

**SANITIZED DEC. – 02-317 U – BY – GEORGE V. PIPER – SUBMITTED FOR
DECISION - SUBMITTED FOR DECISION ON BRIEFS – 02/16/04 – ISSUED –
02/23/04**

SYNOPSIS

PURCHASERS' USE TAX -- PROVEN SEPARATE SALE OF ASPHALT IN CONNECTION WITH ROAD MAINTENANCE ACTIVITIES TAX EXEMPT – Due to the practice of the West Virginia Division of Highways (“DOH”) of using separate and distinct bids for materials, for hauling, and for lay-down of asphalt in connection with road maintenance activities, coupled with Petitioner’s practice of selling asphalt to DOH by the use of separate, distinct, non-dependent and arms-length bids, the separate sale of said asphalt is exempt from use tax, as set forth in 110 C.S.R. 15, 112.1.2 (May 1, 1992) *et. seq.*

FINAL DECISION

A Tax Examiner with the Field Auditing Division (the “Division”) of the West Virginia State Tax Commissioner’s Office (“the Commissioner”) conducted an audit of the books and records of the Petitioner.

The Director of the Field Auditing Division of the Commissioner’s Office issued a purchasers’ use tax assessment against the Petitioner. This assessment was for the period of April 1, 1999 through December 31, 2001, for tax, interest, through March 31, 2002, and no additions to tax.

Written notice of this assessment was served on the Petitioner.

Thereafter, by mail postmarked April 26, 2002, the Petitioner timely filed with this tribunal, the West Virginia Office of Tax Appeals, a petition for reassessment and a petition for refund. See W. Va. Code § 11-10A-8(1)-(2) [2002].

PROCEDURAL HISTORY

The initial hearing was held on September 10, 2003, during which Petitioner presented its case in chief, arguing that the value of asphalt manufactured and removed from inventory in performing maintenance activities was erroneously subjected to purchasers’ use tax by the tax auditor when in fact the same was tax

exempt. Further, the Petitioner argued that it is also entitled to a refund of purchasers' use tax because it over-paid use tax on its purchases and sales during the audit period.

Upon completion of said hearing, a briefing schedule was ordered by the presiding administrative law judge (ALJ) for both sides and on October 27, 2003, Petitioner's counsel filed his brief. Thereafter, on November 11, 2003, Petitioner's counsel filed a "Motion to Amend Administrative Record and Order" stating, in pertinent part, that during the first administrative hearing, Vice-President of Petitioner had testified as to his understanding that one of the Tax Commissioner's representatives had previously told Petitioner that maintenance work was not taxable. However, on cross examination, the Vice-President testified that he had no documentation to prove that the same was true.

Petitioner's counsel went on to state that, on November 11, 2003, he became aware of the fact that newly discovered evidence existed, which would support the Vice-President's testimony and that pursuant to 121 C.S.R. 1, § 78, he was moving to have the record opened for an additional period of time.

Whereupon, the ALJ granted said motion on the date of the second administrative hearing by pre-arrangement and without objection by Commissioner's counsel, finding that the "memorandum drafted by the former Commissioner" was unknown to Petitioner at the time of the prior hearing, that said memorandum is likely to affect the outcome of the litigation and that reasonable diligence did not disclose the Memorandum's existence prior to September 10, 2003.

After completion of the second hearing another briefing schedule was ordered by the ALJ and Petitioner's counsel was permitted to file an "Amended Brief In Support of Petition For Reassessment" in lieu of the brief that he originally filed.

FINDINGS OF FACT

1. Petitioner is a business engaged in the production, sale, and lay-down of asphalt.
2. During all times relevant to this matter Petitioner was engaged in the selling of asphalt and asphalt services to the State of West Virginia's Department of Transportation, Division of Highways ("DOH").
3. West Virginia Code § 11-15-9-(a)(3) specifically exempts sales made directly to the State of West Virginia, its institutions and subdivisions from the imposition of consumers' sales and service tax (and, likewise, from the purchasers' use tax).
4. The instant audit and assessment concern only the sale of materials to DOH under maintenance contracts, also known as "purchase order work."
5. Maintenance contracts are a mechanism used by the DOH to obtain unit prices for materials and services for small maintenance projects in the upcoming fiscal year.
6. Unlike a traditional bid/let contract, where both materials and labor are requested by DOH in a unitary contract, maintenance contracts do not specify any specific quantity of materials, whether or not any labor will be requested subsequent to the material purchased.
7. At the time of bid, vendors, such as Petitioner, do not know the amount of materials that may be purchased by the DOH, when they may be purchased, or whether or not DOH will require any associated services to be performed subsequent to the purchase of materials.

8. The maintenance contracts at issue contain an “open-market” clause, whereby DOH reserves the right to make multiple awards of these contracts.

9. In point of fact, all qualified vendors who bid on the maintenance contracts are “awarded” the contract for the upcoming fiscal year. The terms of the contracts specifically state that all qualified bidders who submit a bid “F.O.B. Vendor’s Plant” will be awarded a contract for those items bid. (See, Contracts, Exhibits 5A – 5F).

10. A particular vendor is not required to bid on all items let for bid in the maintenance contract. A vendor may bid on any combination items in the open-end contract, including materials, materials hauling, or lay-down. The contracts at issue herein clearly state that a vendor’s bid on one item of the contract cannot be contingent upon a bid of any other item and that the award of any contract item cannot, and is not, contingent upon the award of any other contract item.

11. Administration of these contracts rests solely in the discretion of DOH. The vendor does not know when, how much, or whether DOH will request materials or work under the contract.

12. As there are no quantities or amounts contained in the bid documents (only unit prices) these so-called “contracts” do not become binding upon either DOH or the vendor until DOH issues a State Contract Release Order, otherwise known as an “SCO.”

13. The vendor is not authorized to ship, nor is DOH authorized to receive, materials prior to issuance of an “SCO.”

14. After the maintenance contracts are bid, DOH is free to accept a vendor’s bid on any, all, or none of the items in the contract.

15. Because the contract is not exclusive among vendors, DOH is able to source materials, labor, and hauling at the lowest possible price using any combination of vendors and labor providers who have bid on the contract.

16. The purpose of the maintenance contracts is to provide a mechanism for DOH to obtain prices for materials to perform anticipated, but yet-to-be-determined, maintenance activities, which are relatively small jobs.

17. When DOH determines a need for maintenance materials, DOH prepares the estimate of the amount of materials to be used, and completes a worksheet with the vendor's prices in order to determine the best overall price.

18. In some cases, different vendors will provide the materials, hauling, and lay down. In other cases, the same vendor will sell the materials to DOH and provide the labor.

19. In all cases, DOH utilized separate contracts to procure materials and labor for maintenance projects.

20. Under the terms of the contracts, the unit price charged by a vendor does not change, regardless of whether that same vendor is also selected to provide services under a separately issued SCO.

21. Each of these contracts contained an open-market clause, making them non-exclusive as between Petitioner and DOH.

22. Each of these contracts contains the following statement with regard to taxes: "The State of West Virginia is exempt from federal and state taxes and will not pay or reimburse such taxes."

23. Petitioner's witness testified that during his twenty-five (25)-year tenure with DOH he understood that materials purchased pursuant to these contracts were not taxable.

24. Under the terms of these contracts, all materials were purchased F.O.B., vendor's plant, meaning that title passed to DOH prior to incorporation into a roadway.

25. All materials purchased by DOH were purchased through the issuance of separate, uniquely number SCO's.

26. Under the terms of the contracts, the award of the contract for materials and the award of the contract for lay down were not dependent on each other.

27. As part of the administration of these contracts, DOH prepares worksheets which estimate the costs of proposed maintenance work.

28. At the administrative hearing, Vice-President of Petitioner testified as to his understanding that a representative of the State Tax Commissioner had told Petitioner that maintenance contract work was not taxable.

29. Petitioner's Vice-President further testified as to his belief that a representative auditor of the Tax Commissioner had indicated that maintenance work was not taxable.

30. Subsequent to the September 10, 2003 administrative Hearing, a State Tax Commissioner Memorandum, dated April 24, 1991, was discovered. This Memorandum was subsequently admitted to the record of this case as Petitioner's Exhibit No. 10.

31. The April 24, 1991 Tax Commissioner Memorandum, addresses the taxability of transactions involving the purchase of materials and labor by DOH

pursuant to maintenance contracts. The text of this Memorandum states (emphasis added):

Based upon information submitted to the Tax Commissioner by the West Virginia Division of Highways, the West Virginia Contractors Association and the West Virginia Flexible Pavement Council, the Tax Commissioner is of the opinion that if separate contracts are awarded by the Division of Highways, one for material and the other for lay down of those materials, they should be treated as separate and distinct contracts for purposes of the Consumers' Sales and Use Taxes. The Division of Highways intends to use separate contracts for materials and contracting labor. Therefore, it will not be necessary to include sales tax in quotations for these materials.

.....

Vendors may rely upon this determination when submitting quotations to the Division of Highways in response to its recent requests for quotations for the supply of stone and aggregate or hot laid bituminous concrete.

DISCUSSION

The only issue requiring determination is whether Petitioner has made a showing that its sales of asphalt to DOH pursuant to separate and distinct contracts, in connection with maintenance activities are exempt because the same are arms-length and not dependent upon any contract to haul or lay down same.

110 C.S.R. 15, § 112.1.2 states:

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. The three exceptions to this rule are as follows:

...

112.1.2. Where the manufacturer-contractor (or natural resource producer-contractor) enters into two separate and distinct

written contracts in arm's-length transactions with the contractor (customer), one for the furnishing of materials and the other for the furnishing of contracting work with respect to new construction or to a capital improvement to a building or structure or real property.

112.1.2.1. The contract to furnish materials and the contract to furnish contracting work shall not be treated as separate and distinct contracts for purposes of the consumers' sales and use taxes unless it is established by the contractor through clear and convincing evidence that:

112.1.2.1.a. Each contract was an arm's-length transaction;

112.1.2.1.b. The performance of one-contract was not dependent upon the award of the other contract; and

112.1.2.1.d. Title to the materials passed to the contractor (customer) prior to the time the materials were incorporated in the capital improvement to a building or structure or real property.

112.1.2.2. The burden of proving that Section 112.1.2 of these regulations applies shall be upon the contractor.

Because 110 C.S.R. 15, § 112.1.2.2 places the entire burden upon the Petitioner to prove the above elements, this tribunal has reviewed each one and finds as a matter of law that Petitioner has indeed carried its burden of proof.

Each Contract was arm's length

The clear language of the bidding documents shows that the West Virginia Division of Highways ("DOH") retains the ability to purchase either materials only, labor only, or both materials and labor from a particular contractor at its sole discretion, highlighted by the fact that the West Virginia Division of Highways often utilizes multiple vendors in addition to its own personnel to perform maintenance activities.

The relevant contract language reads as follows:

The Division of Highways reserves the right to request any one or combination of items for which bids are received at the lowest overall total as set forth above. Acceptance of a bid for any one item shall not be dependent upon the acceptance of a bid for any other item or any combination of items.

Testimony of Petitioner's witness, 25-year DOH veteran, supports the finding that these contracts were arm's-length. Petitioner's testified:

Q. In your opinion, was the contract between Petitioner and the Department of Highways an arm's-length transaction:

A. Certainly to the best of my understanding they are. Their contractor was free to bid on as much of the contract as they wish. There's no way that they can link what they do one place to another. There's certainly no type of collusion done prior to bidding. It's about as arm's length as I could imagine.

In addition to the explicit contract language and opinion of Petitioner's witness, it must also be noted that DOH prepares a cost-comparison worksheet prior to the issuance of an SCO. This cost-comparison by DOH ensures that it is selecting the lowest overall combination of items and vendors when performing a maintenance project.

In this case, there is ample evidence to indicate that DOH and Petitioner were dealing at arm's-length. There is no obligation on the part of DOH to purchase any item bid by Petitioner. Further, Petitioner is not permitted to make acceptance of any bid item contingent upon the award of any other item. Finally, acceptance by DOH of any item bid in these contracts does not affect the price of any other item in the contract. The contracts at issue in this matter were arm's-length transactions.

**Performance of the Materials Purchase Contract Was Not Dependent
On the Award of the Lay-Down or Hauling Contract**

The second requirement of this regulatory section is that the performance of one contract must not be dependent upon the award of the other contract. In this case the sale of materials by the Petitioner to DOH was not dependent or contingent upon the award of the hauling or lay-down items.

The requirements of 110 C.S.R. 15, § 112.1.2.1.b have been met by the language of the bidding documents, which clearly state that a bidder is allowed to bid on any or all of the items (materials, hauling, and/or lay-down) let; however, no specific item could be conditionally bid dependent on the award of another bid item. As set forth in the contract between the bidder and DOH:

Vendors may bid any or all items on the bid schedule. However, the amount bid on any one item may not be conditioned on the acceptance of the bid on any other item or items.

All qualified vendors who submit a valid bid 'F.O.B. Vendors' Plant' will be awarded a contract for those items bid (see Section 1B).

The language of the contracts clearly ensures that DOH is free to administer the contract in any way it desires, including the award of separate items to separate vendors.

When the contracts are let for bid Petitioner cannot know the amount of materials that may be purchased, or whether DOH will require any associated services to be performed pursuant to the contract. While Petitioner is free to bid on any or all items in the open-end contract, it may not bid on one item contingent upon a bid of any other item.

As the contracts are not exclusive among vendors, and vendors are not allowed to bid items contingent upon the award of any other item, DOH is unfettered in its administration of these contracts.

As testified by Petitioner's witness:

Q. So I guess that's three different scenarios which this contract contemplates. What are those scenarios?

A Well, essentially the scenarios are for the Highway Department to simply purchase materials at the plant. They go there with either their trucks or some other method of getting the material from the plant to wherever they wish to take it.

Then you have the mechanism where they use this contract to procure the material at a particular plant, use a similar portion of the contract, the second part of the contract from another vendor/contractor to haul it and lay it down.

The third scenario that would be feasible would be for them to use the first part of the contract to buy the material at the plant and then use the second part to have that same material hauled and laid down at a separate location.

Q. When a person bids for this contract, do they know which of those three scenarios is going to be utilized when it comes time for performance?

A. No, they don't. That's a decision made by the Highway Department itself.

(Transcript at pp. 32-33). As can be seen, performance of separate items under this open-end contract is not dependent on the award of any other item. As further testified to by Petitioner's witness:

Q. If the Highways Department purchases materials from one vendor, must the Highways Department then also retain the same vendor for any additional hauling or lay down?

A. No. There's no requirement under this contract. In fact, it excludes any requirement that any one item be contingent upon any other item.

(Transcript at pp. 37-38).

As can be seen, the performance of the materials purchase item of the contracts by Petitioner was not dependent on the award of the hauling or lay-down items. The contract terms and conditions specifically prohibit a vendor from conditioning the performance of one item upon the award of another. Further, DOH retains sole discretion as to the awarding of these contract items. As such, it must be held that the performance of any item of this contract was not dependent on the award of any other item. Therefore, the second requirement of regulation 110 C.S.R. 15, § 112.1.2.1 has been satisfied.

**The Award of The Materials Purchase Contract
Was Not Dependent Upon The Award of The Hauling or Lay-Down Contract.**

The third requirement of this regulatory section is that the award of one contract was not dependent upon the award of the other contract. In this case the sale of materials by Petitioner to DOH was not dependent on the sale of hauling or lay-down items.

The requirements of 110 C.S.R. 15, § 112.1.2.1.c have also been satisfied by the clear language of the bidding documents in that by the terms of the contract, DOH had sole discretion in determining whether or not Petitioner would provide either the materials and labor or solely the materials or solely the labor for a particular maintenance project. As previously stated, DOH retains discretion to administer the contracts during their term. Prior to the issuance of an SCO, the contract is not executory, merely expectant. Prior to the issuance of an SCO, DOH prepares a worksheet to determine which combination of vendors will result in the lowest overall cost to DOH. As Petitioner's witness' testimony stated:

For an example, in a particular district you may have three
or four producers of asphalt products, you may have three

or four companies that are in the business of laying it down. All of those may bid on all or part of those contracts and have it awarded to them.

When the Department of Highways then has an element to work that they want to do, they go out, they measure it up, they compute roughly what the quantities are going to be, they go back and plug it into a worksheet that has the price, has the quantity of work to be determined, and then they look at what combination will give them the best overall price, the cheapest price.

Sometimes that may involve a producer, producing the material and a different person laying it down and hauling it, sometimes it involves the same person, same producing the material, taking that material out to the job and putting it down. That's basically how the process works.

Q. With regard to the procurement of materials, does the Department of Highways procure the materials under separate contract?

A. Yes, they do.

Q. And so the work associated with a maintenance project and the materials associated with a maintenance project, would those be unitary contracts or separate contracts?

A. They would be separate contracts. We have a contract that says, okay, Highway Department, we're going to sell you a ton of asphalt at our plant. Now, you can come pick it up with your own truck and take it out and put it on the road, you can hire a truck someplace and have it come in and pick it up and take it out on the road for your people to put down, or we may give you prices that allows us to do that work for you as a separate contract, but it becomes your property at the plant, F.O.B. the plant. That's what our documents say.

Q. Does the price for the asphalt change depending on what Highways wants the people associated with the labor to do with it?

A. No. There's one price. No bid item in the contract is contingent on any other bid item.

(Transcript at pp. 28-30). Petitioner's witness further testified:

- Q. Who does these worksheets?
- A. The district that is going to be requesting the work does them.
- Q. It's not the Petitioner.
- A. No.
- Q. It's highways does that?
- A. That's correct.
- Q. Why does Highways do that?
- A. Well, its their contract to administer. They can decide what items they want to do and what they don't want to do.
- Q. So what's ordered or not ordered is in the sole discretion of Highways?
- A. That's correct.
- Q. Under the terms of the 1999 contract, were the award of the contract for materials and the contract for lay-down dependent upon each other?
- A. No, they were not.
- Q. Could the Highways Department have issued either one of these contracts to a different vendor?
- A. Assuming that there was a vendor who had bid on them, that's correct.
- Q. There's no contingency that says when you buy materials from one contractor, you need to use their lay-down services.
- A. No. In fact, it specifically says that that is not allowed, cannot be a contingent bid.

(Transcript at p. 52). Clearly, the award of the materials sale portion of the contract was not dependent upon the award of the lay-down or hauling portions of this contract.

As the award of various portions and activities of these contracts were not dependent on each other, it has been conclusively demonstrated that the third requirement of 110 C.S.R. 15, § 112.1.2.1 has been satisfied.

**Title to All Materials Sold Passed to
The West Virginia Department of Transportation
Prior to Their Incorporation Into The Roads of This State**

The fourth and final requirement of this regulatory section requires that title to the purchased materials pass to DOH prior to the time they are incorporated into the roadways of this State. By the terms of the contract and by operation of West Virginia Law, title passes at the vendor's plant.

The contracts clearly and equivocally state that all types of asphalt bid are "F.O.B. Vendor Plant." The term "F.O.B." is an abbreviation for "free on board," and generally signifies the place of delivery of goods from the seller to buyer. Black's Law Dictionary. It is axiomatic that title presumptively transfers upon delivery.

The West Virginia Supreme Court has indicated that title to goods transfers upon the terms of the contract. In the case of *Vaccaro Brothers & Co. v. Farris*, 92 W.Va. 655, 115 S.E. 830 (1923), title was found to transfer upon the delivery of goods to the carrier:

Where plaintiff sold defendant a carload of bananas f.o.b. New Orleans, and the bananas were of the kind and quality agreed upon and were delivered to the carrier, properly packed and iced for shipment, consigned to the defendant pursuant to contract, title passed upon delivery to the carrier. And if such sale were made "rolling" f.o.b. New Orleans, that is, while the car was on its journey from New Orleans, by diverting it from the original consignee to the defendant, and the bananas, when diverted, conformed to the contract, title thereto passed to the defendant upon diversion thereof to him.

Syllabus point 1, *Vaccaro Bros. v. Farris* (Emphasis added).

At hearing, Petitioner's witness correctly related the point when DOH takes title to materials:

Q. And how does the Highways Department determine which vendor would be cheapest for materials purchased?

A. Well, for F.O.B. at the plant, they use the price that the contractor, or the vendor, bid at each of the plants that they have in their contract proposal and would take the one that would be the cheapest for them to pick up.

Q. And how are those materials sold to the Highways Department?

A. Well, it anticipates that the contractor will bring all the materials together that's necessary to make a mix of asphalt, of paving material, and they'll put it in our trucks, ours or trucks under our hire, and it's F.O.B. at that plant.

Q. What does F.O.B. mean?

A. It means it's our property right there.

Q. Where does title transfer to the materials under the terms of this contract?

A. Well, F.O.B. at the plant. It says the bid price, F.O.B. vendor's plant.

Q. So title would not transfer to the Highways Department once they're made a road or made a part of a roadway.

A. No. The material becomes the property of the Highway Department when it's put in those trucks that we're supplying one way or another.

(Transcript at p. 26.38). Petitioner's witness further testified:

Q. And under the terms of the contract, if the State purchases materials under an SCO, when does title to those materials transfer?

A. The purchase is F.O.B. at the plant, so the transfer is when it's put in our vehicle at the plant, ours being either one we owned or one we've contracted for.

Q. And does the State assume the risk of loss if something was to happen to that asphalt from the time it leaves the plant to the time it's incorporated into the roadway?

A. Yes, it does. It's our material once it's put in our conveyance.

Q. And by "our" you mean the State?

A. Yes, I'm sorry. I mean the State.

(Transcript at p. 43). As can be seen, DOH takes title to all materials it purchases at the vendor's plant. As such, it is clear that title to the materials passes to DOH prior to the materials incorporated into a roadway or other structure. Therefore, the fourth and final requirement of 110 C.S.R 15, § 112.1.2.1 has been met.

In short, Petitioner has demonstrated by clear and convincing evidence that: the contract to furnish materials to the West Virginia Division of Highways is a separate and distinct arm's-length transaction; performance of the materials purchase contract was not dependent on the award of the lay-down contract; the award of the materials purchase contract was not dependent upon the award of the hauling or the lay-down contract; and title to all materials passed to DOH prior into incorporation into the roadways of this state. As such, the requirements of 110 C.S.R. 15, § 112.1.2 have

been satisfied and all materials purchased by the West Virginia Division of Highways from Petitioner are not subject to use tax.

With respect to the Tax Commissioner's argument that the Legislature has already defined what is a contract for purposes of providing labor and materials to DOH, in that the same constitutes one (1) instrument, see 157 C.S.R. 3, § 2.20, it is concluded that decisions regarding taxability must be based upon the Tax Commissioner's regulations, not upon other agencies' regulations or pronouncements.

It is also Determined that, because the Petitioner neither pursued nor quantified its refund petition at hearing or in its briefs, the refund petition must be and is hereby Denied.

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 reassessment and for a refund, 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, and that the petitioner-taxpayer is entitled to the refund. See W. Va. Code § 11-10A-10(e) [2002] and 121 C.S.R. 1, § 63.1 (Apr. 20, 2003).

2. The Petitioner-taxpayer in this matter has carried the burden of proof with respect to the issue of whether sales of asphalt, in connection with the highway maintenance work, is exempt from purchasers' use tax.

3. On the other hand, the Petitioner has failed to carry the burden of proof with respect to the issue of whether it was entitled to a refund with respect to purchasers' use (or consumers' sales and service tax) tax during the audit period.

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 April 1, 1999 through December 31, 2001, for tax and interest, should be and is hereby **VACATED**, and the Petitioner owes no further purchasers' use tax liability for the period in question.

It is **ALSO** the **FINAL DECISION** of the **WEST VIRGINIA OFFICE OF TAX APPEALS** that the petition for refund of purchasers' use tax (and of consumers' sales and service tax) is **DENIED**.