SANITIZED DEC. – 01-556 U – BY – George V. Piper – ISSUED – 02/20/03 – SUBMITTED FOR DECISION ON BRIEFS – 02/10/03

SYNOPSIS

PURCHASERS' USE TAX – EXCEPTION TO INTEGRATED MANUFACTURER/CONTRACTOR RULE NOT APPLICABLE – Finding by tribunal that duct-work for all intents and purposes was finished when it was brought into West Virginia for use in Petitioner's contracting business nullifies the exception in the integrated manufacturer/contractor rule because no further manufacturing took place at the job site.

PURCHASERS' USE TAX – RENOVATION IS A CAPITAL IMPROVEMENT – Petitioner's contract with a private concern for the complete renovation of a building, which entailed a complete HVAC (air conditioning) and plumbing system for the building, did not constitute a service activity but rather contracting resulting in a capital improvement pursuant to 110 C.S.R. 15, § 107.3.23.1 and 23.2, 23.3 and 23.4.

PURCHASERS' USE TAX – CONSTITUTIONAL CHALLENGE MAY NOT BE SUSTAINED – Because the State Tax Commissioner and this Tribunal are both agencies of the executive branch of government, neither may hold that any tax statute is unconstitutional on its face; that authority is reserved solely for the judiciary.

FINAL ORDER

The Auditing Division issued a purchasers' use tax assessment against the Petitioner. This assessment was for the period of January 1, 1998 through May 31, 2001, for tax and interest, through May 31, 2001.

Thereafter, by mail postmarked October 4, 2001, the Petitioner timely filed a petition for reassessment.

This case was submitted for decision on February 10, 2003 after completion of the briefing schedule.

FINDINGS OF FACT

1. Petitioner is a contractor specializing in plumbing, heating, and air-conditioning. It also has a facility out-of-state, where it manufactures ductwork for use in its contracting activity.

2. Petitioner had several jobs in West Virginia during the audit period. As a contractor performing capital improvements in West Virginia, Petitioner is required to pay sales or use tax on all purchases of tangible personal property and services for use in this activity. When the taxpayer manufactures ductwork at its shop and then uses the ductwork at the job site, the taxpayer is not required to pay tax on the raw materials purchased to manufacture the ductwork; however, he must pay tax on the gross value of the finished product ultimately used in contracting activity in this state. This assessment was principally a result of taxpayer's failure to pay tax on the gross value of manufactured items used in capital improvement activities in West Virginia.

3. Another portion of the assessment is due to taxpayer's failure to pay tax on purchases of tangible personal property and/or services that were used in capital improvement activities in this state.

DISCUSSION

The first issue is whether the Petitioner, in accordance with the "integrated manufacturer/contractor rule" (Publication TSD-355), may properly avail itself of the exception therein for on-site manufacturing because: (1) all ductwork performed as part of its contracting activities is custom made for each individual job; (2) Petitioner maintains various manufacturing tools at the individual job sites such as welders, bending tools, shears, vices, etc., in order to customize the ductwork; (3) a tax-paid inventory for steel used to manufacture its "customized" ductwork is maintained by the Petitioner; and (4) Petitioner has paid sales and/or use tax in its out-of-state facility on its tools used at the job site to complete the manufacturing process.

The problem with the Petitioner's argument is that it misses the point, in that use tax was not imposed on its purchase of any raw materials used to manufacture

ductwork. Rather, the tax was imposed on what must be considered a finished manufactured product, which it brought into the State of West Virginia in connection with its contracting activities. Further, this tribunal finds that the ductwork is "finished" because the bending or shearing of same at the job site is not further manufacturing but merely the fitting or manipulation of a finished product.

It should be noted that, for the first time, in its brief, Petitioner argues that it has already paid tax on its tools out-of-state for which it seeks a credit. However, Petitioner has never proven to this tribunal that the same is true or in what amount(s) was the tax paid on tools and other supplies.

The second issue is whether Petitioner has made a showing that its renovation of one of the local facilities was not subject to use tax because it was: (1) a taxable service and not a capital improvement (contracting); and/or (2) the customer was the federal government, which is exempt from the payment of sales or use tax.

Again, Petitioner's argument is misplaced because the renovation of an older building, which obligated Petitioner to provide a complete HVAC (air conditioning) and plumbing system for that building, may not, by any stretch of the imagination, be considered a service activity.

In fact 110 C.S.R. 15, § 107.3.23.1, 107.3.23.2, 107.3.23.3 and 107.3.23.4 make clear that a repair, which of course would include any renovation, is a capital improvement if it adds value to the real property or its useful life, if it becomes part of the building or real property, if it is so permanently affixed to the building, structure or real property that removal of same would cause material damage to the materials

being removed or the realty itself, or is intended to become a permanent installation or to remain for an indefinite period of time.

Clearly, a major restoration of a building's air conditioning and plumbing systems is a capital improvement because it meets all four (4) of the tests in the regulation.

Additionally, the contract to renovate the older building was not between the Petitioner and the federal government but with a private contractor and, therefore, no government exemption is applicable.

The third issue is whether the tax may not be imposed because it amounts to double taxation, which is violative of the commerce clause of the United States Constitution.

Because the State Tax Commissioner, and the West Virginia Office of Tax Appeals, are agencies of the executive branch of state government, neither has the authority to declare any taxing statute to be unconstitutional on its face; that authority is reserved solely for the judicial branch of government.

The issues presented in this matter involve the following important rules of administrative agency authority and statutory construction.

Initially, it is important at all times to recognize and to give more than just "lip service" to two general points: (1) rather than utilizing a so-called "de novo" scope of review, deference is to be given to the expertise of the administrative agency, even with respect to an "issue of law," when that issue of law is one within the peculiar expertise of the administrative agency; and (2) any applicable legislative regulation does not merely reflect the administrative agency's position but, instead, has been legislatively reviewed and approved, has exactly the same force and effect as a

statute, and is, therefore, subject to the usual, deferential rules of statutory construction, see Feathers v. West Virginia Board of Medicine, 211 W. Va. 96, 102, 562 S.E.2d 488, 494 (2002).

The following specific points flow from these general points. "[I]f the statute is silent or ambiguous with respect to the specific issue, the question for the reviewing [tribunal] is whether the agency's answer is based on a permissible construction of the statute." Syllabus point 4, in relevant part, Appalachian Power Co. v. State Tax Department, 195 W. Va. 573, 466 S.E.2d 424 (1995) (emphasis added). Similarly, "the Tax Commissioner [or the West Virginia Office of Tax Appeals] need not write a rule [or an administrative decision] that serves the statute in the best or most logical manner, he [, or she, or the Office of Tax Appeals] need only write a rule [or a decision] that flows rationally from the statute." Id., 195 W. Va. at 588, 466 S.E.2d at __(emphasis added). Thus, "[I]nterpretations of statutes by bodies charged with their administration are given great weight unless clearly erroneous.'" Syllabus point 3, Shawnee Bank, Inc. v. Paige, 200 W. Va. 20, 488 S.E.2d 20 (1997) (internal citation omitted) (emphasis added). Finally, "courts will not override administrative agency decisions, of whatever kind, unless the decisions contradict some explicit constitutional provision or right, are the results of a flawed process, or are either fundamentally unfair or arbitrary." Appalachian Power, 195 W. Va. at 589, 466 S.E.2d at __(quoting Frymier-Holloran v. Paige, 193 W. Va. 687, 694, 458 S.E.2d 780, 787 (1995).

CONCLUSION(S) 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 reassessment, the burden of proof is upon the petitioner-taxpayer, to show that the assessment is incorrect and contrary to law, in whole or in part. See W. Va. Code § 11-10A-10(e).

2. The Petitioner-taxpayer in this matter has failed to carry the burden of proof with respect to the issues raised.

DISPOSITION

WHEREFORE, it is the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the purchasers' use tax assessment issued against the Petitioner for the period of January 1, 1998 through May 31, 2001, for tax and interest, updated through February 28, 2003, should be and is hereby **AFFIRMED**.

Because the Petitioner has previously remitted partial payment of the assessed purchasers' use tax liability, only the balance remains due to the State Tax Department of West Virginia.