

STATE OF NORTH CAROLINA
COUNTY OF WAKE

BEFORE THE
SECRETARY OF REVENUE

IN THE MATTER OF:

The Denial of the Claims for Refund of Sales and)
Use Tax for the periods November 1, 1993 through)
June 30, 1996 and January 1, 1997 through)
August 31, 1999 by the Secretary of Revenue)
Of the State of North Carolina)
)
vs.)
)
[Taxpayer])

FINAL DECISION
Docket No. 2002-36

On February 13, 2002, this matter was heard by the Assistant Secretary of Revenue, Eugene J. Cella, in the City of Raleigh, upon application for hearing by the [Taxpayer]. The Sales and Use Tax Division was represented by Mr. Andy Sabol, Assistant Director. The Taxpayer was represented by [three Attorneys].

ISSUE

The issue to be decided is whether the Taxpayer is liable for use tax on its purchases of tangible personal property incorporated into building components at out-of-state locations for those building components that are brought into the State and used in the fulfillment of performance contracts to erect structures.

EVIDENCE

- E-1 Memorandum dated May 16, 2001 from the Secretary of Revenue to the Assistant Secretary of Administrative Hearings.
- E-2 Taxpayer's claim for refund for the period January 1, 1993 through June 30, 1996 and statement of facts and grounds for recovery dated December 13, 1996.
- E-3 Taxpayer's claim for refund for the period January 1, 1997 through August 31, 1999 and statement of facts and grounds for recovery dated December 27, 1999.
- E-4 Letter dated December 18, 1996 from the Taxpayer's representative to the Department.
- E-5 Letter dated January 14, 1997 from the Department to the Taxpayer.
- E-6 Letter dated April 15, 1997 from the Department to the Taxpayer's representative.

- E-7 Letter dated April 22, 1997 from the Taxpayer's representative to the Department.
- E-8 Letter dated August 1, 1997 from the Department to the Taxpayer's representative.
- E-9 Letter dated September 16, 1997 from the Taxpayer's representative to the Department.
- E-10 Letter dated October 20, 1997 from the Department to the Taxpayer's representative.
- E-11 Letter dated November 17, 1997 from the Taxpayer's representative to the Department.
- E-12 Letter dated December 23, 1997 from the Taxpayer's representative to the Department.
- E-13 Letter dated December 31, 1997 from the Department to the Taxpayer's representative.
- E-14 Letter dated March 20, 1998 from the Department to the Taxpayer's representative.
- E-15 Letter dated December 28, 1999 from the Taxpayer's representative to the Department.
- E-16 Letter dated February 3, 2000 from the Department to the Taxpayer's representative.
- E-17 Letter dated January 5, 2001 from the Taxpayer's representative to the Department.
- E-18 Letter dated January 31, 2001 from the Department to the Taxpayer's representative.
- E-19 Letter dated February 23, 2001 from the Taxpayer's representative to the Department.
- E-20 Letter dated March 6, 2001 from the Department to the Taxpayer's representative.
- E-21 Letter dated June 7, 2001 from the Department to the Taxpayer's representative.
- E-22 Letter dated June 22, 2001 from the Taxpayer's representative to the Department.
- E-23 Letter dated July 25, 2001 from the Department to the Taxpayer's representative.
- E-24 Letter dated September 4, 2001 from the Taxpayer's representative to the Department.
- E-25 Letter dated September 10, 2001 from the Department to the Taxpayer's representative.
- E-26 Letter dated September 19, 2001 from the Taxpayer's representative to the Department.
- E-27 Letter dated October 4, 2001 from the Department to the Taxpayer's representative.
- E-28 Letter dated December 6, 2001 from the Taxpayer's representative to the Department.
- E-29 Stipulations of Fact.
- E-30 Letter dated December 7, 2001 from the Department to the Taxpayer's representative.
- E-31 Letter dated December 13, 2001 from the Department to the Taxpayer's representative.

- E-32 Letter dated December 13, 2001 from the Assistant Secretary to the Taxpayer's representative.
- E-33 New York Supreme Court Appellate Division [decision].
- E-34 Missouri Administrative Hearing Commission [decision].
- E-35 Wisconsin Circuit Court [decision].
- E-36 Connecticut Supreme Court [decision].
- E-37 Minnesota Supreme Court [decision].
- E-38 Texas Court of Appeals [decision].
- E-39 Massachusetts Appeals Court [decision].
- E-40 Vermont Supreme Court [decision].
- E-41 Colorado [Final Determination].
- TP-1 Brief of [Taxpayer] dated February 6, 2002.
- TP-2 State v. Roger Blackstock, 314 NC 232, 333 S.E. 2d 245 (1985).
- TP-3 1957 Session Law.

FINDINGS OF FACT

On December 6, 2001, the Division and the Taxpayer entered into written stipulations of fact. Those facts are supported by the foregoing evidence and testimony of record and are as follows:

1. [Taxpayer] seeks a refund for sales and use tax for the periods November 1, 1993 through June 30, 1996 and January 1, 1997 through August 31, 1999 (hereinafter collectively referred to as the "Tax Periods").
2. During the Tax Periods at issue, [Taxpayer] timely filed all Monthly, Quarterly, and Annual Sales and Use Tax Returns with the Department and tendered timely payments of the taxes shown thereon to be due.
3. On December 18, 1996, pursuant to G.S. 105-266.1, [Taxpayer] filed an Application for Refund of Use Tax Paid with the Department. This application was amended on September 16, 1997 and November 17, 1997. The refund sought for the period November 1, 1993 through June 30, 1996 is \$94,280.71 plus interest as provided by law. [Taxpayer's] request for refund was timely under G.S. 105-266(c) and G.S. 105-266.1.
4. On December 28, 1999, pursuant to G.S. 105-266.1, [Taxpayer] filed a Claim for Refund with the Department. The refund sought for the period January 1, 1997 through August

- 31, 1999 is \$171,184.40 plus interest as provided by law. [Taxpayer's] request for refund was timely under G.S. 105-266(c) and G.S. 105-266.1.
5. On February 3, 2000, the Department denied [Taxpayer's] Claim for Refund for the period January 1, 1997 through August 31, 1999.
 6. On January 31, 2001, the Department denied [Taxpayer's] Claim for Refund for the period January 1, 1993 through June 30, 1996 and January 1, 1997 through August 31, 1999.
 7. On February 23, 2001, pursuant to G.S. 105-266.1, [Taxpayer] submitted a timely request for an administrative hearing for its refund claims.
 8. The parties agree that [Taxpayer] is entitled to a hearing before the Secretary or his designee for the refund claims for the Tax Periods pursuant to G.S. 105-266.1.
 9. [Taxpayer's] Claims for Refund are for use tax paid on the cost of raw materials purchased and used in its out-of-state factories to manufacture building components and hardware ("Building Components") that were incorporated by [Taxpayer] into buildings assembled in North Carolina. [Taxpayer] accrued and paid use tax on the cost of the materials used to manufacture the Building Components.
 10. Pass through items ("Pass Through Items") include such items as lumber, cement, nails, staples, insulation, windows, doors, and some hardware that were purchased by [Taxpayer] in final form from suppliers outside North Carolina. [Taxpayer's] Claims for Refund state that all use taxes paid during the Tax Periods, less the amount of tax paid for Pass Through Items, should be refunded to [Taxpayer] on the grounds that the purchases on which those taxes were paid are not subject to use tax under G.S. 105-164.6.
 11. [Taxpayer's] second refund claim of \$171,184.20 was based on [Taxpayer's] estimate that approximately 16.64% of the use taxes paid by [Taxpayer] during the second refund claim Tax Period related to Pass Through Items. This estimated amount was deducted from the total use tax paid by [Taxpayer] in calculating the refund amounts shown on the second claim for refund. No such deduction was made from the first claim for refund.
 - a. More recently, [Taxpayer], having computerized its records, was able to determine a more accurate percentage for use tax paid on Pass Through Items for the State of North Carolina, such percentage being 34.3%; therefore the correct amount of the second refund claim at issue in this case is \$134,918.60. The parties agree that 34.3% is a reasonable estimate of the percentage of use taxes paid by [Taxpayer] during the Tax Periods related to Pass Through Items. Therefore, the correct amount of the first refund claim is \$61,942.43, and the total amount of refund claims in this case is \$196,861.03 plus interest.
 12. Taxpayers are allowed a credit against the amount of state and local use tax due in North Carolina for any state and local sales or use tax legally due and paid to another state or local taxing jurisdiction for purchases of tangible personal property stored, used, or consumed in North Carolina. [Taxpayer] has received all such credits to which it is entitled. Such credits are not available with respect to the taxes at issue in this case.

13. The contract between [Taxpayer] and its customers provides that title does not pass until the building is completed on site by [Taxpayer] and turned over to the customer. [Taxpayer] bears the risk of loss for any damage to the Building Components and other materials prior to that time. A copy of the standard form of contract between [Taxpayer] and its customers is attached as Exhibit A of the Stipulations of Fact (E-29).
14. For purposes of the taxes at issue in this case, [Taxpayer] operates in the capacity of a construction contractor in North Carolina.
15. [Taxpayer's] customers own the real estate on which the buildings are erected by [Taxpayer].
16. The erection and installation of a [Taxpayer] building is a permanent improvement to real property in North Carolina for sales and use tax purposes as the contract between [Taxpayer] and its customers provides for [Taxpayer] to deliver, erect, and affix a completed building in finished condition to the customer's building site at a lump sum price specified in the contract.
17. The Building Components become a permanent improvement to real estate and when a completed building was transferred to the customer, sales or use tax was not due on the sales price charged by [Taxpayer] for the building.
18. [Taxpayer] is a corporation organized under the laws of [another state]. Its principal place of business is located in [a city located in the other state]. At all pertinent times [Taxpayer] was qualified to do business in the state of North Carolina.
19. [Taxpayer] is engaged in the production, sale, and on-site erection of prefabricated timer-frame, metal-sheathed warehouses, and other buildings for use by farm and industry in approximately 40 states.
20. [Taxpayer] has no factories in North Carolina at which it manufactures Building Components but [Taxpayer] does maintain sales offices in North Carolina, from which it occasionally makes retail sales of Building Components. [Taxpayer] collects and remits North Carolina state and local sales tax upon such sales. [Taxpayer] makes no claim for refund of these sales taxes.
21. The overall style of the buildings made by [Taxpayer] is uniform, but various features such as doors, windows, and skylights may be specially ordered and the dimensions of the building itself may be varied to suit the purchaser's needs.
22. [Taxpayer] purchases the raw materials ("Raw Materials") used in its business in bulk from vendors outside North Carolina and stores them in its own warehouses in various locations outside of North Carolina. The principal Raw Materials include, among others, steel and lumber. The Raw Materials are not purchased by [Taxpayer] for application to any particular customer order, either within or without North Carolina. Determinations of the quantities of Raw Materials to be purchased for any given period are made by [Taxpayer] based on projections on a factory-by-factory basis based on the prior history of quantities used at the respective factories and considerations of the economy.
23. During the Tax Periods, [Taxpayer] had several factories, all of which were located outside North Carolina. Two of the factories were located in [two cities located in two

other states]. [Taxpayer] manufactured Building components for its North Carolina customers only at [Taxpayer's] factories in [two cities located in two other states]. These two factories also made Building Components for customers in at least 16 other states. At its factories, [Taxpayer's] employees manufactured from Raw Materials the Building Components used in erecting [Taxpayer's] buildings.

24. When [Taxpayer] receives an order, the necessary Raw Materials are withdrawn from storage and are consumed and transformed by [Taxpayer] in the manufacture of finished Building Components in accordance with the customer's specifications and in the manner described in paragraphs 25 through 32 hereto. The manufacturing processes performed by [Taxpayer] in each of its various out-of-state factories is uniform.
25. The Building Components that are made by [Taxpayer] include trusses, lower columns, upper columns, purlins, metal panels, overhand rafters and hardware. The manufacturing processes performed by [Taxpayer] with respect to each of those Building Components are briefly discussed below.
26. To manufacture the trusses, the upper chords and lower chords that will form the truss are run through a machine which cuts the chords to the proper lengths and to the proper angles at both ends of each chord. Lumber webbing, which is attached between the upper and lower chords, is also cut to the correct length and to the correct angles. The trusses (chords and webs) are then transferred to a fixture table where they are positioned "face-up" and metal gusset plates are positioned at each joint. Metal gusset plates are manufactured by [Taxpayer] from rolled steel. The gusset plates are then stitched into position with a pneumatic gun nailer. The truss is then repositioned "face-down" and additional metal gusset plates are positioned onto the joints on that side of the truss. The truss is then positioned onto a conveyor and transported through a roller press machine. The roller press machine imbeds the metal gusset plates into the wooden chords and webs at the pre-selected positions. The trusses include end trusses and intermediate trusses.
27. To manufacture the lower columns, [Taxpayer] utilizes preservation treated lumber. The lumber is trimmed to length as required. The lumber is then run through [Taxpayer's] column machine, a computerized manufacturing process, which indexes the lumber to various prepositioned locations and clamps it from the top and side. While clamped, nails are driven into the column lumber at prescribed angles. The laminating process (indexing, clamping, and nailing) is repeated until the column is completed. The lower columns then proceed to the drilling station and holes are drilled through the bottom of the lower columns at the prescribed locations.
28. To manufacture the upper columns, [Taxpayer] cuts the lumber to length and cuts the ends of lumber to the prescribed angles. The lumber is then run through [Taxpayer's] column machine which indexes the lumber to various prepositioned stops as part of the computerized manufacturing process. The same laminating process (indexing, clamping, and nailing) is used for the upper columns and the lower columns. The upper columns then are affixed with 2-inch by 2-inch blocks on the outside of the upper columns. When assembled together, the upper columns and the lower columns form the main support, sidewall, structural corner, and end columns (collectively, the columns).
29. To manufacture the purlins, [Taxpayer] feeds the lumber through a machine, a computerized manufacturing process, which cuts each end of the lumber to the correct

length, and squares the end of the lumber. Thereafter, metal connector plates, also manufactured by [Taxpayer], are positioned at each end of the purlin and are pressed into position. At the same time during the manufacturing process, holes are drilled into the purlins at prepositioned locations so that the purlins may be readily assembled to the truss at the job site. [Taxpayer] also manufactures wind ties, utilizing the same process as that used to manufacture purlins.

30. To manufacture the metal panels, [Taxpayer] purchases coils of galvanized cold-rolled steel which are shipped to an independent contractor outside North Carolina for application of coatings to the steel. The rolled steel, with applied coatings, is then delivered to [Taxpayer's] factories. When a factory receives an order, it manufactures the required interior and exterior metal panels by processing the rolled steel through a machine that rolls channels into the steel to add strength. The steel is then cut to specific length according to the requirements of the particular order. With the application of different paints and produced in various sizes, the metal panels are used for a variety of purposes including, inter alia, exterior sheeting, sidewalls and roof panels.
31. To manufacture the overhang rafters, [Taxpayer] utilizes a manufacturing process essentially similar to that employed in manufacturing the trusses. Anywhere between 2 and 6 pieces of lumber are cut to the proper lengths, and are cut to the proper angles at the ends of each piece of lumber. The overhang rafter is then transferred to a fixture table where it is positioned "face-up" and metal gusset plates, manufactured by [Taxpayer], are positioned at the various joints. The metal gusset plates are then stitched into positions with a pneumatic gun nailer. The overhang rafters are then repositioned "face-down" and metal gusset plates are positioned onto a conveyor and transported through a roller press machine which inbeds the metal gusset plates into the wooden members.
32. [Taxpayer] also manufactures some of the hardware for the buildings at its plants in [a city in another state], using a variety of metal working machines; an example of manufactured hardware is the gusset plates that are used in the manufacture of trusses. To manufacture gusset plates, galvanized coil steel is run through die machines where the steel is cut to size, straightened and punched to create diagrams with indentations to fit with the trusses.
33. All of the transportation, loading, unloading, and erection of the buildings is performed by [Taxpayer's] employees or, in certain circumstances, by subcontractors hired by [Taxpayer]. The Building Components and the Pass Through Items are transported to the building site in North Carolina by [Taxpayer's] employees in its trucks, typically in one load.
34. The erection-site crew typically consists of three members: a "crew foreman", a "lead man" and a "laborer", all of whom are [Taxpayer's] employees.
35. Generally, it takes [Taxpayer's] crew less than one week to complete the erection of a building.

CONCLUSIONS OF LAW

Based on the foregoing findings of fact, the Assistant Secretary of Revenue makes the following conclusions of law:

1. G.S. 105-164.6(a) imposes use tax on the storage, use or consumption in this state of tangible personal property purchased inside or outside the state for storage, use or consumption in the state on the purchase price of each item or article of tangible personal property that is stored, used or consumed in the state.
2. G.S. 105-164.6(a) provides that an excise tax is imposed on the purchase price of tangible personal property purchased inside or outside the state that becomes a part of a building or other structure in the state.
3. In G.S. 105-164(4a), the General Assembly has broadly defined the term “use”, in pertinent part, as meaning “...the exercise of any right or power or dominion whatsoever over tangible personal property by a purchaser thereof...”
4. The purpose of North Carolina’s sales and use tax scheme is two-fold. The primary purpose is to generate revenue. The second purpose is to equalize the tax burden on all state residents. In re Assessment of Additional N.C. & Orange County Use Taxes, 312 N.C. 211, 322 S.E. 2d 155 (1984).
5. The purpose of the use tax is to remove the discrimination against local merchants resulting from the imposition of a sales tax, and to equalize the burden of the tax on property sold locally and that purchased without the state. Watson Indus. V. Shaw, 235 N.C. 203, 69 S.E. 2d 505 (1952).
6. When construing a statute imposing a tax, any ambiguities are resolved in favor of the Taxpayer.
7. Articles of tangible personal property that are used to fabricate building components brought into the state are used in the same manner as property not modified or incorporated into components as contemplated under G.S. 105-164.6(a).
8. This property becomes part of a building or other structure within the state within the provisions of G.S. 105-164.6(b).
9. The Taxpayer’s purchases of these articles of tangible personal property are subject to the applicable state and county use tax.

DECISION

This matter appears to be a case of first impression in North Carolina. The respective parties have submitted the decisions of a number of jurisdictions where the Taxpayer has previously litigated this issue (See E-33 through E-41). While none of these decisions control the decision of the Department, they all are instructive.

It is the opinion of the undersigned that the Division's position is supported by the language of the statutory scheme taken as a whole. Our General Assembly has broadly defined the term "use" as "the exercise of any right or power or dominion whatsoever over tangible personal property...", G.S. 105-164(49). [The] Minnesota supreme Court addressed this issue with a similarly worded statute. [In the Minnesota decision, the Court stated] that,

In our opinion, [Taxpayer's] manufacturing process does not transform the raw materials into something which is not used in Minnesota. Despite their alteration at the factories, the raw materials are still tangible personal property used in Minnesota as parts of [Taxpayer's] prefabricated buildings. The raw materials, in their altered form as building components, are used in Minnesota when they are erected into prefabricated buildings. [Taxpayer] clearly exercises a right or power over the raw materials when it constructs the prefabricated building, and thus [Taxpayer] 'uses' the materials in Minnesota.

This reasoning applies in North Carolina. The undersigned is unaware of any requirement that raw materials be unaltered to be subject to the use tax.

The Supreme Court of Vermont also has addressed this issue. The Court has stated, "[Taxpayer] plunges us down a slippery slope of line drawing. Most of what [Taxpayer] has done is to cut pieces of wood and fasten them together, albeit with great precision. The wood and metal are immediately identifiable in the new building component. We think we must find more change of character and use to invoke an exception to the statutory coverage," [cite to Vermont decision].

The Division has argued that to allow the Taxpayer a refund would result in unfair treatment for an in-state fabricator. It is clear that the intent of our General Assembly was to level the playing field for in-state and out-of-state sellers. Consequently, the issue of fairness is important in this matter. The Vermont Court addressed this very issue in the case cited above. The court found, "Finally, we find compelling the Department's contention that to not impose a

use tax on [Taxpayer] would be inherently unfair to similarly situated taxpayers. For example, a Vermont contractor purchasing building supplies in Vermont to build a home in Vermont would pay sales tax on the supplies, and a New Hampshire contractor bringing lumber and supplies into Vermont to build a home in Vermont would be subject to Vermont's use tax," [cite]. The Court noted that any alterations made to the raw materials at the construction site would not change the tax consequences but pointed out that if [Taxpayer's] interpretations were applied and if the same alterations occurred in another state the use tax would not apply. The Court concluded that this interpretation would be, "clearly unfair to similarly situated building contractors and is contrary to the complimentary nature of Vermont's sales and use tax," [cite]. This same discrimination result would occur in North Carolina if the Taxpayer's interpretation were applied here.

Based on the foregoing evidence, findings of fact, and conclusions of law, the Taxpayer's purchases of tangible personal property are subject to the applicable state and county use tax and the denials of the Taxpayer's demands for refunds are hereby sustained.

Made and entered this 24th day of May, 2002.

Signature _____

Eugene J. Cella
Assistant Secretary of Revenue