

STATE OF NORTH CAROLINA  
COUNTY OF WAKE

IN THE OFFICE OF  
ADMINISTRATIVE HEARINGS  
14 REV 09438

<p>FIRST PETROLEUM SERVICES INC PETITIONER,</p> <p>V.</p> <p>N C DEPARTMENT OF REVENUE RESPONDENT. RESPONDENT.</p>	<p><b>FINAL DECISION ORDER ON PARTIAL SUMMARY JUDGMENT</b></p>
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**THIS CAUSE** coming on to be heard on October 10, 2015 at 11:00 a.m., before Administrative Law Judge upon Petitioner's Motion for Partial Summary Judgment and Respondent's request for Summary Judgment pursuant to Rule 56(c). Michael J. Tadych of Stevens Martin Vaughn & Tadych, PLLC and Louis E. Wooten of The Wooten Law Firm appeared on behalf of Petitioner. Andrew O. Furuseh, Assistant Attorney General, N.C. Department of Justice appeared on behalf of Respondent.

And based upon the arguments of counsel and the pleadings in this case, including the affidavits of the parties submitted in connection with Petitioner's Motion for Partial Summary Judgment and Respondent's Response and the entire record, which includes, but is not limited to, the following: Two 3-ring binders of exhibits; three CDs illustrating the subject contracts; Petitioner's memorandum of law; and Respondent's memorandum of law.

**THE UNDERSIGNED FINDS THE FOLLOWING FACTS AND CONCLUSIONS OF LAW:**

**BACKGROUND AND CONTEXT**

1. Petitioner, First Petroleum Services, Inc. ("FPS"), is engaged in the business of selling and installing petroleum fueling equipment, primarily fuel tanks and fueling islands, to customers including governmental agencies. (Allsopp Dep., p. 11)
2. Approximately fifty percent (50%) of Petitioner's business is comprised of traditional "retail" sales directly to end user customers. (Allsopp Dep., pp. 11-12)
3. The remaining portion of Petitioner's business is in the bid-specification market which involves the installation of petroleum fueling equipment, primarily fuel tanks and fueling islands, by Petitioner onto the real property owned by Petitioner's customers (the "Installation Projects").

4. Historically, Petitioner treated the transfer of the equipment installed onto the customer's property in connection with an Installation Project as a "sale" transaction for which sales tax was due absent an exemption from sales tax.

5. On those Installation Projects with governmental agencies, Petitioner did not collect a sales tax on the belief that the putative sales of equipment to the governmental agencies in connection with the Installation Project were exempt from sales taxes.

6. Upon audit, Respondent determined that Petitioner was a "performance contractor" and was thus "liable for the use tax on tangible personal property used in the performance of its contracts." (Resp.'s Mem. in Opp. to Petitioner's Motion for Sum. J., p. 2. See also, Resp.'s Mem. in Opp. to Petitioner's Motion for Sum. J., p. 3, "The Auditor determined that Petitioner was a performance contractor for the contracts it entered into during the Period [sic] at Issue [sic] and used use tax on its purchases."). In other words, Respondent concluded that the Installation Projects were taxable "uses" by Petitioner of the tangible personal property that Petitioner installed on its customers' property in connection with the Installation Projects.

7. In its Final Determination, Respondent assessed Petitioner with a use tax based on the cost of the equipment it purchased in connection with the installation projects. (Resp. Prehearing Statement at p. 2) Petitioner pursued an administrative review by this Court and has moved for partial summary judgment.

8. In its Motion for Partial Summary Judgment, Petitioner placed in issue eleven (11) contracts it entered into in connection with the making of improvements upon the real property owned by federal, state or local governmental entities (the "Government Contracts"). The sole issue before the court is whether FPS acted as a "performance contractor" in connection with the Government Contracts identified above as interpreted by Respondent in Sales and Use Tax Bulletin 31-1 and thus, is liable for the use tax assessed by the Department pursuant to N.C. Gen. Stat. § 105-164.6.

9. If an individual Government Contract is a performance contract, then Petitioner will owe a use tax based on the purchase price paid by Petitioner for the equipment it purchased in connection with Petitioner's fulfillment of that individual Government Contract; and Respondent would be entitled to summary judgment with respect to the equipment purchased by Petitioner in connection with that individual Government Contract. If an individual Government Contract is not a performance contract, then Petitioner will not owe a use tax based on the purchase price paid by Petitioner for the equipment it purchased in connection with that individual Government Contract, and Petitioner will not owe a use tax and shall be entitled to summary judgment with respect to the equipment purchased by Petitioner in connection with that individual Government Contract.

10. In its Memorandum Opposing Petitioner's Motion for Partial Summary Judgment, Respondent argues that its staff's determination that Petitioner was a "performance contractor" with respect to the Government Contracts is dispositive. Respondent argues that Petitioner's website, Secretary of State filings, and general operations support its conclusion that Petitioner is

a “performance contractor” and the assessment of the use tax with respect to all Installation Projects. As such, Respondent asserts that summary judgment should be entered in its favor.

11. Under Sales and Use Tax Bulletin 31-1A, a contract for making improvements on real property is a performance contract if “the tenor of the agreement is for the contractor to perform a job, retaining the right to control the means, the method, and the manner of accomplishing the desired result” and that “[a] performance contract does not provide for a sale of specific items; rather, the contractor agrees to furnish the necessary materials, labor, and expertise to accomplish the job.” This is the standard the Court applies in determining whether an individual contract is a “performance contract.”

### FINDING OF FACTS

12. Each of the Governmental Contracts relate to large government construction projects ranging in value from around \$100,000.00 to more than \$730,000.00.

13. Each of the Government Contracts contains extensive details regarding the method, manner and means by which Petitioner is to complete the installation of the petroleum equipment.

14. The specifications in the Government Contracts typically identify or describe in precise detail the exact products and components Petitioner is to provide in completing the project; and further require Petitioner to submit to the owner’s engineer’s detailed information on the materials Petitioner proposes to install on the owner’s property, which the engineers can either approve or disapprove.

15. In addition, Government Contract specifications often contain detailed drawings or installation instructions and requirements created by the owner’s engineers and architects that Petitioner must follow during installation and completion of the project.

16. Some specifications require Petitioner to submit detailed shop drawings depicting the placement and installation of components for review and approval by the owner’s engineers and architects.

17. In other words, it is the owner, not Petitioner, who ultimately determines which “specific items” Petitioner will ultimately install and the manner, method and means by which Petitioner will complete the installation.

18. For instance, in Petitioner’s subcontract with Pizzagalli Construction Company for portions of the RA Thomas Water Treatment Plant for the City of Winston Salem and Forsyth County, the contract required Petitioner “to complete the work as described in contract documents” prepared by the owner’s engineers. (FPS 407, ¶ 1.0, “RA Thomas Contract”) See also Contract General Conditions at FPS 412, Article 5 (“Subcontractor shall perform its work in strict compliance with the Subcontract and the General Contract . . . .”) (Emphasis added).

19. The RA Thomas Contract required Petitioner to deliver the above ground storage tank to the job site by May 8, 2010 and to complete the installation by June 20, 2010. (FPS 407, ¶ 2.0) Thus the RA Thomas Contract specified both the time within which Petitioner was to deliver materials to the job site and the time within which Petitioner was to complete the construction.

20. The RA Thomas Contract also included detailed drawings<sup>1</sup> provided by the owner's engineers, which showed Petitioner precisely where to install each and every component that comprised the overall project. (FPS 463-464)

21. The RA Thomas Contract also included a submittal process under which Petitioner submitted to the owner's engineer the items Petitioner planned to install in order to complete the work. (FPS 407, ¶ 3.1) The RA Thomas Contract required Petitioner to provide the engineer with its submittal no later than November 30, 2008. To the extent a submittal deviated from the contract plans and specifications, Petitioner was required to note same for the owner's engineer. (FPS 408, ¶ 3.2)

22. Upon receipt, the owner's engineers would review the submittals in order to ensure that the materials submitted complied with the owner's plans and specifications. (Allsopp Aff. ¶ 7) To the extent the submittals did not comply, the engineer would note same on the submittal and return the submittal to Petitioner for resubmittal. (Id.)

23. Consistent with the terms of the contract, Petitioner submitted to the owner's engineer for review Petitioner's proposal for the materials he planned to use in connection with the work as well as "shop drawings" that showed exactly how Petitioner planned to complete the work. (See, FPS 421-445) These submittals provided detailed technical information on the materials to be used and the manner in which they were to be installed (and which Petitioner was required to adhere to under the contract documents).

24. Also consistent with the contract documents, the owner's engineers reviewed and commented on Petitioner's submittals. (See, FPS 446-449) These detailed comments controlled the minutia of the Petitioner's installation process, including such comments as the length (4 inches) that a particular fill pipe had to extend and the angle (45°) that the pipe was to be cut. It was through this submittal and review process that the owner, not Petitioner, controlled the method, manner and means by which the petroleum equipment was to be installed.

25. Another example of the Government Contracts is Petitioner's subcontract with George Hicks Construction on the AAFES (Air Force) Furniture Store/North Post Contract (the "AAFES Contract").

26. As with the RA Thomas contract, the AAFES Contract required Petitioner to furnish all the necessary labor and materials to complete the work per the owner's plans and specifications. (FPS 466 and 472, ¶ 1.1A)

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<sup>1</sup> The two pages of drawings provided to the Court indicate that they were two of a total of 377 pages of drawings for the project.

27. The AAFES Contract specifications included a number of code and industry standards that Petitioner was required to comply with as part of its performance under the AAFES Contract. (FPS 473, ¶ 1.2A) By requiring Petitioner to comply with industry standards, those writing the standards, not Petitioner, controlled the method, manner and means by which Petitioner would complete the project.

28. The contract also required Petitioner to prepare shop drawing for the site lay out; product piping and fittings; gasoline fuel system specialties; secondary containment system for a complete piping system; submersible fuel pumps; and other aspects of the overall project, and further provided that Petitioner could not proceed until after the owner had approved Petitioner's shop drawing submittals. (FPS 474-475) The owner's engineer would review the shop drawings and either approve or disapprove Petitioner's proposal for completing the project. (FPS 475 ¶ 1.3B) As a result, the owner's engineer, not Petitioner, had final say on the manner by which Petitioner would complete the project.

29. Other submittals required prior to undertaking the construction included detailed manufacture technical literature on the equipment to be installed; detailed shop drawing of all fuel tanks to be installed; chronological installation reports for the complete fuel tank installation; and other sundry submittals. (FPS 475-476) Again, all of these submittals were subject to final approval by the owner's engineer. (Allsopp Aff. ¶ 7)

30. The AAFES Contract also included specific instructions on the manner, method and means by which Petitioner was to complete specific aspects of the project such as: (1) piping, fittings and specialties; (2) double-wall product piping and containment system; (3) the electronic gasoline dispensing system; (4) submersible turbine pumps; (5) single wall aboveground storage tanks; (6) underground precast concrete utility vaults; (7) tank inventory and release detection system; and (8) dispenser and piping sumps. (FPS 478-493)

31. The owner's specifications on trenching illustrate the level of control retained by the owner over the method, manner and means of completing the project. The trenching specification provides:

Pipe trenches must be large enough to accommodate the piping, together with sufficient spacing and backfill material to provide protection from damage that might be caused by settlement, abrasion, vibration, expansion, contraction, or foreign materials. Vapor-return piping will be separated from product piping by at least twice the largest nominal pipe diameter, with at least six inches of distance between the piping and the trench excavation walls. Trenching width shall be sufficient to maintain the clearance between the pipes and side walls as shown on the drawings and of a depth sufficient to provide the proper bed and cover, and pitch of the lines. Note that the minimum cover to finish grade over product lines in concrete island mat area is 18 inches. Pipe chase in the concrete or asphalt paving shall be constructed as detailed on the drawings and as located on the plot plan. The minimum spacing between adjacent pipes is twice the pipe diameter between pipes; however, piping runs shall not be layered. Piping crossover must be minimized, but where piping runs must cross, the manufacturer's crossover

fittings shall be used. The exception to this rule is where a branch line to a dispenser crosses adjacent product lines with a tee and 45 degree elbow. Piping will be installed in a manner that will facilitate testing, resist corrosion, and prevent damage and movement of system components. The contractor shall provide buried warning tape or line markers for all underground piping to allow for verification of the piping location in the future.

32. The AAFES Contract specifications also included requirements with respect to certain housekeeping matters. For instance the specifications required Petitioner to cover all open pipes with caps or covers during installation and to keep all backfill materials free and clear of trash and debris. (FPS 478) Thus the owner even controlled routine job site housekeeping procedures during the construction project.

33. The specifications also included detailed guidelines on the material Petitioner could use in the project.

34. For instance, all equipment had to be manufactured by manufacturers “regularly engaged in the manufacture of such products and shall be of the best quality used for the purpose in commercial practice.” (FPS 478, ¶ 2.1A) The specifications even specified the manufacturers that Petitioner had to use with respect to certain component parts. (FPS 478, ¶ 2.2B. See also FPS 481, ¶ 2.5B) (“Manufacturer of Pumps: FE Petro, Inc., phone 608-838-8786. No substitute pumps shall be allowed.”).

35. A good example of the level of specificity required by the AAFES Contract as to materials is the specification on manhole covers, which provided “All components of the composite manhole cover assembly shall be designed and constructed of materials strong enough to hold a factor of safety of two over the loading requirements capacity of DOT H2O and EN124C250 and Federal AASHTO loading specifications as to an entire assembly.” (FPS 479, ¶ 2.2E) This is but one example of the high degree of control that the owner kept over the project through the detailed plans and specifications that Petitioner was required to comply with in completion of the AAFES Contract.

36. In addition to the AAFES specifications, AAFES also provided plans that required exacting details for the installation to be performed by Petitioner. (See, FPS 486 to 493, the “AAFES Plans”)

37. The AAFES Plans included a site demolition plan showing the precise locations where Petitioner was to make cuts in the existing curb and gutter in order to prepare the site for installation. (FPS 540)

38. The AAFES Plans also included a gas and electrical detail plan that shows down to the color of wires to be used and the order in which individual wires are to be run, leaving to Petitioner virtually no discretion in the wiring of the electrical components for the project. (FPS 541)

39. The Canopy Lighting, Isometric Petroleum Piping, Tank Vault Petroleum Detail and Vault Detail plans provided similar levels of specificity, again leaving very little to the discretion of Petitioner in terms of the manner, method and means of completing the work. (FPS 542 to 545)

40. Similarly the Bill of Materials provided as part of the AAFES Plans provided exacting details on the materials to be used, often identifying the manufacture and model preferred by the owner's engineers. (FPS 546)

41. As with the RA Thomas Contract, the AAFES Contract also had a submittal process which, in effect, gave the owner the "last word" on the materials to be provided and the method, manner and means by which the installation was to be completed.

42. Petitioner performed work on a gas station and Burger King at Ft. Bragg in Cumberland County. While nominally a subcontractor to Talbot Construction, Inc. who contracted directed with AAFES, a contracting arm of the United States Air Force, Petitioner's subcontract with Talbot's (the "BK Contract") incorporated Talbot's prime contract with AAFES, including all of its exhibits and addenda; expansive general conditions and supplementary conditions; detailed specifications; detailed drawings; and payroll documentation. (FPS 605) The contract specifications for the gasoline dispensing and below grade vault system runs 25 pages and directs Petitioner's conduct from the data submittal process to documenting Petitioner's installation of specifically required components and systems. (FPS 616-641) Detailed drawings for the project directed a wide-ranging array of tasks for Petitioner from the installation of the AAFES decal on the fuel island canopy to wiring of a specific type of fuel blending systems specified by AAFES. (FPS 643-650) Petitioner's required submittal data contained more than 100 pages of proof of licensure; product data; shop drawings; and technical calculations for review and approval by the owner and its representatives before construction could begin. (FPS 650-752)

43. Petitioner contracted with Wake County to upgrade its underground fuel storage tanks per the plans and specifications developed by HDM Associates, a third-party engineering firm hired by Wake County (the "Wake County Contract"). (FPS 651) The Wake County Contract specifications included five pages of specific directions to Petitioner regarding "Facility Fuel-Oil Piping" including required drawings; the data submittal and approval process; performance requirements including the hiring of an engineer; and specific products and systems to be included in the installation. (FPS 692-696)

44. Petitioner also performed work on the Wake County Justice Center. (FPS 740, the "Justice Center Contract") The Justice Center Contract scope of work incorporated specific, technical specifications provided by the owner for cast in place concrete; basic mechanical materials and methods; facility fuel-oil pumping; fire tube boilers; and packaged engine generators. (Id. and FPS 1081-1105) The project was governed by an owner-prescribed set of drawings obtained from a third-party architecture and engineering firm and a 40 page, task-by-task project timeline. (FPS 750, 0863-903) In completing the project, no fewer than six written change orders were executed ultimately adding nearly \$60,000 in specific, additional work by Petitioner. (FPS 1073-1080)<sup>2</sup>

45. Petitioner was retained to provide and install fuel handling systems for the City of Raleigh's Wilders Grove Service Center. (FPS Ex. F. Addend. 1146, 1165-1189) The task-by-task project timeline directed the timing of Petitioner's work. (FPS Ex. F. Addend. 1190-1193) As was the case in other projects during the Audit Period, the detailed specifications for Fuel Dispensing System and Appurtenances provided by the owner for the project runs 19 pages and covers details from the specific above ground fuel tanks to be used to acceptable brands and models of fittings and connectors to be installed. (FPS Ex. F. Addend. 1210-1225, FPS 1127-1144) The project required Petitioner to submit more than 100 pages of product data, shop drawings, and calculations. (FPS Ex. F. Addend. 1226-1329) That data was then reviewed and approved or rejected until approval by the owner's engineers and representatives. (FPS Ex. F. Addend. 1330-1336, FPS 1082-1085)

46. The documents submitted by Petitioner evidencing the remaining Government Contracts similarly provide that the projects undertaken by Petitioner were guided by detailed specifications; designation of particular products; direction of specific procedures; process and designs for installation; and required adherence to the owner's timelines for start and completion.

47. The Government Contracts and other evidence submitted by Petitioner demonstrate that the owner, not Petitioner, controlled the method, manner and means of completing the project. In addition, through the plans and specifications (which either provided exacting detail or actually identified the manufacturer and/or model of equipment to be used) required by the submittal process and the change order process, the owner, not Petitioner, ultimately decided the major component equipment parts to be installed onto the owner's property.

### ULTIMATE FACTS

48. The RA Thomas Contract, the AAFES Contract, and the other Government Contracts discussed above are *not* performance contracts as defined in Sales and Use Tax Bulletin 31-1A.

49. The RA Thomas Contract, the AAFES Contract, and the other Government Contracts discussed above are representative of the level of specificity imposed by the owner on Petitioner in terms of the manner, method and means by which Petitioner was to complete the work in all the Government Contracts.

50. The RA Thomas Contract, the AAFES Contract, and the other Government Contracts discussed above are also representative of the fact that in each of the Government Contracts, the owner – not Petitioner – ultimately determined the material component parts the Petitioner would install on the owner's property.

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<sup>2</sup> Change orders are the process by which the Contractor seeks the owner's permission to deviate from the owner's plans and specifications. The mere fact that a change order process exists demonstrates that the owner, not Petitioner, ultimately controlled the method, manner and means for completing the final project. Virtually all the Government Contracts included a change order process as the exclusive means by which Petitioner could deviate from the owner's plans and specifications.



51. The undersigned has reviewed the materials provided by the parties with respect to the Governmental Contracts and concludes that in each of the Governmental Contracts, the tenor of the various agreements provides for the owner, not Petitioner, to control the method, manner and means of completing the project; and that through the submittal process, the owner, not Petitioner, ultimately decided the material component equipment parts to be installed onto the owner's property.

52. As a result, none of the Government Contracts are "performance contracts" as that term is used in Respondent's Sales and Use Tax Bulletin 31-1A.

### CONCLUSIONS OF LAW

53. The North Carolina Sales and Use Tax Act (N.C. Gen. Stat § 105-164.1 et. seq., the "Act) defines a sale as "the transfer for consideration of title, license to use or consume, or possession of tangible personal property . . . ." N.C. Gen. Stat. § 105-164.3(36).<sup>3</sup>

54. If the sale occurs "at retail" the transaction is subject to *sales* tax unless otherwise exempt under the Act. N.C. Gen. Stat. § 105-164.4; N.C. Gen. Stat. § 105-164.3(34); N.C. Gen. Stat. § 105-164.3(35). (Emphasis added)

55. Generally speaking, the tax is based on the full amount paid by the buyer, including amounts paid for delivery, *installation* and other ancillary expenses of sale. N.C. Gen. Stat. § 105-164.3(37); N.C. Gen. Stat. § 105-164.4. (Emphasis added)

56. The retailer, however, can avoid the tax on the installation costs by separately stating the installation costs on the invoice.<sup>4</sup> N.C. Gen. Stat. § 105-164.13(49).

57. This ensures that the full consideration paid is subject to tax unless the contractor specifically delineates that portion of the consideration properly allocated to non-taxable services.

58. Respondent, pursuant to its regulatory authority, has published a series of sales and use tax bulletins in which Respondent sets forth its interpretation of North Carolina's Sales and Use Tax Act. See N.C. Gen. Stat. § 105-264 (When the Secretary interprets a law by adopting a rule or publishing a bulletin or directive on the law, the interpretation is a protection to the officers and taxpayers affected by the interpretation, and taxpayers are entitled to rely upon the interpretation.").

59. Sales and Use Tax Bulletin 31-1A addresses those situations in which an installer of materials onto the property of another will be treated as a "user" of the materials supplied or a "seller" of those materials, as part of a larger contract to provide both installation services and the sale of materials.

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<sup>3</sup> All statutory references are to the North Carolina Sales and Use Tax Act N.C. Gen. Stat § 105-164.1 et. seq. as it existed during the Audit Period.

<sup>4</sup> The retailer has an incentive to reduce the sales tax in this manner as it reduces the overall cost of good to its customers who ultimately bear the cost of the sales tax.

60. According to Sales and Use Tax Bulletin 31-1A, “[c]ontractors are deemed to be consumers of tangible personal property *which they use in fulfilling performance contracts* and, as such, are liable for payment of the general rate of State tax and any applicable local sales or use tax on such property unless the property is exempt from tax by statute.” (Emphasis added)

61. “In order to establish if a transaction constitutes a performance contract, the *tenor of the agreement* is for the contractor to perform a job, retaining the right to control the means, the method, and the manner of accomplishing the desired result.” Id. (Emphasis added).

62. “A performance contract does not provide for a sale of specific items; rather, the contractor agrees to furnish the necessary materials, labor, and expertise to accomplish the job.” Id.

63. In the instant case, the owner in each of the Government Contracts, not Petitioner, controlled “the means, the method, and the manner of accomplishing the desired result.”

64. Through the owner’s bid specifications and submittal processes, the owner, not Petitioner, ultimately determined the materials that would be installed on the owner’s property in each of the Government Contracts.

65. Under these circumstances, the “overall tenor” of each of the Government Contracts does not allow Petitioner to simply supply a finished product. Rather, the method, manner and means of completing are within the control of the owner. The owner, not Petitioner, controls the method, manner and means for completing the Installation Projects that are the subject of the Government Contracts.

66. As a result, the Government Contracts are not “performance contracts” within the meaning of Sales and Use Tax Bulletin 31-1A, and Petitioner is not liable for the use tax assessed by Respondent with respect to the Government Contracts.<sup>5</sup>

67. Respondent argues that because Petitioner generally holds itself out as a performance contractor, all of Petitioner’s contracts, including the Government Contracts, must be performance contracts. Respondent’s Sales and Use Tax Bulletin 31-1A, however, does not support this analysis. Specifically, Sales and Use Tax Bulletin 31-1A provides that “contractors are deemed to be consumers of tangible personal property which they use in fulfilling performance contracts.” In other words, the contractor is only a user of the tangible personal property that it uses in connection with a performance contract. Similarly, in determining whether a contract is a performance contract, Sales and Use Tax Bulletin requires the Court to

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<sup>5</sup> In its Memorandum in Opposition to Petitioner’s Motion for Summary Judgment, Respondent cites N.C. Gen. Stat § 105-164.6(a) for the proposition that the use tax applies to “property that becomes part of a building or other structure.” The entire Section states that the use tax applies to “[t]angible personal property purchased inside or outside this State for storage, use, or consumption in this State” including “property that becomes part of a building or other structure.” In other words, not all “property that becomes part of a building or other structure” is subject to use tax, only that “property that becomes part of a building or other structure” that is “purchased inside or outside this State for storage, use, or consumption in this State.” Because under Sales and Use Tax Bulletin 31-1A petitioner is not deemed to be the “user” of the tangible personal property purchased in connection with the Government Contracts, this property is not subject to use tax even though the property ultimately became a part of a building or other structure.

examine “the tenor of the agreement,” not the general means by which the taxpayer conducts its business. Thus, Sales and Use Tax Bulletin 31-1A requires a contract by contract analysis to determine in which cases the contractor is deemed to be the user of the tangible personal property. Under the analytical framework established by Sales and Use Tax Bulletin, it is the individual contract, not the general manner in which the contractor conducts its business that is the relevant inquiry.

68. Respondent emphasizes the fact that each of the Government Contracts requires Petitioner to provide all the labor and materials necessary to complete the scope of work. This is true of virtually all construction contracts because the whole purpose of the contract is for the contractor to build something for the owner.

69. Respondent’s Sales and Use Tax Bulletin 31-1A draws a distinction between those construction contracts in which the contractor determines the method, manner and means of completing the final project and those in which the owner determines the method, manner and means of completing the final project.<sup>6</sup> In both cases, the contractor supplies the labor and materials necessary to complete the work. The key is who *controls* the method, manner and means by which the work is completed.

70. In this case, due to the detailed requirements set forth in the plans and specifications provided by the owner, it is the owner, not Petitioner who ultimately determines the method, manner and means by which Petitioner will fulfill its obligation to provide the necessary labor and materials to complete the scope of work set forth in each of the Governmental Contracts. While Petitioner is required to supply the labor and materials necessary to complete the project, Petitioner must nevertheless complete the project in accordance with the owner’s plans and specifications.

71. Respondent argues that this Court should uphold its determination because it subjects Petitioner to a lower overall tax liability. Specifically, Respondent argues that the sales tax is based on the entire contract price (*i.e.*, labor and materials) and the use tax is based only on the cost of the materials. As a result the overall tax liability of Petitioner is lower if the Court requires Petitioner to pay a use tax as opposed to a sales tax.

72. The problem with this analysis is that Petitioner believed that its sales on the Government Contracts were exempt from sales taxes and thus did not collect a sales tax from its customers. If Respondent requires Petitioner to pay a use tax at this juncture, Petitioner will be unable to recoup the cost of the use tax from its customers, now some four years after the fact. Thus, imposing the use tax in this instance exposes Petitioner to higher taxes because currently it owes no sales or use taxes on any of the items purchased in connection with the Government Contracts.

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<sup>6</sup> Given the high degree of control retained by the owner under the Government Contracts, the Court can scarcely fathom a clearer example of a contract in which the owner, not the contractor, retains the right to control the method, manner and means for completing the project. Having drawn a distinction between those contracts in which the owner retains the right to control the method, manner and means for completing the project, the Department must accord proper (*i.e.*, sales) tax treatment for those contracts in which the owner, not the contractor, controls the method, manner and means for completing the project.

73. Moreover, Respondent is not free to disregard its own Sales and Use Tax Bulletins and treat the transaction as a taxable use when the transaction is properly characterized as a sale under Respondent's Sales and Use Tax Bulletins. Respondent must apply the law consistent with its own interpretations and cannot deviate from those interpretations on an arbitrary basis.

74. Respondent also argues that if the use tax does not apply, then Petitioner should be liable for a sales tax because according to Respondent, Petitioner does not meet any the requirements for any exemption from the sales tax.

75. In this case, Respondent has assessed Petitioner for the use tax under N.C. Gen. Stat. § 105-164.6. (See, Memo in Opposition to Motion for Summary Judgment, p.2, "As a performance contractor, Petitioner was liable for the use tax on the tangible personal property it used in the performance of its contracts."). (See also, Notice of Final Determination, conclusion, also citing N.C. Gen. Stat. § 105-164.6. 3) The Final Determination makes clear that the assessment is being made under N.C. Gen. Stat. § 105-164.6 (the use tax statute), not N.C. Gen. Stat. § 105-164.4 (the sales tax statute).

76. Because the Department failed to assess Petitioner for the sales tax, whether Petitioner or its customers qualified for a sales tax exemption is not before this Court.

77. Moreover, the statute of limitations for making a separate assessment based on the sales tax has long since passed, and Respondent cannot now make a separate sales tax assessment at this time. See N.C. Gen. Stat. § 105-241.8.<sup>7</sup>

78. Respondent also argues that Petitioner is not entitled to partial summary judgment because many of the Government Contracts are not direct contracts with governmental entities, but rather subcontracts with either the general contractor for the governmental project or a lower tier subcontractor.

79. Again, this analysis misses the mark. The primary issue is whether Petitioner was the seller or consumer of the tangible personal property it purchased in connection with the Government Contracts. That issue turns on whether the contracts themselves were performance contracts or not. As stated above, the Government Contracts are not performance contracts and therefore Petitioner did not "consume" the personal property it purchased in connection with the Government Contracts and is not liable for the use tax assessed against it by Respondent. Whether Petitioner was a subcontractor or had a direct contract with the property owner does not determine whether Petitioner is a "consumer" of tangible personal property and subject to the use tax assessed by Respondent.

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<sup>7</sup> The Court notes that while N.C. Gen. Stat. § 105-241.14(b)(1) permits the Department to change the basis of its assessment, the assessment of a sales tax at this juncture is not a mere change in basis for the original use tax assessment. Instead it is an entirely new assessment of an entirely different tax on an entirely different theory. It is untenable to conclude that the General Assembly intended to give Respondent "two bites" at the apple by allowing it to assert an entirely different theory of taxation well after the expiration of the statute of limitations and after the parties have litigated its initial case theory under a "changed basis" claim pursuant N.C. Gen. Stat. § 105-241.14(b)(1).

80. At the hearing, Respondent argued that whether the transactions at issue were exempt for sales taxes was relevant because Petitioner had asked the Court in its Statement in Support of Petition to grant it relief as to those transactions that were exempt from sales.

81. In Petitioner's Statement in Support of Petition, Petitioner asks the Court to "reduce the proposed assessment to the extent it is based on use taxes assessed with respect to sales of good to entities exempt from paying sales taxes." In other words, Petitioner does not claim that the sales themselves are exempt from taxes. Instead, it asks that the tax be reduced for those transactions in which the sale was to an entity exempt from taxes. Thus whether the transaction itself is exempt from sales taxes is irrelevant.<sup>8</sup>

82. In its briefing and at the hearing, Respondent argued that the court should not rule in Petitioner's favor because other taxpayers across the state may pay more in sales taxes. Fortunately the General Assembly has addressed the lack of clarity under Sales and Use Tax Bulletin 31-1A by providing a "bright line test" that subjects all materials installed onto real property to the use tax. See N.C. Gen. Stat. § 105-164.3(33a) and N.C. Gen. Stat. § 105-164.4H, effective as of January 1, 2015.

83. Finally, Respondent suggests that the Court should give deference to the determination by Departmental personnel that the contracts at issue in this case are performance contracts.

84. While it is true that this Court is required to give "due regard to the demonstrated knowledge and expertise of the agency with respect to facts and inferences within the specialized knowledge of the agency", N.C. Gen. Stat. § 150B-34, the critical issue here involves the level of control by parties to a construction contract.

85. Having given due regard to the position and expertise of Respondent, the undersigned is of the opinion that each of these contracts must be analyzed in view of Respondent's Sales and Use Tax Bulletin 31-1A, which requires an examination of the *tenor* (emphasis added) of the contracts to determine the degree of *control* (emphasis added) retained by the owner. These contracts have demonstrated a fluidity that allows the owner to control them throughout their term. This is important in determining the tenor of the contracting party's intent.

86. In its Cross Motion for Summary Judgment, Respondent asks this Court, in effect, to conclude that all of Petitioner's Installation Projects during the audit period and with respect to which Respondent assessed a use tax are "performance contracts."

87. As indicated above, Sales and Use Tax Bulletin 31-1A requires a contract by contract analysis in order to determine whether Petitioner is liable for the use tax on the tangible personal property installed on the owner's property with respect to an individual contract.

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<sup>8</sup> Petitioner filed its petition *pro se*. Since filing its petition, counsel for Petitioner has clarified through its Prehearing Statement, its affidavit in support of summary judgment and its memorandum in support of its motion for summary judgment that Petitioner challenges the assessment to the extent it seeks to impose a use tax on tangible personal property installed on real estate owned by a governmental entity. At the time it filed its petition, Petitioner believed based on representations from governmental agencies that all such projects were sales tax exempt. (Allsopp Dep. pp. 125, 140, 159, 164)

88. Because Respondent has not presented evidence as to the nature of the other contracts entered into by Petitioner during the audit period, this Court cannot conclude that the other contracts were performance contracts and thus Respondent's Request for Summary Judgment in its favor pursuant to Rule 56(c) is **DENIED**.

### CONCLUSION

89. The Governmental Contracts are each large contracts for the installation of fuel islands and fuel tanks (i.e., ultra-hazardous materials) on government property. The contracts involve significant sums of money, in some cases hundreds of thousands of dollars. In order to sustain Respondent's position, the Court would necessarily have to conclude that the Petitioner, not the government, ultimately determined the method, manner and means by which Petitioner would install the fuel tanks and fuel islands. The Court simply finds untenable the notion that the government would leave this up to the contractor and the Court's review of the Government Contracts bears out what appears to be basic common sense: the government, not the contractor, controlled the method, manner and means by which the project was completed. Only by doing so could the government ensure that the contractor completed the project to the government's standards and that the fuel tanks and fuel islands were properly completed so as to reduce the risk of environmental hazards.

90. Because of the high level of control by the owner over the method, manner and means by which Petitioner completed the Government Contracts, Petitioner reasonably believed that the Government Contracts were not performance contracts as that term is described in Sales and Use Tax Bulletin 31-1A. Had Petitioner believed otherwise, there is simply no plausible reason why Petitioner would not have paid a use tax and built the cost of the use tax into its bid on the Government Contracts. Because Sales and Use Tax Bulletin 31-1A fails to articulate a clear standard by which a taxpayer can determine that it is subject to a use tax or not, the Court believes that it would be fundamentally unfair to subject the Petitioner to a use tax at this juncture, when it is too late for Petitioner to pass the cost of that tax to the end consumer. Given Petitioner's reasonable reading of the Bulletin, it seems equitable to refrain from assessing Petitioner with a use tax or sales tax. This conclusion is consistent with Proposed Assessments of Additional Sales & Use Tax for Period of Jan. 1, 1994 Through Nov. 30, 1996 by Sec'y of Revenue v. Jefferson-Pilot Life Ins. Co., 161 N.C. App. 558, 560, 589 S.E.2d 179, 181 (2003) which underscores that tax laws shall be construed in favor of taxpayers.

BASED ON a thorough review of the oral arguments, the filings, and documentation presented, it appears that material and factual issues are not in dispute.

### FINAL DECISION

1. No material issue of fact exists as to whether the Government Contracts at issue in connection with Petitioner's Motion for Partial Summary Judgment and the undersigned concludes that all of the subject contracts are not performance contracts as a matter of law. As a result, Petitioner is entitled to partial summary judgment with respect to said contracts and no use tax shall be owed by Petitioner with respect to material purchased in connection with the Government Contracts. Thus, Petitioner's Motion for Partial Summary Judgment is **GRANTED**.

2. Respondent's request for Summary Judgment in its favor is **DENIED**.

ACKNOWLEDGMENT

It is acknowledged that whenever, in this document, reference is made to the Undersigned, the undersigned Judge, or the Court, reference is being made to the undersigned Administrative Law Judge with the Office of Administrative Hearings.

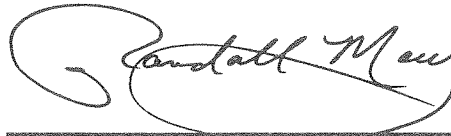
NOTICE

**This is a Final Decision** issued under the authority of N.C. Gen. Stat. § 150B-34.

Under the provisions of North Carolina General Statute § 150B-45, any party wishing to appeal the final decision of the Administrative Law Judge must file a Petition for Judicial Review in the Superior Court of the county where the person aggrieved by the administrative decision resides, or in the case of a person residing outside the State, the county where the contested case which resulted in the final decision was filed. **The appealing party must file the petition within 30 days after being served with a written copy of the Administrative Law Judge's Final Decision.** In conformity with the Office of Administrative Hearings' rule, 26 N.C. Admin. Code 03.0102, and the Rules of Civil Procedure, N.C. General Statute 1A-1, Article 2, **this Final Decision was served on the parties the date it was placed in the mail as indicated by the date on the Certificate of Service attached to this Final Decision.** N.C. Gen. Stat. § 150B-46 describes the contents of the Petition and requires service of the Petition on all parties. Under N.C. Gen. Stat. § 150B-47, the Office of Administrative Hearings is required to file the official record in the contested case with the Clerk of Superior Court within 30 days of receipt of the Petition for Judicial Review. Consequently, a copy of the Petition for Judicial Review must be sent to the Office of Administrative Hearings at the time the appeal is initiated in order to ensure the timely filing of the record.

IT IS SO ORDERED.

This the 22nd day of December, 2015.

A handwritten signature in cursive script, reading "J Randall May", written over a horizontal line.

J Randall May  
Administrative Law Judge

On this date mailed to:

Michael J Tadych  
Attorney at Law  
1101 Haynes Street Suite 100  
Raleigh NC 27604-1455  
Attorney for Petitioner

Andrew O Furuseth  
Assistant Attorney General  
NC Department of Justice  
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Raleigh NC 27699-9001  
Attorney for Respondent

This the 22nd day of December, 2015.



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