SANITIZED DECS. – 99-134 U & 99-135 FN(R) – BY – GEORGE V. PIPER
ISSUED – 7/17/03 – SUBMITTED FOR DECISION – 3/7/03

SYNOPSIS

PURCHASERS' USE TAX – Notwithstanding Petitioner's arguments to the contrary, Petitioner's business practice of cutting holes in roofs and walls to either install or reinstall large items of machinery and equipment usually with considerable amounts of ductwork, all with the intention of permanency, constitute structures and will be considered capital improvements, the installation of which is considered contracting. 110 C.S.R. 15, § 111.7 (1992).

FINAL DECISION

The West Virginia State Tax Commissioner's Office ("the Commissioner") conducted an audit of the books and records of the Petitioner.

Thereafter, on April 28, 1999, the Director of this Division of the Commissioner's Office issued a purchasers' use tax assessment against the Petitioner.

This assessment was for the period of April 1, 1996 through March 31, 1999, for tax and interest, through May 31, 1999, and no additions to tax.

Written notice of this assessment was served on the Petitioner.

Also, on April 28, 1998, the Commissioner issued a business franchise tax assessment against the Petitioner, pursuant to Chapter 11, Articles 10 and 23 of the West Virginia Code, for the period of January 1, 1995 through December 31, 1997, for tax and interest, through May 31, 1997, and no additions to tax.

Written notice of this assessment was served on the Petitioner.

Thereafter, by mail postmarked May 4, 1999, the Petitioner timely filed petitions for reassessment.

After filing its petitions for reassessment the Petitioner submitted full payment of the business franchise tax assessment, thereby converting same to a petition for refund under the provisions of W. Va. Code § 11-10-8(c).

At the hearing, Petitioner's counsel withdrew its now converted petition for refund claim pertaining to the business franchise tax assessment; however, he maintains that his client is entitled to a refund with respect to the use tax assessment, because credit for same was never credited by the tax auditor.

It should be noted that because this claim is actually for a credit against the assessment, the same cannot be considered as a refund matter.

In his initial brief, Petitioner's counsel delineated three (3) areas in dispute: 1) the reclassification of contracts; 2) the reclassification of the maintenance contract, and 3) use tax paid by Petitioner, which was not credited by the tax auditor.

In his reply brief, Commissioner's counsel posited the following: Invoices and items not addressed in this brief that were contested at the hearing by the Petitioner, are considered conceded by the Commissioner as something other than contracting.

In Petitioner's reply brief, he calculated that the amount of the tax assessment, now conceded by the Commissioner, which represented the following: contracts that were incorrectly reclassified to contracting; a maintenance contract between Petitioner and the corporation that was reclassified from service work to contracting; and the aforementioned in use taxes not properly credited by the Commissioner.

During the course of the hearing, Petitioner's counsel also conceded that certain contracts and other items were correctly reclassified by the tax auditor as contracting.

This tribunal has reviewed all of these items and agrees with the parties that the assessment, with respect to those items, should be revised accordingly.

It is noted that the hearing in this case was continued numerous times at the request or concurrence of the Petitioner; the case was submitted on March 7, 2003, for decision.

FINDINGS OF FACT

1. Petitioner is a sheet metal company located in West Virginia.

2. Much of Petitioner's work consists of the fabrication, sale, installation, repair and maintenance of process equipment owned and used by chemical and industrial manufacturers.

3. Twenty-two (22) contracts remain in dispute, which consist of the following:

   (a) Oven hoods – Petitioner laid ductwork six (6) feet, cutting hole in roof to accommodate same. Bolted equipment to floor and ran electrical conduit.

   (b) Dampers - Removal by Petitioner of existing windows, cutting holes in the sides of buildings and installation of one-hundred (100) feet of dampers – dampers bolted to each other or the installed frame.

   (c) Fans – Petitioner relocated fans from one part of a building to another part of that building. Holes cut in the wall to accommodate the fans and existing holes were patched.

   (d) Dryer – Repair job by removing one (1), and installing two (2) sections of dryer shell to the Unit 3 dryer. Bolted to the floor.

   (e) Gutters – Replacement of a portion of the rain gutter around the Credit Union.

   (f) Dust collector – Petitioner poured foundation and installed framework and dust collector, the dimensions of which were forty (40) feet high and sixty (60) feet long with one-hundred (100) feet of duct work.

   (g) Fumeburner – Bolted to the roof of the plastics building with ductwork. Dimensions were ten (10) feet by fifteen (15) feet by twelve (12) feet high.

   (h) Floor ductwork – Installation of two (2), one hundred (100) foot long, eighteen (18) inch in diameter duct work for a waste glass chute.

(i) Tobacco silos – Petitioner dismantled three (3) tobacco silos out-of-state and same were reconstructed by Petitioner with foundation in the State of West Virginia

(j) Equipment relocation – Petitioner fabricated chutes, Y-fittings and nipples, offset pipe hangers and angles with holes in connection with its installation of ductwork and the bolting of equipment to the floor.

(k) Dust collector – Petitioner cut and installed a roof hatch so that the duct collector could be positioned, laid ductwork and bolted ductwork to the floor.

(l) Inspection platforms – Petitioner extended the sides of hoppers by fabricating stairs and platforms for access to industrial hoppers.

(m) Air preheater – Installation with foundation outside the processing building.

(n) Stack – Fabrication and installation of forty (40) foot high smokestack outside the building.

(o) Equipment platforms – Platforms installed by Petitioner for people to walk on in order to gain access to building and equipment. Installation was done by bolting.

(p) Glass crusher – Installed outside the existing structure by bolting same to the pavement.

DISCUSSION

The sole issue is whether the Petitioner has shown that some or all of the twenty-two (22) contracts should not have been reclassified by the tax auditor from service work to contracting.

The regulations are not in dispute except for the interpretation of same and are set forth *en masse*.

In 110 C.S.R. 15, §§ 2.24 and 8a.3 contracting is defined as follows:

> 2.24 "Contracting" or "contracting activity" means and includes the furnishing of work, or both materials and work, for another (by a sole contractor, general contractor, prime contractor or subcontractor) in fulfillment of a contract for the construction, alteration, repair, decoration of improvement of a new or existing building or structure, or any part thereof, or for removal or demolition of a building or structure, or any part thereof, or for the alteration, improvement or development of real property.
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> 8a.3. Additionally, the definition of "contracting" is narrowed beginning July 1, 1989. For contracts entered into on or after July 1st, the work must result in a capital improvement to a building or other structure or to real

property for the work to be contracting. If this condition is not met, the work provided is a taxable service, not contracting. When a taxable service is provided, consumers' sales and service tax must be charged to and collected from the customer, but the vendor may purchase materials that will be used or consumed in making the taxable service free from consumers' sales and use taxes by presenting a resale exemption certificate to the vendor.

The regulations defining "capital improvement" are found at 110 C.S.R. 15 § 107.3.3.1 – 107.3.3.2.c:

107.3.3.1. The term "capital improvement" means an improvement that is affixed to or attached to and becomes a part of a building or structure or the real property or which adds utility to real property or any part thereof and that lasts, or is intended to be relatively permanent. As used herein, the term "relatively permanent" means lasting at least twelve (12) months or longer in duration without the necessity for regularly scheduled recurring service to maintain such capital improvement. "Regular recurring service" means regularly scheduled intervals of less than one (1) year. As used herein, the term "adds utility" means substantially adding to the value of the building or structure or real property or appreciably prolonging or extending the useful life of the building, or structure or real property.

107.3.3.2. The term "capital improvement" includes the construction, alteration, repair, decoration or improvement of a new or existing building or structure, or any part thereof, and the alteration, improvement or development of real property, which:

107.3.3.2.a. adds utility to the building or structure or real property or any part thereof by substantially adding to the value of the building or structure or real property or appreciably prolonging or extending the useful life of the building or structure or real property, and

107.3.3.2.b. becomes part of the building or structure or real property or is permanently affixed to or attached to the building or structure or real property so that its removal would cause material damage to the article being removed or to the building or structure or real property itself, and

107.3.3.2.c. is intended to become a permanent installation or to remain for an indefinite period of time.

To the above Petitioner's counsel posits that because the disputed contracts between Petitioner and its customers were for the sale and installation of tangible personal property and/or did not add utility to the building or structure in which it was placed, the same fall outside the definition of contracting, and are properly classified as "service" for taxation purposes. In support thereof, he cites

110 C.S.R. 15 § 107.3.3.4.a in that the term capital improvement does not include:

> 107.3.3.4.a. A contract for the sale and installation of tangible personal property which, when installed, remains tangible personal property, or which, when installed, does not add utility to the building or structure or the real property; or which, when installed, adds utility to the building or structure or to real property but is not intended to remain there for an indefinite period of time; ... [.]

Further, Petitioner's counsel argues that in each of the contracts, the work performed by Petitioner did not result in a capital improvement to the customer's building, structure, or realty. As such, Petitioner's original taxation treatment of the transaction was proper, and must be acknowledged as a matter of law. Additionally, he argues that a contract for the improvement of realty does not include the sale and installation of machinery which is readily removable without damage to the property or structure. He relies upon 110 C.S.R. 15 § 107.3.17.5.1:

> 107.3.17.5.a. A contract solely for the sale and installation of freestanding tangible personal property, including a contract to furnish and install freestanding machinery and equipment or other tangible personal property not essential to the building or structure nor intended to become a part of the realty, and if temporarily or incidentally attached, is readily removable without substantial damage to the tangible personal property or to the building or structure or real property.

Whereupon, Petitioner concludes that because these contracts were for work on industrial equipment, which did not result in a capital improvement to any building, structure or real property, the equipment cannot lawfully constitute contracting as per 110 C.S.R. 15, § 107.3.19, to wit:

> 107.3.19. Machinery and Equipment – The term "machinery and equipment" means and includes property intended to be used in the production, manufacturing or processing of tangible personal property, the performance of services or for other purposes (e.g., research, testing, experimentation) not essential to the fixed works, building, or structure itself, but which property incidentally may, on account of its nature, be attached to the realty without losing its identity as a particular piece of machinery or equipment and, if attached, is readily removable without damage to the unit or to the realty. "Machinery and equipment"

> `1does not include junction boxes, switches, conduit, wiring, or valves, pipes, and tubing incorporated into fixed works, buildings, or other structures, whether or not such items are used solely or partially in connection with the operation of machinery and equipment, nor does it include items of tangible personal property such as power shovels, cranes, trucks, and hand or power tools used to perform the construction contract.

Petitioner's counsel further concludes that because the machinery and equipment remained separate and distinct from the structure, the work performed by Petitioner is properly classified as service in light of in 110 C.S.R. 15 § 111.5:

> 111.5 Property Remaining Tangible Personal Property After Installation. The following is a list of proper, which, under normal conditions, remains tangible personal property after installation and does not constitute a capital improvement. This list is non-exclusive and is offered for illustrative purposes only.
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> 111.5.3. Freestanding machinery and equipment, tools, appliances, and materials used exclusively as such by manufacturers, industrial processors and other persons performing a processing function with the items.

This tribunal understands the complexity of this issue; however, the regulation, which is really on point, was not mentioned by either side: 110 C.S.R. 15, § 111.7, which provides as follows:

> 111.7 Tangible Personal Property Which Become Structures by Their Basic Nature. – Items which are manufactured as tangible personal property can, by their very nature, become a structure and will be considered to constitute a capital improvement to a building, structure, or real property. Installation of these items will be considered to be contracting. However, the determination is factual and must be made on an item by item basis. The following is a list of criteria to be used in making such a determination:
>
> 111.7.1 The degree of architectural and engineering skills necessary to design and construct the structure.
>
> 111.7.2 The overall scope of the business and the contractual obligations of the person designing and building the structure.
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> 111.7.3 The amount and variety of materials needed to complete the structure, including the identity of materials prior to assembly and the complexity of assembly.
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> 111.7.4 The size and weight of the structure.
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> 111.7.5 The permanency or degree of annexation of the structure to other real property which would affect its mobility.

111.7.6 The cost of building, moving or dismantling the structure.

Example. A farm silo, which is a prefabricated glass lined structure, is intended to be permanently installed. The prefabricated glass lined structure is 70 feet high, 20 feet around, weighs 30 tons, and it is affixed to a concrete foundation weighing 60 tons, and it is set in the ground specifically for the purpose of supporting the silo. The assembly kit includes 105 steel sheets and 7,000 bolts. The silo can be removed without material damage to the realty or the unit itself at a cost of $7,000. In view of its massive size, the firm and permanent manner in which it is erected on a most substantial foundation, its purpose and function, the expense and size of the task and the difficulty of removing it, it is considered a structure and not machinery and equipment.

111.7.7 The above criteria is intended only to be summation of factors which the Tax Commissioner will consider in determining whether or not a project involves contracting.

The one common denominator in all of these contracts is the size and scope of the project, the size of the item to be installed, and the considerable amount of labor necessary to complete same. For example, on several of the projects Petitioner had to cut holes in walls or roofs in order to begin work; many of the items to be installed were extremely large (silos, stacks, etc.), and almost all required extensive ductwork to complete same.

The permanency of all of these projects is further evidenced by the necessity of bolting the machinery or equipment to the floor or structure or in many cases installing a separate foundation for such items.

It should be noted that one of the contracts, namely the replacement of a portion of the gutters around the credit union, would clearly serve the realty and would be taxable as contracting in any event.

The issue 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-Halloran 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 taxation status of the transactions at issue.

DISPOSITION

WHEREFORE, it is the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the business franchise tax assessment issued against the Petitioner for the period of January 1, 1995 through December 31, 1997, for tax and interest, should be and is hereby **AFFIRMED**.

Because the Petitioner has previously remitted the amount of business franchise tax, no business franchise tax or interest remains due to the State Tax Commissioner of West Virginia.

It is **ALSO** 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 April 1, 1996 through March 31, 1999, should be and is hereby **MODIFIED** in accordance with the above Conclusion(s) of Law for tax and interest, on the revised tax, updated through July 31, 2003, for a total revised liability.