect" and wrong "as a matter of law." (*Id.* at p. 52 line 22 – p. 53 lines 22 & p. 63 lines 15-19, R. pp. 383-384, 386).

Regarding the Department's position that Lowe's was not a "true contractor", Ms. Crawford testified that Lowe's "fits within" the statutory definition of a "contractor." *See* S.C. CODE ANN. § 40-11-20(4), (8) & (9) (2011); (4/20/16 T. p. 163 line 23 – p. 164 line 20, R. pp. 198-199); *see also* (4/20/16 T. p. 55 lines 1-18, R. p. 90). Further, she acknowledged that a retailer can also hold a contractor's license, but cannot "act as both during the same transaction." (*Id.* at p. 202

lines 5-11, R. p. 237). Moreover, she admitted that no statutes or regulations say a retailer cannot also be a contractor or general contractor as defined under the statutes and regulations. (*Id.* at p. 227 lines 14-24, R. pp. 262). Nonetheless, the Department determined Lowe's was not a "true contractor" because it advertised itself as a retailer and the vast majority of its sales were sales at retail. (6/7/16 T. p. 14 lines 1-3 & p. 39 lines 19-22, R. pp. 374, 380) (defining a true contractor as "not a retailer"; stating the company's primary business activity was a retailer). The Department acknowledged there is no statute, regulatio*n, or other authority that uses or defines the term "true contractor."* (*Id.* p. 39 line 23 – p. 40 line 1, R. p. 380). *Accord* (4/20/16 T. p. 163 lines 1-9, R. p. 198) (stating the concept was her "personal opinion").

Regarding the amount of the gross proceeds subject to tax, the Department testified that the property Lowe's used to perform the improvements to real property "should be taxed at fair market value." (6/7/16 T. p. 15 lines 2-10, R. pp. 374). It testified that for fair market value, "generally the concept is a willing buyer and willing seller." It admitted that the taxed transaction at issue in this case was the deemed sale of materials to Lowe's and that Lowe's is the willing buyer to consider: "Q: The buyer in this case being Lowe's. The willing buyer. A: The deemed sale is to Lowe's yes." (*Id.* at p. 122 line 14 – p. 123 line 13, R. p. 401).

The Department relied on S.C. CODE ANN. REGS. § 117-309.17 (2012), entitled "Withdrawals from Stock, Merchants," in trying to determine fair market value. A Department witness testified that the regulation applies to "retailers" and gave examples involving a convenience store and office supply store where the regulation would apply (6/7/16 T. p. 20 line 19 – p. 21 line 17 & p. 95 line 17 – p. 96 line 21, R. pp. 375-376, 394); (ALC Order p. 14, R. p. 15).

The Department testified that if Lowe's were a "true contractor" no markup would have applied; thus, Lowe's would have properly remitted tax. (4/20/16 T. p. 161 line 19 – p. 162 line 2, R. pp. 196-197). Significantly, it conceded that between Lowe's and a "true contractor" – "those two taxpayers would be treated differently for performing the exact same transaction." (6/7/16 T. p. 38 line 1 – p. 39 line 13, R. p. 380).

In addition, the Department admitted some contractors buy in bulk, at discounted prices and, unlike Lowe's, are not taxed on a markup:

> Q: Well, contractors are all different sizes, aren't they?
> A: Yes, sir.
> Q: Some buy at discount, do they not?
> A: They do buy at discount.
> Q: Okay. Some buy in bulk and actually store some of it, don't they?
> A: I would assume they would.
> Q: Okay. So, they might even have an inventory of building materials and they don't know where or what project it's going to go on, is that correct?
> A: That's correct.
> Q: But you deem them to be construction contractors and they would be taxed on what they paid for the materials?
> A: That's right.
> Q: No matter what they paid?
> A: According to our policy, yes.
> Q: Okay. And you've never taxed markup on a construction contractor?
> A: I have not.
> Q: And the reason why you are treating Lowe's not as a construction contractor is because it has big box retail stores, is that right?
> A: Because they represent themselves as a retailer.

(4/20/16 T. p. 157 line 12 – p. 158 line 14, R. pp. 192-193). The Department addressed a scenario wherein a hypothetical "true contractor" started making substantial retail sales of TPP in the state. It stated that for materials used to perform real property improvements, the contractor would only be taxed on what it paid at the time of purchase – even discounted prices:

> Q: So, would you segregate [the tangible personal property]? Would you just tax the stuff that went to the store at 40 percent markup or would you tax everything they buy at 40 percent markup?
>
> * * *
>
> A: For anything that's sold in the store, he would have to pay on the markup.
>
> Q: But all the other stuff he's buying for his construction contracts, he's taxed at his cost?
>
> A: As long as he doesn't sell it in the store.
>
> Q: So if goods are not sold in the store, then they don't have to be taxed at the markup?
>
> A: In that case, no.

(*Id.* at p. 158 line 15 – p. 161 line 21, R. pp. 193-196).

Finally, Mr. McCormack testified for the Department as follows: "If – if a person is a true contractor, then the transaction between [the customer] and the contractor is not subject to tax. The tax transaction is when the contractor is purchasing the material . . . . The – the person receiving the – the services of the improvement is not subject to the tax." (6/7/16 T. p. 36 line 17 – p. 37 line 23, R. pp. 379-380). He agreed that retailers face the threat of consumer class actions and "have to be careful. They can't collect a tax if it's not owed. If they do[,] they open themselves up to liability." (*Id.* at p. 60 line 21 – p. 61 line 5, R. pp. 385-386).

To address the subject of the generally accepted meaning of the term "fair market value," each party presented testimony from recognized experts. Mr. Charles Crider, a Certified General Appraiser with an MAI designation, who teaches for the Appraisal Institute and the Appraisal Standards Board, was recognized by the ALC as an expert on the generally accepted meaning of "fair market value." He testified on behalf of Lowe's and confirmed that "fair market value," as applied to any business inventory, is generally understood to mean the original acquisition cost of the items, reduced by any intervening depreciation or obsolescence:

> Q: Let's assume that 100 percent of the items that are consumed, used by Lowe's in performing real property

> contracts, contrary to what you heard this morning, were previously purchased at wholesale, withdrawn from the business or stock and used or consumed in connection with the business of use[d or] consumed by [the] person withdrawing it. Let's also assume they're not contractors so that those other provisions [of the Retail Sale Statute] don't apply. So, if this [12-36-90(1)(c)] applies to everything we're talking about, applying the generally understood meaning of fair market value, what does that mean?
>
> A: As far as value goes, we're still looking at cost because that has to be the maximum that someone would be willing to pay. If I had an alternative, why would I pay more than cost?

(4/20/16 T. p. 120 line 7 – p. 121 line 19, p. 128 lines 7-13 & p. 132 line 24 – p. 133 line 16, R. pp. 155-156, 163, 167-168; Joint Exs. 46, 47, R. pp. 969-977.)

Dr. Hendrikus van Bulck, a certified public accountant, testified on behalf of the Department and was qualified by the ALC as an expert in valuation principles and practices. He is not an appraiser and does not have expertise in appraisal standards or methodologies, but has experience in valuing business inventories. (4/20/16 T. p. 280 line 20 – p. 282 line 5, R. pp. 315-317). Dr. van Bulck opined that for the materials withdrawn, used, or consumed in performance of the Installation Contracts, the "fair market value" should be determined at the retail level of trade – i.e., by using the price individual customers would pay for the materials in a retail sale. (*Id.* at p. 314 line 9 – p. 316 line 3, R. pp. 349-351).

G. ALC's Final Order

Having concluded that Lowe's is both a contractor and a retailer, the ALC framed its first issue for determination as "in which capacity Lowe's functions during [its] [I]nstallation [C]ontract transactions." (ALC Order p. 18, R. p. 19). To answer that question, the ALC sought to determine at what point a retail sale occurred. (*Id.* at pp. 18-19 R. pp. 19-20). It determined that the "primary objective" of the Installation Contracts was to facilitate retail sales of TPP. (*Id.* at p. 20, R. p. 21). The ALC ultimately decided the Installation Contract transactions contained two

parts: (1) a taxable retail sale of materials by Lowe's to a customer, followed by (2) a nontaxable sale of installation service by Lowe's as a contractor. (*Id.* at pp. 25-26, R. pp. 26-27).

Specifically, the ALC concluded that the sale of materials used in the Installation Contract "resembled a traditional retail sale," largely because the offer of installation services was contingent upon a purchase of materials. (*Id.* at pp. 20-22, R. pp. 21-23). The ALC brushed aside as "insignificant" evidence that, unlike a traditional retail sale, Lowe's' customers leave without the purchased material in hand and do not even obtain title to the property until after installation is complete. (*Id.* at pp. 21-22, R. pp. 22-23). The ALC similarly dismissed the fact that most of the Installation Contracts involved Special Order Materials, that are not for resale and are not placed in inventory. (*Id.* at pp. 22-23, R. pp. 23-24). The ALC stated that, unlike a contractor, Lowe's could purchase materials using its resale certificate and resell the items to customers. (*Id.* at pp. 23-25, R. pp. 24-26). Therefore, the ALC concluded, Lowe's' customers were the final purchaser of the materials and the retail sale to those customers was subject to tax. (*Id.* at pp. 25-26, R. pp. 26-27).

Second, the ALC determined that Lowe's should have remitted sales tax based on the retail price of the Installation Contract materials, rather than its cost. (*Id.* at p. 27, R. p. 28). The ALC stated that S.C. CODE ANN. § 12-36-90 (2014) (the "Gross Proceeds Statute") measures tax based on "the value proceeding or accruing from the sale, lease, or rental of tangible personal property." (*Id.*). It found that the retail price was the appropriate measure of value because of its determination that the retail sale being taxed was the sale of TPP between Lowe's and its customer. (*Id.*).

Third, the ALC dismissed Lowe's' Equal Protection Claim as moot because it determined that Lowe's did not act as a contractor during the pertinent part of the transactions at issue, and therefore was not treated differently from other contractors. (*Id.* at p. 28, R. p. 29).

Finally, the ALC upheld the Department's assessment of interest, but declined to assess penalties in this matter due to the complexity of the issues presented. (*Id.* at pp. 28-30, R. pp. 29-31).

H. Installation Contract Issues in Other States

As indicated above, Lowe's utilizes a standardized form for its Installation Contracts nationwide. Therefore, the contracts at issue in this matter contain the same terms and conditions as contracts used by Lowe's in other jurisdictions. (4/20/16 T. p. 43 lines 4-17, R. p. 78; ALC Order p. 4 n.10, R. p. 5). Lowe's has confronted some of the same issues presented in this case in other states: e.g., whether Lowe's should be treated as a contractor for sales tax purposes when performing real property improvements via its Installation Contracts, and whether the Installation Contracts are real property improvements or retail sales of TPP. (4/20/16 T. p. 67 lines 10-18, R. p. 102).

Early in the company's contractor line of business, Lowe's received a letter from the Maryland Department of Revenue putting it "on notice that in the state of Maryland [on] these transactions, you're serving as a contractor, and you need to cease and desist charging sales tax." Ohio and Utah sent similar notices to Lowe's. (4/20/16 T. p. 75 line 19 – p. 76 line 7, R. pp. 110-111).

Other states have claimed that when performing its Installation Contracts, Lowe's should not be treated as a contractor for sales tax purposes and that the contracts were taxable sales of TPP. Consequently, Lowe's has had to litigate these same issues in multiple jurisdictions. (4/20/16 T. p. 83 line 7 – p. 86 line 17, R. pp. 118-121). Courts and tribunals in Oklahoma, Indiana, and Kansas have concluded that Lowe's installs real property improvements as a contractor during its Installation Contract transactions. *See Matter of Lowe's Home Ctrs., LLC*, 394 P.3d 149 (Kan. Ct. App. 2017); *Lowe's Home Ctrs., LLC v. Indiana Dep't of State Revenue*, 23 N.E.3d 52 (Ind. T.C.

2014), cert denied (2015); *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 (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).

IV. STANDARD OF REVIEW

The ALC's Final Order is subject to judicial review pursuant to S.C. CODE ANN. § 1-23-610 (Supp. 2019). The applicable standard of review is in section 1-23-610(B), which states that this Court may reverse or modify the Final Order where the finding, conclusion, or decision is:

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

"Determining the proper interpretation of a statute is a question of law, and this Court reviews questions of law *de novo*", *Town of Summerville v. City of North Charleston*, 378 S.C. 107, 110, 662 S.E.2d 40, 41 (2008), "without any deference to the court below." *CFRE, LLC v. Greenville Cty. Assessor*, 395 S.C. 67, 74, 716 S.E.2d 877, 881 (2011). *Accord Duke Energy Corp. v. S.C. Dep't of Revenue*, 415 S.C. 351, 355, 782 S.E.2d 590, 592 (2016).

V. ARGUMENTS

A. THE ALC ERRED AS A MATTER OF LAW BY MISINTERPRETING AND MISAPPLYING THE PLAIN LANGUAGE OF THE RELEVANT SALES TAX STATUTES AND REGULATIONS

The ALC upheld the Department's Final Determination as to the sales tax and interest assessed against Lowe's on the independent basis that the Installation Contracts involved sales

of TPP by Lowe's to customers under the general definition in S.C. CODE ANN. § 12-36-110 (2014) (the "Retail Sale Statute"); thus, Lowe's underpaid sales tax because the gross proceeds of sales were the retail selling prices paid by customers. In reaching this conclusion, the ALC violated elemental principles of statutory construction and the special rule that comes into play when a court must determine the applicability of a tax statute. The court's role is to "ascertain and effectuate the intent of the [L]egislature." *Grant v. City of Folly Beach*, 346 S.C. 74, 79, 551 S.E.2d 229, 231 (2001). Where "a statute's language is plain and unambiguous, and conveys a clear and definite meaning," there is nothing to interpret, "and the court has no right to look for or impose another meaning." *Id.* And when the statute is one imposing a tax, in the absence of statutory clarity, the court must interpret the statute in favor of the taxpayer: "[i]n the enforcement of tax statutes, the taxpayer should receive the benefit in cases of doubt." *S.C. Nat'l Bank v. S.C. Tax Comm'n*, 297 S.C. 279, 281, 376 S.E.2d 512, 513 (1989). "There is no question that all tax laws must be construed against the taxing power and in favor of the taxpayer where there is any doubt in the mind of the Court." *Pacolet Mfg. Co. v. Query*, 174 S.C. 359, 364, 177 S.E. 653, 655 (1934); *accord Clark v. S.C. Tax Comm'n*, 259 S.C. 161, 169, 191 S.E.2d 23, 26 (1972).

Here, a proper reading of the relevant sales tax statutes and regulations shows that the purchase by Lowe's of both the Stock Materials and Special Order Materials used in performing the Installation Contracts was the taxable "retail sale" under the Retail Sale Statute at section (1)(a), encompassing sales of building materials to construction contractors for resale or use in the form of real estate, or section (1)(e), addressing sales to contractors for use in the performance of construction contracts. Like other contractors, Lowe's owed sales tax based on the purchase price paid to acquire the items of TPP used in the Installation Contracts.

Pursuant to the Dual Business Regulation, Lowe's was ***required*** to purchase ***all*** materials as if they were at wholesale. In compliance with the regulation, Lowe's properly remitted tax on the cost paid to acquire the property when Lowe's used it to perform the Installation Contracts.

1. Lowe's Is a Contractor under the Relevant Law

Under the plain and unambiguous terms of South Carolina law, the undisputed facts show that Lowe's operated as a contractor when using items of TPP in performance of its Installation Contracts. The ALC was correct in concluding that Lowe's qualifies as a "contractor" under S.C. CODE ANN. § 40-11-20 (2011) (the "Contractor Statute") and S.C. CODE ANN. REGS. § 117-314.2 (2012).[6] While the term "contractor" is not defined in the Sales and Use Tax Act, this Court may rely on the definition of contractor found in Title 40 of the South Carolina Code, which defines a "contractor" as a "general or mechanical contractor regulated under [the contractor licensing chapter of the Code]." S.C. CODE ANN. § 40-11-20(4) (2011).[7] In turn, a "general contractor" is defined as "an entity which performs or supervises or offers to perform or supervise general construction," which includes the "improvement of any kind to real property." *Id.* § 40-11-20 (8) & (9) (2011). The Department provides, by regulation, that a contractor includes "any person, firm, association or corporation making repairs, or additions to real property." S.C. CODE ANN. REGS. § 117-314.2 (2012). These defined terms contain no caveats, exceptions, or exclusions.

Based on the undisputed evidence, Lowe's qualifies as a contractor. It contracts with customers to perform real property improvements and supervises third-party installers or subcontractors during improvement projects. (ALC Order p. 10, R. p. 11). Also, Lowe's was

[6] The Department essentially concedes that Lowe's is a contractor. The Department testified that for its Installation Contracts, Lowe's was "making improvements to real property" and "providing contracting services." (6/7/16 T. p. 41 line 13 – p. 42 line 4, R. pp. 381).

[7] *See* ALC Order p. 10, R. p. 11 (stating the definitions provided in Title 40 "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)) (citing *City of Camden v. Fairfield Elec. Co-op., Inc.*, 372 S.C. 543, 548, 643 S.E.2d 687, 690 (2007)).

licensed with the South Carolina Department of Labor, Licensing and Regulation. Lowe's was initially licensed as a Residential Builder and then a General Contractor. (Joint Ex. 33 (Contractor Licenses), R. pp. 890-898; 4/20/16 T. p. 44 line 12 – p. 45 line 5 & p. 117 lines 5-11, R. pp. 79-80, 152). Because Lowe's falls within these unambiguous definitions, the analysis ends there. *Paschal v. State Election Comm'n*, 317 S.C. 434, 436, 454 S.E.2d 890, 892 (1995) (stating when a statute has "clear and definite meaning, there is no occasion for employing rules of statutory interpretation and the court has no right to look for or impose another meaning"). Thus, the ALC correctly rejected the Department's "true contractor" analysis.

2. The Installation Contracts Were Retail Sales under Either S.C. CODE ANN. §§ 12-36-110(1)(a) or (1)(e)

Under South Carolina law, "sales tax, equal to five percent of the gross proceeds of sales, is imposed upon every person engaged or continuing within this State, in the business of selling tangible personal property at retail." S.C. CODE ANN. § 12-36-910(A) (2014). An additional tax of one percent is applied to all transactions subject to sales tax pursuant to section 12-6-1110 (2014).

The Retail Sale Statute defines what constitutes a "sale at retail" or "retail sale" subject to sales tax. Retail sales include, in pertinent part:

> (a) sales of building materials to construction contractors, builders, or land owners 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; and
>
> (e) sales to contractors for use in the performance of construction contracts.

S.C. CODE ANN. §§ 12-36-110(1)(a), (c), (e) (2014).

If the Installation Contracts are properly interpreted as construction contracts, the retail sale occurred under (1)(a) or (1)(e) of the Retail Sale Statute and sales tax attached at the time Lowe's purchased the materials to be used in performing the real property improvements via the contracts.

See Springs Indus., Inc., 99-ALJ-17-0153-CC, 11/09/1999 (quoting sections 12-36-110(1)(a) and (e); stating, "[T]he sale of building materials to construction contractors . . . for resale or use in the form of real estate is a retail sale. As such, sales tax is collected on the sale of such materials at the time they are purchased."). When addressing the Retail Sale Statute, the Department admitted that assuming Lowe's was a "contractor", then section (1)(a) or (1)(e) would apply and the taxable retail sale would be when Lowe's bought materials from its vendors. Moreover, it stated that if section (1)(a) or (1)(e) of the Retail Sale Statute applied, then section (1)(c) could not apply. (4/20/16 T. p. 165 line 19 – p. 166 line 18, R. pp. 200-201; 6/7/16 T. p. 91 lines 3-25, R. p. 393).

To determine whether the Installation Contracts were construction contracts, this Court must consider the nature and characteristics of the contracts. In *Springs Industries, Inc.*, an administrative 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 particular, the fact that a lump-sum price is charged and the agreement makes references to a "contractor" supports that the agreements are construction contracts. *Id.*

Here, when customers purchase real property improvements, Lowe's and the customer sign a single, written Installation Contract that contains clear and unambiguous terms and conditions. (4/20/16 T. p. 38 line 24 – p. 41 line 9, R. pp. 73-76; ALC Order p. 4, R. p. 5; Joint Ex. 34 (Non-Special Order Contract) and Joint Ex. 35 (Special Order Contract), R. pp. 899-910). The nature and characteristics of the contracts establish that they were sales to customers of real property improvements or construction contracts. For instance, the contracts provide that Lowe's is required to provide ***both*** labor and materials necessary to complete the real property improvement for one fixed, lump-sum price. As such, they are lump-sum contracts. (*E.g.,* Joint Ex. 34 (Non-Special Order Contract) p. 4, R. p. 903; 4/20/16 T. p. 43 line 18 – p. 44 line 11, R. pp. 78-79).

Further, the Installation Contracts provide that Lowe's will serve as the general contractor and will subcontract the installation services. (Joint Ex. 34 (Non-Special Order Contract) p. 4, R. p. 903; Joint Ex. 35 (Special Order Contract) p. 4, R. p. 909). Thus, Lowe's is "responsible to Customer for obtaining any and all licenses and building permits which are legally required to perform the Contract." (*Id.*) Moreover, Lowe's "warrants 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).

More importantly, the contracts explicitly involve conveyances of real property improvements to customers. In particular, the contracts provide 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." Customers do not gain title to the materials upon signing or paying for the contracts; instead, they gain the right to a future real property improvement. (*E.g.,* Joint Ex. 34 (Non-Special Order Contract) 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).

Given the Installation Contracts' terms and conditions, customers knew they were purchasing real property improvements. (*E.g.,* Joint Ex. 34 (Non-Special Order Contract), R. pp. 899-904; 4/20/16 T. p. 41 lines 2-9, R. p. 76). Stated otherwise, customers who entered into the contracts knew they were not purchasing 20 square feet of wood or two boxes of shingles; rather, they were purchasing a completed floor or a newly-shingled roof affixed to their real property.

Thus, the Installation Contracts were retail sales under section (e) of the Retail Sale Statute when Lowe's purchased the materials from its vendors for use in performing the contracts. *See* S.C. CODE ANN. § 12-36-110(e) (2014) (defining retail sales as "sales to contractors for use in the performance of construction contracts"). The Department admitted that the Installation Contract transactions were not retail sales of TPP to customers. (6/7/16 T. p. 15 line 15 – p. 17 line 15, R. pp. 374-375). It agreed they were real property improvement or construction contracts where Lowe's incorporated TPP into customers' residences, thereby converting the TPP to real property. At the hearing, the Department testified that for the Installation Contracts, Lowe's was "making improvements to real property" and "providing contracting services." (*Id.* at p. 41 line 13 – p. 42 line 4, R. p. 381). Regarding his own experience entering into an Installation Contract, the Department's Policy Manager testified: "I was buying improvement to real property"; the transaction "[wa]s not considered a sale to me. It's considered a deemed sale to Lowe's itself" because "they're [sic] the last consumers of the tangible personal property." (*Id.* at p. 45 lines 12-15, p. 46 lines 10 – p. 48 line 21, R. p. 382).

Alternatively, the materials became incorporated into real property upon completion of the installation. Thus, the Installation Contracts were retail sales of "building materials to [a] construction contractor[]" for "use in the form of real estate" under section (a) of the Retail Sale Statute. S.C. CODE ANN. § 12-36-110(1)(a) (2014). *See also* S.C. CODE ANN. REGS. § 117-314, 117-314.1 & 117-314.2 (2012). The term "building materials" is broadly defined as "any material used in making repairs, alterations or additions to real property." S.C. CODE ANN. REGS. § 117-314.2 (2012). The Department's Final Determination states that every Installation Contract "involve[d] building materials that were previously purchased at wholesale and withdrawn from the business or stock" to complete real property improvements. (6/7/16 T. p. 51

lines 4-12, R. p. 383). And, the Department testified that the items consumed in the course of the Installation Contracts were building materials within the definition of the regulation. (4/20/16 T. p. 224 lines 3-23, R. p. 259). Also, it agreed, "All the building materials on the installation contracts become part and parcel of the customer's real property" and Lowe's was the "final user – consumer of the building materials". "There's no resale to a retail customer that's contemplated." (6/7/16 T. p. 111 lines 16-23, R. p. 398).

3. The Gross Proceeds Subject to Tax Are Based upon Lowe's' Cost to Acquire the Materials Used to Perform the Installation Contracts

The Gross Proceeds Statute defines the term "gross proceeds of sales," which is the base upon which sales tax is applied in the event of a "retail sale." The statute provides, in relevant part: "[g]ross proceeds of sales" includes "the proceeds from the sale of tangible personal property." S.C. Code Ann. § 12-36-90(1)(b) (2014). As set forth above, the taxable retail sale was Lowe's' purchase of the materials used to fulfill its Installation Contracts under section (1)(a) or (1)(e) of the Retail Sale Statute. Under section (1)(b) of the Gross Proceeds Statute, the sales tax due would be "the proceeds from the sale of tangible personal property" by the supplier to Lowe's.

Department regulations discuss the sales tax treatment of contractors. Consistent with S.C. Code Ann. §§ 12-36-110(1)(a) & (e) (2014), Regulation 117-314 provides 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 ANN. REGS. § 117-314 (2012) (emphasis added). Regulations 117-314.1 and 117-314.2 further provide 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 at the time of purchase based on the price paid. *Id.* §§ 117-314.1 & 117-314.2 (2012).

Even in situations in which the real property improvement is owned by a contractor and will be resold through a lease or rental following construction, sales tax applies to the contractor's purchase of the necessary construction materials:

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

Id. § 117-314.1 (2012) (emphasis added). Because sales to – and purchases by – contractors are subject to sales tax at the time of sale, the timing and tax amount are set at the time of the purchase.

The Retail Sale Statute and S.C. CODE ANN. REGS.§ 117-314 (2012) provide that, ordinarily, a contractor pays sales tax on the amount paid to acquire TPP at the time of acquisition. However, the Dual Business Regulation ***requires*** "dual businesses" to purchase all TPP as if it were at wholesale and without paying the sales tax upon acquisition:

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

S.C. CODE ANN. REGS. § 117-324 (2012) (emphasis added). The Department testified that the Dual Business Regulation deals with "[b]usinesses that, in fact, sell items at retail and are construction contractors." It also admitted that "if you're a retailer and you make more than isolated sales, you're required by this regulation, even if you do construction contracts, to purchase pursuant to a resale certificate." (4/20/16 T. p. 225 lines 12-19, R. p. 260). Consequently, Lowe's was required to purchase all of its merchandise using its resale certificate, even when it bought TPP for use in

Installation Contracts, and even when purchasing Special Order Materials that did not go into inventory and were not for resale. In compliance with the Dual Business Regulation, Lowe's remitted tax upon the cost paid to acquire the property at the time it used and consumed it in the course of performing an Installation Contract. S.C. CODE ANN. REGS. § 117-324 (2012).

The approach of the Dual Business Regulation is 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), in which 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 account directly to the Department for the tax when the promotional merchandise was exchanged for stamps based on the ***purchase price*** of the merchandise to the company because the merchandise was acquired for company promotional use and would otherwise have been subject to tax at the time of purchase.

4. The ALC's Decision Renders South Carolina an Outlier on Treatment of the Installation Contracts for Sales and Use Tax Purposes

The court's interpretation makes South Carolina an outlier in the taxation of construction contracts by "dual businesses" that are both contractors and retailers. Uncontroverted evidence establishes that other states have found that Lowe's is a contractor when acting pursuant to its Installation Contracts and that the Installation Contracts are real property improvements, not sales of TPP. The record includes unrebutted evidence that tax authorities in Maryland, Ohio, and Utah have all concluded that the transactions are sales of real property improvements and Lowe's should be taxed as a contractor when performing its Installation Contracts. (4/20/16 T. p. 75 line 19 – p. 76 line 7, R. pp. 110-111).

Moreover, tribunals and courts in Kansas, Indiana, and Oklahoma have overruled taxing authorities' claims that a "recognized retailer" like Lowe's cannot also be a contractor and the Installation Contracts should be treated as retail sales of TPP. Like South Carolina, Kansas, Indiana, and Oklahoma all impose sales tax on sales of TPP at retail.[8] All three states have definitions similar to those contained in the South Carolina sales tax code that tie a retail sale of TPP to a transfer of property.[9]

Oklahoma's taxing authority took the position that a retailer like Lowe's can never be a contractor; thus, the Installation Contracts were sales of TPP to customers. Lowe's responded that, under Oklahoma law, it was acting as a contractor when it used items of TPP to perform real property improvements to customers' residences and, thus, was the final consumer and user of the materials. After litigating the controversy, an administrative hearing officer ruled in favor of Lowe's that, "[it] was, indeed, a contractor and should not be charging sales tax to its customers."

The officer also ruled that the distinction the Oklahoma Tax Commission drew between Lowe's and other contractors would be an equal protection violation if upheld. The Oklahoma Tax Commission formally adopted the officer's findings and conclusions. (4/20/16 T. p. 83 line 7 – p. 85 line 3, R. pp. 118-120); *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 (Feb.

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[8] Kansas law states: "there is hereby levied and there shall be collected and paid a tax . . . upon . . . [t]he gross receipts received from the sale of [TPP] at retail within this state." KAN. STAT. ANN. § 79-3603(a). Indiana law provides: "An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana." IND. CODE § 6-2.5-2-1(a). Oklahoma law states: "There is hereby levied upon all sales . . . an excise tax of four and one-half percent (4.5%) of the gross receipts or gross proceeds of each sale of . . . [TPP]." OKLA. STAT. tit. 68, § 1354(A)(1).

[9] Kansas defines a "[r]etail sale" as "any sale . . . for any purpose other than for resale." The term "sale" means "the exchange of [TPP], as well as the sale thereof for money, and every transaction, conditional or otherwise, for a consideration, constituting a sale, . . . regardless of the method by which the title, possession or right to use the [TPP] is transferred." KAN. STAT. ANN. § 79-3602(jj), (kk). Indiana provides a person is "selling at retail" when "the person acquires [TPP] for the purpose of resale; and transfers that property to another person for consideration." IND. CODE § 6-2.5-4-1(b). Oklahoma law defines a "sale" to include "the transfer of either the title or possession for a valuable consideration of [TPP], regardless of the manner, method, instrumentality or device by which such transfer is accomplished." OKLA. STAT. tit. 68, § 1401(6).

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).

Similarly, Indiana asserted that Lowe's was not acting as a contractor when it sold installed home improvements pursuant to Installation Contracts. The dispute was also litigated. The Indiana Tax Court ruled in favor of Lowe's on all issues, including holding that Lowe's was as a contractor for purposes of its Installation Contracts and the contracts were lump-sum, i.e., not a sale of TPP followed by a sale of installation services. The Tax Court invalidated a regulation the Indiana Department of Revenue relied upon in its efforts to bifurcate the Installation Contracts into separate transactions. The Indiana Supreme Court subsequently denied review of the Tax Court decision. (4/20/16 T. p. 85 lines 7-25, R. p. 120); *Lowe's Home Ctrs., LLC v. Indiana Dep't of State Revenue*, 23 N.E.3d 52 (Ind. T.C. 2014), cert denied (2015).

Finally, the Kansas Department of Revenue asserted that Lowe's was not a contractor and was exclusively a business conducting retail sales of TPP when it entered into Installation Contracts. The Kansas Board of Tax Appeals ruled in favor of Lowe's' position that it was a "contractor engaged in providing residential remodeling services" in the disputed transactions; thus, the transactions were not retail sales to customers. The Kansas Court of Appeals affirmed the Board of Tax Appeals' decision. (4/20/16 T. p. 86 line 1 – p. 87 line 1, R. pp. 121-122); *Matter of Lowe's Home Ctrs., LLC*, 394 P.3d 149 (Kan. Ct. App. 2017).

Each of these rulings supports that Lowe's is a contractor for its Installation Contracts and the contracts are real property improvements.[10]

[10] Perhaps the ALC strayed from the contract terms and mischaracterized the Installation Contracts in a strained attempt to be consistent with the decision in *Home Depot U.S.A., Inc., d/b/a The Home Depot v. South Carolina Department of Revenue*, Docket No. 15-ALJ-17-0253-CC. But *Home Depot* is different. Unlike Home Depot, Lowe's' Installation Contracts (i) are fixed, lump-sum contracts; and (ii) provide that Lowe's retains title to

5. The ALC's Decision Is Legally Flawed

As established above, Lowe's' purchase of materials used to complete the Installation Contracts is governed by the plain language of section (1)(a) or (1)(e) of the Retail Sale Statute. The ALC committed several legal errors in avoiding this straightforward interpretation; concluding instead that "a retail sale occurs [under the general definition of the Retail Sale Statute] when the customer pays for the materials listed in the installation contract." (ALC Order p. 19, R. p. 20).

a. *The ALC's "primary objective" rationale is contrary to law.*

In the first instance, the court adopted a rationale that is not authorized by South Carolina law when it recharacterized the Installation Contracts as retail sales of TPP to customers combined with sales of ancillary services, on the theory that the "primary objective" of the contracts is "to facilitate a retail sale to customers." (*Id.* at p. 20, R. p. 21). This use of a primary objective test to bifurcate the Installation Contracts appears nowhere in the South Carolina law, is inconsistent with the Retail Sale Statute, and is therefore legally unauthorized. Furthermore, the ALC's primary objective theory introduces difficult line-drawing problems that could apply to any dual business. Moreover, it mischaracterizes the contracts. The auditor originally reached the same conclusion that the Installation Contracts were two separate transactions in issuing the proposed assessment. Significantly, she did so ***without ever seeing or reviewing*** the Installation Contracts. Most significantly, the Department testified that this interpretation "is incorrect" and wrong "as a matter of law." (6/7/16 T. p. 52 line 22 – p. 53 line 22 & p. 63 lines 15-19, R. pp. 383-384, 386).

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the materials used to perform the real property improvements until after the project is complete. (Joint Ex. 34 (Non-Special Order Contract) p. 4, R. p. 903; Joint Ex. 35 (Special Order Contract) p. 4, R. p. 909; 4/20/16 T. p. 41 lines 2-9 & p. 45 line 9 – p. 46 line 20, R. pp. 76, 80-81).

b. *The ALC's interpretation ignores the clear terms of the contracts.*

The ALC's construction also ignored the undisputed terms of the Installation Contracts themselves. In light of the contracts' clear terms, the ALC erred in interpreting that they were retail sales of TPP under the general definition of the Retail Sale Statute. *See McPherson v. JE Sirrine & Co.*, 206 S.C. 183, 204, 33 S.E.2d 501, 509 (1945) ("In construing and determining the effect of a written contract, the intention of the parties and the meaning are 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; and a meaning cannot be given it other than that expressed.***") (emphasis added). Under the general definition, a "retail sale" means "all sales of tangible personal property except those defined as wholesale sales." S.C. CODE ANN. § 12-36-110 (2014). In turn, the term "sale" is defined, in relevant part, as a "transfer, exchange, or barter, conditional or otherwise, of tangible personal property for a consideration, including . . . a transfer of title or possession." *Id.* § 12-36-100(4) (2014). Thus, a retail sale is limited to a transfer of title or possession of TPP. Fatally, the contracts at issue provide that Lowe's retains title to all items of TPP used to perform the real property improvements until ***after*** they are incorporated into real property and lose their character as TPP. *See supra*, p. 11 & 27. Interpreting the contracts as involving retail sales of TPP "deems" a transfer of title to have occurred despite clear contractual terms to the contrary. A contractor's incorporation of TPP into a customer's real property does not (and cannot) constitute a general retail sale because title of TPP does not transfers to the customer.

See Hercules, 280 S.C. at 435, 313 S.E.2d at 306.[11] Based on this language, the ALC's ruling is in error.[12]

In addition to the language relating to title, the ALC ignored language establishing that the contracts are lump-sum agreements. The contracts indicate that Lowe's is required to provide ***both*** the labor and materials necessary to perform the real property improvement via the Installation Contract for one fixed, lump-sum price: "Lowe's agrees to sell the goods and/or materials (the "Goods") ***and*** the services to install same (the "Installation Services") . . . for the stated ***total cash price*** (the "Price")." (Joint Ex. 34 p. 4, R. p. 903; Joint Ex. 35 p. 4, R. p. 909). The court disregarded this language and focused on the fact that the contracts show the estimated amounts associated with the materials and labor components of the real property improvements. (ALC Order p. 20, R. p. 21). It did not cite any authority and Lowe's is aware of none, which holds that merely listing estimated amounts associated with materials and labor on the face of the contract converts it into a retail sale of TPP. Under the statutory scheme, if the contract is lump sum and the seller has neither transferred title to nor possession of the property until it is incorporated into real property, then there is no basis for concluding that a retail sale has occurred.

c. *The ALC relied on assumptions about the contracts rather than evidence of record.*

The ALC noted that Lowe's carries the burden of proof and has "offered no evidence that a customer might view the purchase of materials through an installation contract as anything other

[11] The Indiana Department of Revenue also sought to "bifurcate Lowes's installation contracts into separate 'events:' (1) a retail sale of [TPP] subject to sales tax . . . and (2) the subsequent, non-taxable service of adding that [TPP] to a structure or facility." *Lowe's Home Ctrs, LLC*, 23 N.E.3d at 56. In rejecting the Department's attempt, the Tax Court ruled that Lowe's was required to actually pass title to the customers at the time of payment in order for the transaction to be a retail sale of TPP. The Tax Court ruled that title did not pass based on the plain language of the contracts and because work remained to be done to put the items in the condition that the terms of the contract required (that is, they had to be affixed to the customers' real property at which point the items lost their identity as TPP). *Id.*

[12] There is no dispute that the customer leaves without possession of TPP. (4/20/16 T. p. 38 line 23 – p. 41 line 9, R. pp. 73-76; ALC Order p. 4, R. p. 5).

than a retail purchase." (ALC Order p. 21 n.30, R. p. 22). The court then stated that "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 already paid for, he could do so without Lowe's claiming title or ownership over the materials." (*Id.*) (emphasis added). What the court presumed, believing it was "lacking evidence to the contrary," is directly contradicted by the record. (Joint Ex. 34 (Non-Special Order Contract), R. pp. 899-904; Joint Ex. 35 (Special Order Contract), R. pp. 905-910). In particular, the Installation Contracts provide that although the customer may cancel the contract prior to midnight of the third day after the transaction, there is a "Remedy for Breach" operative thereafter which allows Lowe's to "recover the greater of liquidated damages or 20% of the total Contract price or such actual damages as Lowe's . . . prove[s]." (Joint Ex. 34 p. 5, R. p. 904; Joint Ex. 35 p. 5, R. p. 910). The contracts also provide that "if Customer fails to pay . . . Lowe's shall be entitled to recover its legal costs, including reasonable attorney's fees" which are agreed to "constitute 15% of the amount under the Contract[.]" (*Id.*). The actual remedy established by the evidence is directly contrary to what the court presumed.

Similarly, even though the ALC did not make a specific finding that customers obtain title to materials involved in the Installation Contracts upon processing the transaction at the register, it essentially presumed that they do. The court stated that "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." (ALC Order p. 21, R. p. 22). This assumption lacks merit. In addition to the contract terms deferring the transfer of title until after the materials are incorporated in the customers' real property, *supra*, p. 11 & 27, under the contracts, Lowe's only "pay[s] the installer after completion of the work and receipt of a

[Certificate of Completion], signed and dated by Customer." Lowe's "warrants that the Installation Services will be performed . . . in a good and workmanlike manner" and "bears the risk" and arranges for the work to be performed properly. (Joint Ex. 34 p. 4, R. p. 903; Joint Ex. 35 p. 4, R. p. 909). Mr. Price testified that "if the installer is walking into the customer's house and drops a box of tile and breaks every one, he's got to come back to the Lowe's store and get more tile. The customer bought a tile floor, not tangible personal property." (4/20/16 T. p. 43 line 18 – p. 44 line 11, R. pp. 78-79). This undisputed evidence shows a difference in the risk of loss between a traditional retail sale and an Installation Contract under which Lowe's retains title and bears the risk until the customer accepts the improvement.

d. *The ALC erred in interpreting the Dual Business Regulation.*

In addition, the ALC erred in construing the Dual Business Regulation, stating that "[t]he plain language of Regulation 117-324 makes it abundantly clear ***that it is not applicable to contractors*** and, as such, works to directly discredit [Lowe's] argument that as a contractor it was required to purchase at the lesser wholesale cost to comply with the regulation." (ALC Order p. 24, R. p. 25) (emphasis added). That is wrong. The regulation states that it "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." *See* S.C. CODE ANN. REGS. § 117-324 (2012) (emphasis added). The plain text of the regulation shows it ***does apply to contractors*** who make more than isolated or accommodation sales and are engaged in selling.

In interpreting the regulation, the ALC suggested that Lowe's misused its resale certificate to obtain an advantage all other contractors are denied. (ALC Order pp. 23-26, R. pp. 24-27). But Lowe's did exactly what the Dual Business Regulation required. S.C. CODE ANN. REGS. § 117-324 (2012). It did not violate or misuse its resale certificate. The Department has promulgated a

regulation which explicitly confirms that companies making both retail sales and withdrawing for use from the same stock of goods may use their resale certificates to comply with the Dual Business Regulation, stating, "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.***" S.C. CODE ANN. REGS. § 117-305.4 (2017) (emphasis added). Retailers who also act as contractors, like Lowe's, generally do not know at the time of the purchase whether the product will be resold at retail or installed through a construction contract. By paying the sales tax based upon what it paid for the building materials, at the time it used and consumed the materials in performing real property improvements for customers, Lowe's complied with the regulation while still retaining its status as a contractor under South Carolina law. This does not lead to an absurd result as the ALC suggests. (ALC Order p. 24, R. p. 25). The Dual Business Regulation's requirement that Lowe's use a resale certificate does not distinguish Lowe's from all other contractors, only from contractors that do not also have dual roles as retailers and contractors. And, the requirement does not place Lowe's in a better position than other so-called true or exclusive contractors, who may purchase at discounts but, unlike Lowe's, are not taxed on a markup. *See* (4/20/16 T. p. 158 line 15 – p. 161 line 13, R. pp. 193-196) (testifying that even if a contractor who bought at bulk opened up a store and sold certain items of TPP at retail, with respect to the materials used to perform real property improvements, it would be taxed on what it paid at the time of purchase – even discounted prices).

B. THE INTERPRETATION URGED IN THE DEPARTMENT'S FINAL DETERMINATION (AND REJECTED BY THE ALC) IS ALSO ERRONEOUS AS A MATTER OF LAW

Remand is unnecessary because the Department's interpretation in the Final Determination is wrong as a matter of law and should be rejected on *de novo* review.

1. The Department's Position that Lowe's Is Not a True Contractor Is Contrary to Law

As discussed above, Lowe's falls within the plain meaning of "contractor" under the Contractor Statute and S.C. CODE ANN. REGS. § 117-314.2 (2012). *See supra*, pp. 24-25. The Department concedes as much. When confronted with the Contractor Statute, Ms. Crawford admitted that Lowe's "fits within this definition" when it installs real property improvements at customers' homes. (4/26/16 T. p. 163 line 23 – p. 164 line 20, R. pp. 198-199). Also, the Department testified that for its Installation Contracts, Lowe's was "making improvements to real property" and "providing contracting services." (6/7/20 T. p. 41 line 13 – p. 42 line 4, R. p. 381). The Department has indicated that taxpayers are not retailers with respect to their real property improvement contracts (but rather contractors). *See* Private Letter Ruling 07-4 (S.C. Dep't of Revenue (July 13, 2007)).

Nevertheless, the Final Determination concluded that Lowe's could never be a "true contractor" because "[t]he taxpayer advertises itself as a retailer – the taxpayer's website states that the taxpayer is a '[r]etailer of a complete line of home improvement products and equipment.'" (Joint Ex. 32 (Final Determination) p. 5 of 8, R. p. 861). The Department's position is blatantly contrary to its own regulation, which provides that "***any*** person, firm, association or corporation making repairs, or additions to real property" is a contractor. S.C. CODE ANN. REGS. § 117-314.2 (2012) (emphasis added). And, it is contrary to the Contractor Statute, which broadly defines a contractor to include "***an entity*** which performs or supervises or offers to perform or supervise" "improvement of any kind to real property." S.C. CODE ANN. § 40-11-20(4), (8), (9) (2011) (emphasis added). There is no restriction against a contractor also being a retailer. As noted, the ALC correctly rejected the Department's argument that a company cannot act as contractor just because it also holds itself out as a retailer. (ALC Order p. 10, R. p. 11).

Although neither the statute nor regulation requires a taxpayer to hold itself out as contractor, the undisputed evidence shows that Lowe's did. (Joint Ex. 20 (Lowe's 2011 10-K) p. 7, R. p. 615).

2. The Department's Fair Market Value Approach Is Legally Unjustified

Based on the erroneous conclusion that Lowe's was not a "true contractor," 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 (c) of the Retail Sale Statute. (6/7/16 T. p. 51 lines 4-12, R. p. 383; Joint Ex. 32 (Final Determination) pp. 3 of 8, 5 of 8, R. pp. 859, 861). Under the Department's theory, the withdrawal, use or consumption of the property was a "deemed sale" of the building materials by Lowe's to Lowe's. On the issue of the tax base, the Department interpreted that sales tax should be imposed on the "fair market value" of the items of TPP used to perform the Installation Contracts pursuant to section (c) of the Gross Proceeds Statute, which states 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) (2014); (6/7/16 T. p. 15 lines 2-10, R. p. 374). The Department determined that fair market value should be determined at the retail level of trade, using a 40% markup from Lowe's' acquisition cost to the "retail price." (Joint Ex. 32 (Final Determination) 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 is not what the Gross Proceeds Statute or South Carolina law requires.

a. *Regulation 117-309.17 is not a contemporaneous construction of the Gross Proceeds Statute.*

The South Carolina Tax Code neither defines nor gives guidance on the meaning of "fair market value" as used in the Gross Proceeds Statute. (4/20/16 T. p. 222 lines 20-25 & p. 310 lines

21-25, R. pp. 257, 345). The Department looked to S.C. CODE ANN. REGS. § 117-309.17 (2012), entitled "Withdrawals From Stock, Merchants," to support its fair market value approach. The regulation states:

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

S.C. CODE ANN. REGS. § 117-309.17 (2012).

Section 117-309.17 should have no bearing on the valuation of building materials used by Lowe's (as ***contractor***) to perform real property improvements. The regulation's title shows and the Department's testimony confirms that the regulation applies only to withdrawals by ***retailers***. (*See* 6/7/16 T. p. 20 line 19 – p. 21 line 17 & p. 95 line 17 – p. 96 line 21, R. pp. 375-376, 394; ALC Order p. 14, R. p. 15). In any event, the regulation (promulgated in 2002) comes approximately a dozen years after the Gross Proceeds Statute was enacted (1990). It has long been the law in South Carolina that regulations that are not promulgated contemporaneously with a statute which they purport to interpret are entitled to little deference. *See S.C. Att'y Gen. Op.*(Oct. 1, 1986), 1986 S.C. AG LEXIS 69, *9-*10 (relying on "the rule of statutory construction that the longstanding ***contemporaneous construction*** of a statute by the agency charged with administration and enforcement of the statute is most significant"); *S.C. Ambulatory Surgery Ctr. Ass'n v. S.C. Workers' Comp. Comm'n*, 389 S.C. 380, 389, 699 S.E.2d 146, 151 (S.C. 2010) (applying rules of statutory construction to regulations).

b. ***Section (1)(c) of the Gross Proceeds Statute cannot apply to Special Order Materials.***

There is no dispute that 60% of the materials at issue were Special Order Materials that were not for resale and were never placed into any store inventory – physically or for accounting purposes – for traditional retail purchases." (ALC Order pp. 5-6, R. pp. 6-7; 4/20/16 T. p. 62 lines 11-20, R. p. 97; Joint Ex. 37 (Summary of Inventory Versus Special Order Sales), R. pp. 918-919). As a matter of law, section (1)(c) of the Gross Proceeds Statute cannot apply to the majority of the property purchased by Lowe's for use in its contractor operations.

S.C. CODE ANN. § 12-36-90(1)(c) (2014) states that the "[g]ross proceeds of sales . . . includes . . . the fair market value of tangible personal property previously ***purchased at wholesale which is withdrawn*** from the business or stock and used or consumed by ***any person withdrawing it.***" (Emphasis added). The South Carolina Tax Code defines "wholesale sale" to mean sales 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).

The Department has asserted that Lowe's is uniformly – and without any distinction between Stock Materials versus Special Order Materials – subject to the tax based on the fair market value of TPP purchased at wholesale which is withdrawn from the business or stock. (4/20/16 T. p. 232 line 2 – p. 233 line 9, R. pp. 267-268). Under the plain language of section (1)(c) of the Gross Proceeds 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.

Notwithstanding the regulatory requirement that Lowe's purchase all of its TPP pursuant to its resale certificate, it purchased 60% of the property used under the Installation Contracts directly from vendors as Special Order Materials. Lowe's did not purchase them for purposes of resale. These Special Order Materials (*e.g.*, kitchen cabinets and doors) were not included in

inventory and were not offered for resale because they were expressly purchased for making real property improvements in Lowe's' contractor business. (4/20/16 T. p. 61 line 14 – p. 64 line 10, R. pp. 96-99; ALC Order p. 6, R. p. 7; Joint Ex. 37 (Summary of Inventory Versus Special Order Sales), R. pp. 918-919). Thus, the Special Order Materials are excluded from the statutory definition of "wholesale sale" and fall outside section (1)(c) of the Gross Proceeds Statute.

c. *The Department's interpretation of "fair market value" violates South Carolina law.*

Even assuming that section (1)(c) of the Gross Proceeds Statute applies for purposes of measuring the amount of tax due on at least some of the materials used to perform the Installation Contracts, the Department's interpretation of "fair market value" is arbitrary and contrary to South Carolina law.

In its Final Determination, the Department stated as follows:

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

(Joint Ex. 32 (Final Determination) p. 6 of 8, R. pp. 862) (*quoting Hous. Auth. of City of Charleston v. Olasov*, 282 S.C. 603, 608, 320 S.E.2d 478, 481 (Ct. App. 1984)) (emphasis added). *See also* (6/7/16 T. p. 122 line 14 – p. 123 line 12, R. p. 401) (stating for fair market value, "the concept is a willing buyer and willing seller"). It then concluded that "the fair market value of the inventory withdrawn is the price that the ***taxpayer's retail customers pay*** for inventory in retail transactions." (Joint Ex. 32 (Final Determination) p. 6 of 8, R. pp. 862) (emphasis added).[13]

[13] The Department's expert opined that fair market value should be determined at the retail level of trade, using the price individual customers would pay. (4/20/16 T. p. 314 line 9 – p. 316 line 3, R. pp. 349-351).

The Department misapplied the willing buyer/willing seller standard by failing to consider comparable sales. Under the Department's interpretation, the taxed retail sale at issue was the deemed sale of materials to Lowe's to perform real property improvements. The Department conceded that for purposes of the deemed sale ***Lowe's*** "[was] the final user – consumer of the building materials"; that is, Lowe's was the willing buyer. (6/7/16 T. p. 122 line 14 – p. 123 line 12, R. p. 401). Yet, it arbitrarily assumes that Lowe's would pay what "its retail customers pay".

It is undisputed that Lowe's operates a contracting line of business. Because Lowe's is a high-volume purchaser, it is able to buy from vendors at discounts. (4/20/16 T. p. 110 lines 3-6, R. p. 145). The price that Lowe's or a similarly-situated contractor of Lowe's' size would pay for TPP (considering the costs incurred by such a large contractor and its negotiating power) is the relevant factor in measuring fair market value. The interpretation that Lowe's would willingly pay, without being under compulsion, the same retail or shelf price that an individual walk-in customer would pay for materials that Lowe's could otherwise buy at cost is implausible and erroneous. The Department interpretation is arbitrary because it failed to give a reasoned explanation for basing its valuation on a walk-in customer instead of Lowe's. *See Judulang v. Holder*, 565 U.S. 42, 53, 132 S. Ct. 476, 484, 181 L. Ed. 2d 449 (2011) (noting it is important to "examin[e] the reasons for agency decisions—or, as the case may be, the absence of such reasons").

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

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

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

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

Texaco Refining & Mktg., Inc. v. Dep't of Revenue, 127 P.3d 771, 777 (Wash. Ct. App. 2006) (quoting WASH. ADMIN. CODE § 458-20-112) (emphasis added).

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

C. THE DEPARTMENT'S FINAL DETERMINATION VIOLATES LOWE'S' CONSTITUTIONAL RIGHT OF EQUAL PROTECTION

The Equal Protection Clause of the Fourteenth Amendment to the U.S. Constitution provides that no state shall "deny to any person within its jurisdiction equal protection of the laws." U.S. CONST. AMEND. XIV, § 1. Likewise, the Equal Protection Clause of the South Carolina Constitution states that no person shall "be denied the equal protection of the laws." S.C. CONST. ART. I, § 3. These provisions serve to protect a person "from state action which selects him out for discriminatory treatment by subjecting him to taxes not imposed on others of the same class." *Allegheny Pittsburgh Coal Co. v. Cty. Comm'n of Webster Cty., W. Va.*, 488 U.S. 336, 345, 109

S.Ct. 633, 639, 102 L.Ed.2d 688 (1989) (internal quotation marks and citation omitted). The goal is to "keep[ ] governmental decision-makers from treating differently persons who are in all relevant respects alike." *Nordlinger v. Hahn*, 505 U.S. 1, 10, 112 S. Ct. 2326, 2331, 120 L. Ed. 2d 1 (1992). Thus, states must "apply each law, within its scope, equally to persons similarly situated and that any differences of application must be justified by the law's purpose." *Town of Iva v. Holley*, 374 S.C. 537, 541, 649 S.E.2d 108, 110 (Ct. App. 2007) (citing *Sylvia Dev. Corp. v. Calvert Cty., Md.*, 48 F.3d 810, 818 (4th Cir. 1995)). Any such classifications must not be arbitrary. *Id.* (citing *F.S. Royster Guano Co. v. Com. of Virginia*, 253 U.S. 412, 415, 40 S. Ct. 560, 64 L. Ed. 989 (1920)).

The Department's regulations discuss the sales tax treatment of contractors. Regulation 117-314 provides 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 ANN. REGS. § 117-314 (2012) (emphasis added). Regulations 117-314.1 and 117-314.2 further provide 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 at the time of purchase based on the price paid. *Id.* §§ 117-314.1 & 117-314.2 (2012).

The Department seeks, without statutory authority, to divide South Carolina contractors into two arbitrary categories – those that also make retail sales versus those that do not – and it seeks to impose different tax burdens on the two groups for engaging in the exact same activity. Nothing in the South Carolina Tax Code authorizes such a discriminatory scheme. There is no statutory caveat or exception to the definition of contractor under S.C. CODE ANN. § 40-11-20 (2011) or S.C. CODE ANN. REGS. § 117-314.2 (2012) which suggests that contractors who also sell merchandise at retail must be classed differently and bear different tax burdens than other

contractors making the same real property improvements. Rather, the Department has unilaterally chosen to implement its own aberrational enforcement policy against Lowe's.

In *Allegheny Pittsburgh Coal Co.*, the West Virginia legislature enacted a statute which provided that all property should be taxed at a rate uniform throughout the state according to its estimated market value. The statute did not distinguish between recently sold property and property which had not been recently sold. Nonetheless, a county tax assessor chose to value recently sold property on the basis of its recent purchase price, but assessed neighboring property which had not been recently sold under another method. 488 U.S. at 338. The U.S. Supreme Court held that the distinction drawn by the assessor, on her own initiative, resulted in disparate treatment of property in the same class, which violated the petitioners' equal protection rights:

> But West Virginia has not drawn such a distinction. Its Constitution and laws provide that all property of the kind held by petitioners shall be taxed at a rate uniform throughout the State according to its estimated market value. ... We are not advised of any West Virginia statute or practice which authorizes individual counties of the State to fashion their own substantive assessment policies independently of state statute. *See Salsburg v. Maryland*, 346 U.S. 545, 74 S.Ct. 280, 98 L.Ed. 281 (1954). The Webster County assessor has, apparently on her own initiative, applied the tax laws of West Virginia in the manner heretofore described, with the resulting disparity in assessed value of similar property.

Id. at 345.

The same principle applies here with respect to the Department which, on its own initiative, chose to arbitrarily impose a materially greater tax burden on Lowe's than is imposed on all other contractors doing the same work. *See* (6/7/16 T. p. 38 line 1 – p. 39 line 13, R. p. 380) (admitting that between Lowe's and a "true contractor" – "those two taxpayers would be treated differently for performing the exact same transaction."). The Department's use of the Gross Proceeds Statute to markup the fair market value of TPP by 40% treats Lowe's differently from other similarly-situated contractors. The Department attempted to justify such treatment by contending that

Lowe's was not a "true contractor." (6/7/16 T. p. 38 line 8 – p. 39 line 22, R. p. 380). The arbitrary line in the sand the Department seeks to draw is undermined by its acknowledgment that plenty of other contractors buy in bulk and receive discounts, yet those contractors are not taxed at a markup. (4/20/16 T. p. 157 line 12 – p. 158 line 8, R. pp. 192-193). Moreover, taxing items Lowe's purchases to perform real property improvements via its Installation Contracts at an artificially higher base places Lowe's at a competitive disadvantage to similar contractors. The Department's position creates 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.

Notably, the Oklahoma Tax Commission determined that treating Lowe's differently from other contractors would violate the Equal Protection Clause. (*See In the Matter of the Sales Tax and Use Tax Protest of Lowe's Home Centers, LLC a/k/a Lowe's Home Centers, Inc.*, Okla. Tax Commission Order, Case No. P-09-195-H, p. 49-50 (Feb. 26, 2015), *aff'g In the Matter of the Sales Tax and Use Tax Protest of Lowe's Home Centers, LLC a/k/a Lowe's Home Centers, Inc.*, A.L.J. Findings, Conclusions and Recommendations, Case No. P-09-195-H (July 7, 2014)). In making its determination, the Oklahoma Tax Commission noted that Oklahoma's legislature had not chosen to make a distinction between taxpayers like Lowe's and other contractors performing Installation Contracts. (*Id.*). Likewise, South Carolina's legislature has not created a separate class of taxpayers such that contractors who also sell at retail constitute a separate class from those who exclusively engage in contracting.

Although the ALC concluded that Lowe's equal protection argument is moot on the mistaken conclusion that Lowe's does not operate in its capacity as a contractor in purportedly selling TPP to customers under the Installation Contracts, it went on to state that treatment of

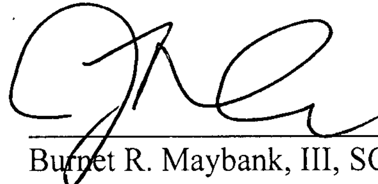
Lowe's as a contractor would somehow violate equal protection because Lowe's would be able to purchase materials at wholesale using its resale certificate. The Dual Business Regulation, however, requires contractors who also have sufficient sales at retail to do exactly that. *See* S.C. Code Ann. Regs. § 117-324 (2012). The argument that Lowe's would be able to acquire materials from vendors at wholesale prices and have an advantage not available to other contractors is also not supported by the record. The Department actually admitted that some contractors may purchase at discounts and that no contractor has been taxed on a markup. (4/20/16 T. p. 157 line 12 – p. 158 line 8, p. 161 line 19 – p. 162 line 2, R. pp. 192-193, 196-197; 6/7/16 T. p. 38 line 8 – p. 39 line 22, R. p. 380).

Based on the foregoing, the ALC erred in ignoring Lowe's' equal protection argument.

VI. CONCLUSION

For the reasons stated above, this Court should reverse the Administrative Law Court's Final Order.

Dated: June 29, 2021



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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

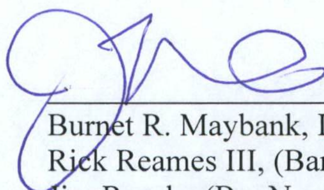
Lowe's Home Centers, LLC..Appellant,

v.

South Carolina Department of Revenue..Respondent.

CERTIFICATE OF COUNSEL

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



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