

**REDACTED DECISION—09-083 CU—BY ROBERT W. KIEFER, JR., ALJ—
SUBMITTED FOR DECISION on NOVEMBER 24, 2008 —ISSUED on MAY 24, 2010.**

SYNOPSIS

CONSUMERS SALES AND SERVICE TAX – PRODUCT USED OR CONSUMED IN CONTRACTING ACTIVITY -- Consumers sales and service tax is required to be paid on the gross value a product assembled from component parts by a contractor and included in a building by that contractor as part of its contracting activity. W. Va. Code §§ 11-15-7 & 8a.

CONSUMERS SALES AND SERVICE TAX – PRODUCT USED OR CONSUMED IN CONTRACTING ACTIVITY -- Where a taxpayer pays consumers sales tax to another state on the purchase of component parts, which it subsequently assembles into a product and installs in a building in West Virginia as part of its contracting activity, it is not entitled to a credit for tax paid to the other state on the component parts since the product is used or consumed in the State of West Virginia.

FINAL DECISION

On November 25, 2008, the Petitioner, filed a claim for refund of consumers sales and service tax in the amount of \$____, for the period of February 1, 2006, through June 30, 2006. The Sales Tax Unit of the Internal Auditing Division (“the Division”) of the West Virginia State Tax Commissioner’s Office (“the Commissioner” or the “Respondent”), by letter dated January 13, 2009, denied the refund claim in its entirety. The reason stated for the denial is not the basis on which this matter was litigated by the parties.

Thereafter, by facsimile electronic transmission received on March 13, 2009, the Petitioner timely filed with this tribunal, the West Virginia Office of Tax Appeals, a petition for refund. W. Va. Code §§ 11-10A-8(1) [2007] and 11-10A-9 [2005].

Subsequently, notice of a hearing on the petition was sent to the Petitioner and a hearing was held in a city in West Virginia, in accordance with the provisions of W. Va. Code § 11-10A-10 [2002].

At the hearing in this matter, the evidence presented by Petitioner persuaded counsel for the State Tax Commissioner that it was entitled to a partial refund. Subsequent to the hearing, Petitioner provided evidence to verify its claim, demonstrating that it was entitled to a refund in the amount of \$____, an amount with which the State Tax Commissioner agreed. This left an amount in controversy of \$____, which Petitioner contends should be refunded to it.

FINDINGS OF FACT

1. Petitioner is a corporation with its principal place of business in a city in Ohio.
2. Petitioner installs fire protection equipment, primarily sprinklers, in buildings and construction projects.
3. During the period covered by this petition for refund, Petitioner performed one taxable job in the State of West Virginia, installing fire protection equipment at a Corporation in a city in West Virginia.
4. Materials used in Petitioner's construction projects were delivered to its fabrication shop located in Ohio.
5. The pipe used in the sprinkler system is cut to length at the shop in Ohio and then threaded if necessary.
6. Couplings are either screwed or welded onto the pipe, as necessary.
7. The threaded rod used to make hangers for the pipe used in the sprinkler system is cut to length at the shop in Ohio.
8. The beam clamps and the ring-shaped hangers are screwed onto the threaded rod at the fabrication shop to make individual hangers.
9. The threaded pipes, the hanger assemblies, and the other materials are then transported to the location of the project.

10. The hangers are then attached to the building structure at the job site.
11. Petitioner's workers then slide the pipe through the hangers, connect the pipes, attach sprinkler heads and assemble the remainder of the system, as per the specifications.
12. The Petitioner's representative described the job as "assembly by number."
13. Petitioner does as much assembly as it can in advance because the shop fabricators are paid less than the field assemblers.
14. Petitioner maintains that all of the materials remain in the same state as when they arrive at its shop in Ohio. The function of the materials is the same. They are merely being "cut to length."
15. Taxpayer was audited by the State of Ohio in 1985, and was under the impression that the taxes were to be paid to the State where the job was located.
16. According to the taxpayer's representative, that changed a year or two later, but the taxpayer did not discover that change until the commencement of the next audit.
17. Between 1985 and 2007, for materials that were used in jobs performed in West Virginia, the taxpayer paid purchasers use tax to the State of West Virginia.
18. The taxpayer was next audited by the State of Ohio in 2007.
19. In the 2007 audit, the State of Ohio took the position that consumers sales tax was due on the component parts that were delivered to the fabrication shop in Ohio and assessed tax thereon, which tax was paid by Petitioner.

DISCUSSION

The issue in this matter is whether Petitioner is entitled to a credit against West Virginia consumers sales tax for consumers sales tax that it paid to the State of Ohio on materials that were delivered to it in Ohio.

West Virginia Code § 11-15-7 provides, in relevant part:

(a) A person exercising the privilege of producing for sale, profit or commercial use, any *natural resources, product or manufactured product*, and . . . engaged in a business or activity in which such *natural resource, product or manufactured product* is used or consumed by him and such use or consumption is not otherwise exempt under this article, shall make returns of the gross proceeds of such sales or, in the absence of sale, the gross value of the *natural resource, product or manufactured product*, so used or consumed by him, and pay the tax imposed by this article.

(b) The tax commissioner shall promulgate such uniform and equitable rules as he deems necessary for determining the gross value upon which the tax imposed by this article is levied in the absence of a sale, which value shall correspond as nearly as possible to the gross proceeds from the sale of similar products of like quality or character by the same person or by another person.

(c) The provisions of this section, as amended by this act, shall apply to *natural resources, products or manufactured products*, used or consumed by the producer or manufacturer thereof on or after the first day of May, one thousand nine hundred eighty-nine. (Emphasis added.)

In complying with the mandate to promulgate legislative rules to implement the provisions of W. Va. Code § 11-15-7, the State Tax Commissioner promulgated W. Va. Code St. R. § 110-15-7.2, which provides in relevant part:

7.2. Use by Producer or Manufacturer. - A person exercising the privilege of producing for sale, profit or commercial use, any natural resource product or manufactured product which he then uses or consumes in a manner which would be taxable had such person purchased the product from another person, such person shall pay consumers sales or use tax on the gross value of such product or products at the time they are first used or consumed by him in this State. "Gross value" shall be determined as provided in Section 7.3 of these regulations.

Clearly, this legislative rule narrows the meaning of W. Va. Code § 11-15-7, as expressed by the plain language of the statute, insofar as it does not include "products" used or consumed by a contractor. The statute applies to "natural resources," "products" or "manufactured products." The distinction between "natural resources," "products" and "manufactured products" is articulated four different times. Certainly this is not a mistake. On the other hand,

the legislative rule makes reference only to “natural resource product” or “manufactured product.” It does not refer to “product” as used in the generic, otherwise all-inclusive sense of the statute. Since the statute refers to “product” in its broad sense, the gross value of any product produced by a taxpayer and then used or consumed by that taxpayer is subject to the consumers sales and service tax. Because the legislative rule is inconsistent with the statute, it is not controlling. Instead, the broader language of the statute must control.

In assembling the hangers and the pipes, Petitioner produced them for commercial use. In this instance, the commercial use was its own contracting activity of installing the fire suppression system at the Corporation in a city in West Virginia.

W. Va. Code § 11-15-8a(a) provides:

(a) The provisions of this article shall not apply to contracting services. However, purchases by a contractor of tangible personal property or taxable services for use or consumption in the providing of a contracting service shall be taxable beginning the first day of March, one thousand nine hundred eighty-nine, except as otherwise provided in this article.

As the statute makes clear, items purchased for use or consumption in a contracting activity are taxable. If Petitioner had purchased the hangers from another person or entity it would have paid tax on them since it used or consumed them in the activity of contracting. Reading W. Va. Code § 11-15-8a(a) *in pari materia* with W. Va. Code § 11-15-7, it is apparent that the items produced by Petitioner must be taxed because they were used in a commercial activity, contracting, and would be taxable under that section if they had been purchased.

Respecting products produced by a contractor which are then used or consumed in the provision of a contracting activity, W. Va. Code St. R. § 110-15-112, provides in relevant part:

112.1. The consumers sales and use tax laws provide that where a person produces a natural resource product or manufactures tangible personal property which such person then uses or consumes in the performance of contracting activity in this State, such person must pay consumers sales or use tax on the

gross value of the natural resource product or manufactured product so used or consumed by such person in such contracting activity.

This rule is entirely consistent with W. Va. Code § 11-15-8a(a). It is also consistent with W. Va. Code § 11-15-7, insofar as it relates to natural resource products and manufactured products. It is inconsistent with § 11-15-7 for the same reasons that § 110-15-7.2 is inconsistent with that section. Specifically, the rule makes no mention of “products,” as that term is used in W. Va. Code § 11-15-7. As with § 110-15-7.2, the broader language of the statute requires the inclusion of the term “product” with the meaning of the narrower language of the legislative rule.

Petitioner contends that it is entitled to a credit for the consumers sales tax that it paid to the State of Ohio. The tax it paid to Ohio was on the component parts it purchased. As it relates to the issue to be decided, the component parts are the threaded rods, the clamps, the hangers, the pipes and the various couplings that are attached to the pipes. Petitioner contends that these items did not undergo any change or alteration which resulted in them being a “product” or “manufactured product.” Petitioner maintains that it is entitled to a credit for the consumers sales tax that it paid to Ohio on these items.¹

The State Tax Commissioner counters by arguing that these items were either altered or assembled into a different product, which he calls a “manufactured product.” He contends that because the items are a “manufactured product” which is used or consumed in Petitioner’s contracting activity, the items are taxable consistent with the provisions of W. Va. Code §§ 11-15-7 & 8a. He argues that because the items are not in the same form as when they were delivered to Petitioner, Petitioner is not entitled to a credit for the tax paid to Ohio.

¹ The testimony presented at the hearing is that the remaining items used on the job were merely removed from Petitioner’s inventory of parts in Ohio, placed in containers and transported to the job site in West Virginia. At the job site they were merely removed from the container and used or consumed in the contracting activity. The Tax Commissioner conceded that because these items were in the same form as they had been received by Petitioner, i.e. they had not been altered or been assembled into a larger component at the time they were used or consumed in the

W. Va. Code § 11-15-2(b)(10) provides, "Manufacturing" means a systematic operation or integrated series of systematic operations engaged in as a business or segment of a business which transforms or converts tangible personal property by physical, chemical or other means into a different form, composition or character from that in which it originally existed." W. Va. Code St. R. § 110-15-2.46 provides:

"Manufacturing" means a systematic operation or integrated series of systematic operations engaged in as a business or segment of a business which transforms or converts tangible personal property by physical, chemical or other means into a different form, composition or character from that in which it originally existed. Manufacturing production begins with the arrival of raw materials and ends when the property has reached that point where no further chemical, physical or other changes are to be made to the resultant property in the production process.

The broad language of the statutory definition seems to include Petitioner's activity. Attaching clamps and hangers to the threaded metal rods and welding or screwing couplings to the water pipes can be considered a transformation or conversion of the component parts by physical or other means into a different form or character. On the other hand, it does not seem to comport with the portion of the legislative rule that speaks to a process commencing with the arrival of "raw materials" and ending at the point where no further changes are to be made. This portion of the legislative rule, which appears to add to the statute, does not describe Petitioner's relevant activity. However, since the legislative rule seems to add to the statute in a manner that is inconsistent with the statute, the statutory language must control.

The State Tax Commissioner's argument is supported by the legislative rule respecting direct use in certain activities, including the "manufacturing" activity. That legislative rule, W. Va. Code St. R. § 110-15-123.3.1, provides, in relevant part:

contracting activity, consumers sales tax had been paid on those items and Petitioner was entitled to a credit for the tax paid to Ohio.

123.3. General Guidelines for Determining Taxability of Purchases for Use in Industries Subject to Direct Use Concept. - General guidelines for determining whether property or services are directly or indirectly used in an activity. . . , are outlined in Sections 123.3.1 and 123.3.2 of these regulations. . . .

123.3.1. Uses of Property or Services Constituting Direct Use. - Uses of property or services which will constitute direct use when used by a person engaged in the business of manufacturing, . . . , thereby making its purchase exempt from sales and use tax shall include only the following[:]

123.3.1.1. Tangible personal property physically incorporated into a finished product resulting from manufacturing production, For example, raw materials used by a manufacturer in making the finished product would be directly used in manufacturing.

123.3.1.2. Tangible personal property or services causing a direct physical, chemical or other change upon property undergoing manufacturing production, For example, equipment used to assemble parts during the manufacturing process would be directly used in manufacturing. . . .

This legislative rule indicates that incorporating tangible personal property into a finished product and assembling components into a finished product are components of a manufacturing process. This is a reasonable conclusion given the broad statutory definition of “manufacturing.”

W. Va. Code St. R. § 110-15-107.3.13 provides, “Fabricator. - The term ‘fabricator’ means any person engaged in any business or activity involving manufacturing, processing or assembling property for sale or commercial use which when installed ordinarily becomes a physical component of a building or other structure or real property.” This is what Petitioner did.

W. Va. Code St. R. § 110-15-107.2.7 provides, in relevant part:

107.2.7. Purchases of Taxable Services.

107.2.7.1. Taxable services purchased by a contractor are subject to consumers sales or use taxes,

* * * *

107.2.7.3. Taxable services include, but are not limited to, the following:

107.2.7.3.1. The fabrication of tangible personal property owned by the contractor for incorporation into a building or other structure or other improvement of real property.

Petitioner fabricated its own tangible personal property for incorporation into a building. Under West Virginia law, this is considered a taxable service that Petitioner consumed in its contracting activity in West Virginia. As such, the fabricated or assembled parts, not the component parts, are subject to the consumers sales and service tax in this State.

During the hearing, counsel for the State Tax Commissioner cited an example set forth in W. Va. Code St. R. § 110-15-112.1.3. The legislative rule and the example provide, in relevant part:

Where the natural resource product or manufactured product² is physically produced or manufactured on the job site where the contracting activity is taking place, and such product is directly used or consumed in contracting activity at that job site, the raw materials used or consumed in such contracting activity are taxable and the gross value of the product or manufactured product is not separately taxed.

* * * *

Example 3: ACE Heating and Contracting (ACE) Company has a contract to install a heating and air conditioning system in a ten story office building that is being constructed. ACE has a metal shop at which it fabricates standard sizes of duct work which it uses in its contracting business. It also sells duct work to other contractors. The gross value of duct work which ACE fabricates at the shop and uses in its contracting activity is subject to consumers sales and service tax. ACE also fabricates duct work at the job site. ACE will not pay consumers sales and service tax on the gross value of the duct work which it fabricates on the job site, but will pay consumers sales and service tax or use tax on the sheet metal which it uses at the job site to fabricate the duct work. ACE will not pay consumers sales and service tax or use tax on the sheet metal which it uses at its shop to fabricate duct work, because this sheet metal is a raw material used to fabricate (manufacture duct work). . . .

This legislative rule makes it apparent that when the fabrication or assembly of a fabricated product from component parts occurs away from the site of the contracting activity, it

² Or, consistent with the statute as set forth above, a “product.”

is not considered part of the contracting activity. Thus, when the fabricated item is installed in a building as part of the contracting activity, it is the fabricated product that is subject to the consumers sales and service tax, not its components. Hence, the West Virginia consumers sales and service tax is not levied on the purchase of the components. Since the tax is not levied on the components in the State of West Virginia, the State of West Virginia is not required to give a credit for consumers sales tax paid on those components to the State of Ohio.

CONCLUSIONS OF LAW

Based upon all of the above it is **DETERMINED** that:

1. In a hearing before the West Virginia Office of Tax Appeals on a petition for refund, the burden of proof is upon the taxpayer to show that it is entitled to the refund. *See* W. Va. Code § 11-10A-10(e) [2002].
2. Consumers sales and service tax is required to be paid on the gross value a product assembled from component parts by a contractor and included in a building by that contractor as part of its contracting activity. W. Va. Code §§ 11-15-7 & 8a.
3. Where a taxpayer pays consumers sales tax to another state on the purchase of component parts, which it subsequently assembles into a product and installs in a building in West Virginia as part of its contracting activity, it is not entitled to a credit for tax paid to the other state on the component parts since the product is used or consumed in the State of West Virginia.
4. The taxpayer in this matter has failed to carry carried its burden of showing that it is entitled to a refund.

DISPOSITION

WHEREFORE, it is the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the Petitioner's petition for refund of \$_____ of consumers sales and service tax, for the period February 1, 2006, through June 30, 2006, is hereby **DENIED**.