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SC REVENUE RULING #92-11

SUBJECT: Manufacturers and Construction Contractors
(Sales and Use Tax)

TAX MANAGER: John P. McCormack

EFFECTIVE DATE: January 1, 1993

REFERENCES: S.C. Code Ann. Section 12-36-110 (Supp. 1991)
S.C. Code Ann. Section 12-36-120 (Supp. 1991)
S.C. Code Ann. Section 12-36-910 (A)(Supp. 1991)
S.C. Code Ann. Section 12-36-1310 (A)(Supp.1991)
S.C. Code Ann. Section 12-36-2120 (Supp. 1991)

AUTHORITY: S.C. Code Ann. Section 12-4-320 (Supp. 1991)
SC Revenue Procedure #87-3

SCOPE: A Revenue Ruling is the Commission's official interpretation of how tax law is to be applied to a specific set of facts. A Revenue Ruling is public information and remains a permanent document until superseded by a Regulation or is rescinded by a subsequent Revenue Ruling.

Question:

How do the State sales and use taxes apply to businesses that manufacture or fabricate items that they will use in constructing real property?

Facts:

Construction contractors usually make items such as concrete facades, cabinets, etc. in one of two ways - either they purchase materials such as concrete, lumber, nails, etc. and make the items on-site or they make the items off-site and take them to the job. Items made off-site are either made for a particular job and have no other use aside from that particular job ("Unique Products") or they are standard items that may be used on other jobs ("Standard Finished Products").

Businesses that make items off-site for their own use may also sell the items to others.

For the purpose of this ruling:

1. "Unique products" are items that are specifically designed for use on a particular construction project. Such items are not standard or interchangeable in any sense and have no resale value and no reasonable fair market value.
2. "Standard finished products" are items that are not specifically designed for use on a particular construction project. Such items are standard or interchangeable and have a resale value and a fair market value. These items are generally mass-produced and are suitable for use on many construction projects.

Discussion:

Code Section 12-36-910(A) reads:

A sales tax, equal to five percent of the gross proceeds of sales, is imposed upon every person engaged or continuing within this State in the business of selling tangible personal property at retail. (emphasis added)

Code Section 12-36-1310(A) reads:

A use tax is imposed on the storage, use, or other consumption in this State of tangible personal property purchased at retail for storage, use, or other consumption in this State at the rate of five percent of the sales price of the property, regardless of whether the retailer is or is not engaged in business in this State. (emphasis added)

Thus, for the sales or use tax to be imposed, there must be a retail sale or a retail purchase of tangible personal property.

The terms "sale at retail" and "retail sale" are defined at Code Section 12-36-110 as:

...all sales of tangible personal property except those defined as wholesale sales. The quantity or sales price of goods sold is immaterial in determining if a sale is at retail.

(1) The terms include:

(a) sales of building materials to construction contractors, builders or landowners for resale or use in the form of real estate;

* * * *

(d) the use within this State of tangible personal property by its manufacturer as building materials in the performance of a construction contract. The manufacturer must pay the sales tax based on the fair market value at the time and place where used or consumed; (emphasis added)

* * * *

The term "building materials" is defined at Regulation 117-174.45 as "tangible personal property....which becomes a part of real property."

In summary, purchases of building materials by a contractor are retail transactions and the tax is due on the material's purchase price. However, if a contractor is the manufacturer of his own building materials, the use of the building materials by the contractor is a retail sale, with the tax being due on the fair market value of the building materials at the time of use.

Therefore, in applying Code Section 12-36-110(1)(d), it must be determined if the taxpayer is a "manufacturer" and whether the building materials used in the performance of the construction contract have a "fair market value".

In Southern Equipment Sales Company, Inc. v. South Carolina Tax Commission, a 1962 Court of Common Pleas case concerning sales of equipment used to produce asphalt for paving roads, it was reasoned "[t]he business of Banks Construction Company is that of a road, street or highway contractor. The incidental sales of asphalt to others does not change the character of the business to that of a manufacturer".

In other words, to be a manufacturer, one must be in the business of producing tangible personal property for sale to others on a regular and continuous basis.

In Metromont Materials Corp. v. South Carolina Tax Commission, Spartanburg County Court of Common Pleas, No. 84-CP-42-14, (1985), the court addressed the issue of a business that fabricates unique products at a facility and then transports those unique products to the construction site for their own use under contracts or subcontracts. Metromont Materials fabricates prestress concrete forms for use in buildings, stadiums, parking garages, etc. The court held:

Based on the evidence produced in the case, the Court concludes that the activities of Metromont's Prestress Division do not constitute the "manufacture" of "building materials" which have a "reasonable and fair market price" Metromont's Prestress Division erects buildings as a general or subcontractor for a completed contract price.

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.... The prestress forms are unique in that the specific members must be designed for each particular project. Members are not standard or interchangeable in any sense and have no resale value and no "reasonable and fair market price".

The court, in supporting its conclusion, cited the similarities between the South Carolina statute and the Alabama statute and cited several Alabama court cases with respect to this issue. See State v. Acker, 45 Ala. Civ. App. 574, 233 So. 2d. 514 (1970) and State v. Air Conditioning Engineers, Inc., 277 Ala. 675, 174 So. 2d. 315 (1965). For additional support, see also Montgomery Woodworks, Inc., 389 So. 2d. 510 (1980) and Tindall Concrete Products, Inc., Spartanburg Court of Common Pleas, No. 84-CP-42-13 (1985).

In summary, with respect to Code Section 12-36-110(1)(d), a taxpayer must be a manufacturer of "standard finished products", since unique products do not have a fair market value. In addition, based on Southern Equipment Sales Company, Inc. v. South Carolina Tax Commission, a

taxpayer must fabricate items, whether "standard finished products" or "unique products", that are sold by the taxpayer on a regular and continuous basis in order to qualify as a manufacturer.

Our discussion would not be complete without mentioning the exclusions and exemptions available to manufacturers.

Manufacturers may make the following purchases free of tax:

1. Machines used in manufacturing tangible personal property for sale, including parts, attachments, and replacements. [Code Section 12-36-2120(17)]

However, to enjoy this exemption, a particular machine must be used substantially in manufacturing tangible personal property for sale. [Hercules Contractors and Engineers, Inc. v. South Carolina Tax Commission, 280 S.C. 426, 313 S.E.2d 300, 308, 309 (1984)]

2. Electricity used to manufacture tangible personal property for sale. [Code Section 12-36-2120(19)]
3. Coal, coke or other fuel used in manufacturing tangible personal property for sale. [Code Section 12-36-2120(9)]
4. Tangible personal property which becomes an "ingredient or component part" of the materials manufactured. [Code Section 12-36-120(2)]
5. Tangible personal property "used directly" in manufacturing tangible personal property for sale. [Code Section 12-36-120(3) & Regulation 117-174.30(b)]

In addition, sales of tangible personal property to a manufacturer or construction contractor that is "subsequently processed, partially or completely fabricated, or manufactured in this State by the manufacturer or contractor, for use in the performance of a construction contract if the property is transported to, assembled, installed, or erected at a job site outside the State and thereafter used solely outside the State" are not subject to tax [Code Section 12-36-110(2)].

Also, the sales of "building materials" where the seller, by contract of sale, is obligated to deliver the building materials out of state are exempt from the tax [Code Section 12-36-2120(36)].

Finally, "[w]hen a taxpayer is liable for the [State] use tax ... on tangible personal property purchased in another state, the amount of the sales or use tax due and paid in the other state is allowed as a credit against the use tax due [South Carolina] ..."

Conclusion:

The State sales and use taxes apply to businesses that manufacture or fabricate items, that they will use in constructing real property, as follows:

Standard Finished Products:

If the taxpayer produces "standard finished products" that it sells at wholesale or at retail on a regular and continuous basis, then the taxpayer is a "manufacturer" of "building materials". As a

manufacturer, if the taxpayer uses such building materials in the performance of a construction contract, then the taxpayer is a "manufacturer/contractor", and is liable for the sales tax based on the fair market value of the building materials at the time and place where used or consumed - the job site. However, if the job site is located outside of South Carolina, then no tax is due.

In addition, as a "manufacturer/contractor", the taxpayer is entitled, to the extent applicable, to the exemptions and exclusion provided in Code Sections 12-36-2120(9), 12-36-2120(17), 12-36-2120(19) and 12-36-120. Also, the credit provisions of Code Section 12-36-1310(C) may be applicable.

Unique Products:

If the taxpayer produces "unique products" that it uses in the performance of a construction contract, then the taxpayer is a contractor. As such, sales to, and purchases by, the taxpayer of the raw materials used to fabricate (within South Carolina) the unique product are subject to the sales and use tax. However, if the fabricated item will be used, and become a part of realty, at a job site located outside of South Carolina, then the sales to, and purchases by, the taxpayer of the raw materials used in the fabrication of that unique product are not subject to the sales and use tax.

If the unique product is fabricated out of state, sales to or purchases by the contractor of the materials used to fabricate the unique product are not subject to the sales and use tax, provided the materials were not sold and delivered to the contractor within South Carolina.

In addition, as a contractor, the taxpayer is not entitled to the exemptions and exclusions provided in Code Sections 12-36-2120(9), 12-36-2120(17), 12-36-2120(19) and 12-36-120, unless a substantial portion of its business also includes the fabrication of "unique products" (and/or standard finished products) that it sells to contractors and other consumers. However, the credit provisions of Code Section 12-36-1310(C) may be applicable.

Note: Sales of "standard finished products" or "unique products" to contractors and other consumers who use them in the performance of a construction contract, or to otherwise make improvements to realty, are subject to the sales and use tax based upon gross proceeds of sales or sales price, unless otherwise excluded or exempted from the tax.

SOUTH CAROLINA TAX COMMISSION

s/A. Crawford Clarkson Jr.
A. Crawford Clarkson, Jr., Chairman

s/T. R. McConnell
T. R. McConnell, Commissioner

s/James M. Waddell Jr.
James. M. Waddell, Jr., Commissioner

Columbia, South Carolina
September 30, 1992