

Legislature Places Burden on Government Entities to Assess Taxability of Certain Purchases for Public Works Projects

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In its most recent session, the Florida Legislature enacted numerous tax law changes affecting a wide-range of taxes. One significant change in the sales and use tax area shifted the burden to the State of Florida and its various political subdivisions for determining whether they are eligible to use their sales tax exemption certificate to purchase building materials and supplies for public works projects. Chapter 2010-138, Laws of Florida (Section 8, CS/HB 7157, revising section 212.08, Florida Statutes). This new legislation is a welcome change for contractors that work on public works projects, because it minimizes uncertainty by having the government entity certify, and be economically responsible for, whether the purchase of the building materials and supplies is tax-exempt.

Background

Florida imposes a sales tax at a rate of 6 percent¹ on retail sales of tangible personal property. Fla. Stat. § 212.05(1)(a). Florida also imposes a use tax at the same rate on tangible personal property that is used or consumed in the state. Fla. Stat. § 212.05(1)(a). This use tax applies whenever a person or entity manufactures, produces or fabricates tangible personal property for their own use. Fla. Stat. § 212.06(1)(b). For this purpose, the term “use” does not include “the sale at retail of that property in the regular course of business.” Fla. Stat. § 212.02(20).

Section 212.08, Florida Statutes, provides numerous exemptions to the imposition of sales and use tax. Among these exemptions are sales made to the U.S. government; a state; or any county, municipality or political subdivision of a state, when payment is made directly to the dealer by the government entity. Fla. Stat. § 212.08(6); F.A.C. r. 12A-1.094(1)(b); *See also* F.A.C. r. 12A-1.038(4) (containing guidelines for claiming and documenting the exemption). This exemption does not apply, however, in the case of sales of tangible personal property (such as building materials) to contractors employed either directly or as agents of the government entity when the tangible personal property will go into, or become part of, a public works project. *Id.* Public works projects generally include public facilities that are financed and owed by a government entity and in which private persons perform all or parts of the work to construct, improve, maintain or repair the facility. F.A.C. r. 12A-1.094(1)(c).

For example, in the typical scenario, when a contractor purchases building materials from a vendor, the contractor must pay sales tax to the vendor on this purchase, because the contractor is not reselling the materials to the government entity, but is instead using the materials to provide non-taxable construction services to the

government entity. In other words, the contractor is considered the ultimate user of the tangible personal property for sales tax purposes, and therefore the contractor is liable for the sales tax. F.A.C. r. 12A-1.094(2) and (3). Similarly, a contractor that manufactures, produces or fabricates building materials (such as trusses, for example) for use in public works projects must pay use tax on the cost price of the materials. Fla. Stat. § 212.06(1)(b). In this typical scenario, it is irrelevant that the government entity has a consumer's exemption certificate (i.e., sales tax exemption certificate), and therefore can purchase tangible personal property free of sales tax, because the government entity is not the direct purchaser of the tangible personal property. In practice, of course, the contractor would mark-up its fees for its sales tax obligations, so that the government entity would ultimately pay the sales tax through higher fees paid to the contractor.

In determining whether a transaction is an exempt sale to a government entity or a taxable sale to a contractor, the statute provides that the substance of a transaction, rather than its form, will control. *Id.* The Florida Administrative Code elaborates on the conditions used by the Department of Revenue (the “Department”) in analyzing this issue. These conditions are: (1) the government entity must issue the purchase order directly to the vendor and provide the vendor with a copy of its consumer's certificate of exemption; (2) the vendor must issue its invoice directly to the government entity, rather than to the contractor; (3) the government entity must make payment directly to the vendor from public funds; (4) the government entity must take title to the building materials from the vendor at the time of purchase or at the time of delivery by the vendor; and (5) the government entity must assume the risk of loss or damage with respect to the building materials at the time of purchase by, for example, obtaining, or being the insured party under, insurance on the building materials. F.A.C. r. 12A-1.094(4)(b). The statute and the administrative code both provide that this last condition is of “paramount consideration.” Fla. Stat. § 212.08(6); F.A.C. r. 12A-1.094(4)(b)(5).

Even if a contractor and government entity satisfy the foregoing conditions, the transaction will be considered a taxable sale to the contractor if the contractor both furnishes and installs the building materials, even if these activities are covered by separate contracts (one sales contract and a separate installation contract) with the government entity. F.A.C. r. 12A-1.094(1)(a)1.

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It appears, however, that the Department will recognize a tax-exempt sale to a government entity where a subsidiary entity manufactures and sells (or just purchases from third parties and sells) building materials to a government entity, while the parent entity installs the building materials. *See* TAA 04A-062 (Nov. 29, 2004). The Department will not recognize a tax-exempt sale, however, if the installing entity is in the chain of ownership of the building materials at any point. For example, the Department has privately rejected a proposed transaction where the parent entity would manufacture the materials, sell them to a subsidiary that would then resell the materials to a government entity, and then have the parent entity install the materials.

The Problem

Many contractors are aware that government entities are exempt from sales tax on their purchases. Unfortunately, many contractors miss the fact that in most instances under Florida law they are the ultimate user of building materials and other supplies that are incorporated into public works projects. Therefore, contractors, mistakenly believing they are purchasing the building materials for resale, sometimes purchase the building materials from the vendor tax-free by issuing a resale cer-

tificate to the vendor. Further compounding the problem, government entities sometimes also do not know the law, and they then mistakenly issue a copy of their consumer's exemption certificate to the contractor to, purportedly, purchase the building materials tax-free. I have heard numerous contractors that know the law complain that their bids on public works contracts rightly include a mark-up for sales tax, but contractors that do not know the law will not include such a mark-up in their bids. For contractors complying with the law, this is a significant disadvantage in the bidding process, and it can inhibit a contractor's ability to be awarded public works projects.

For contractors that know the law, this problem can be avoided if they properly structure a sale of building materials to a government entity. *See* TAA 10A-018 (Apr. 13, 2010); TAA 09A-047 (Sept. 29, 2009); TAA 09A-033 (July 15, 2009); TAA 09A-016 (Apr. 3, 2009); TAA 09A-013 (Mar. 26, 2009); TAA 08A-021 (Aug. 8, 2008). First, the government entity would purchase tangible personal property directly from a vendor free of tax using its consumer's exemption certificate, and make sure that the five conditions set forth in Florida Administrative Code Rule 12A-1.094(4)(b) are satisfied. Second, the government entity would engage the contractor to install the building materials, which is a tax-free service.

However, complying with the conditions in Florida Administrative Code Rule 12A-1.094(b)(b) can be deceptively simple, which perhaps is why the Department has been asked to issue numerous Technical Assistance Advisements on this issue. Nonetheless, there may not be sufficient time for a contractor or government entity to obtain their own Technical Assistance Advisement, or there may not be enough dollars at stake to warrant the expense of obtaining one. Consequently, there is risk in utilizing this solution, because there is uncertainty as to whether the Department will accept the bifurcated transaction.

New Legislation

Before the enactment of new legislation, if a contractor and a government entity incorrectly structured a purported exempt-sale of building materials, the contractor would generally be liable for the tax, interest and penalties. In contrast, if the contractor had merely purchased the building materials from the vendor and paid the sales tax, the contractor would have ultimately been reimbursed for the tax through higher fees charged to the government entity.

The new legislation, which becomes effective January 2, 2011, potentially alleviates this problem by essentially making the government entity figure out whether the purchase of building materials has been properly structured as two separate transactions (the first being a tax-exempt sale to a government entity and the second being a tax-free sale of installation or construction services). In such cases, the government entity claiming the exemption is required to certify the exemption to the contractor and the dealer by providing them with a Certificate of Entitlement to the exemption. Fla. Stat. § 212.06(b). The Department has proposed a form for

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this certificate which requires the government entity to certify that, among other items, the five conditions described above that are contained in Florida Administrative Code Rule 12A-1.094(4)(b) are satisfied.

It is important to note that this new provision does not apply to the federal government. Fla. Stat. § 212.06(b). Consequently, this new legislation does nothing to aid contractors working on federal public works contracts. Proposed changes by the Department to Florida Administrative Code Rule 12A-1.094 also except from the new provision contractors and subcontractors that manufacture or fabricate their own materials for incorporation into public works projects.

Possession of a government entity's Certificate of Entitlement alleviates the dealer from the obligation of collecting the tax from the contractor, and it alleviates the contractor from paying the sales tax. *Id.* Under proposed changes by the Department to Florida Administrative Code Rule 12A-1.094, in the absence of such a certificate, the transaction is taxable unless the contractor can demonstrate that the sale was, in substance, a tax-exempt sale directly to the government entity. The governmental entity does not bear this burden of establishing the substance of the transaction in the absence of a certificate.

Importantly, where the contractor has a Certificate of Entitlement and the Department disagrees with the government entity that the transaction is taxable, the new law provides that the government entity, and not the contractor or dealer, is solely responsible for any tax, interest and penalties as a result. *Id.* The government entity cannot transfer this liability through contract or agreement, such as by requiring indemnification from the contractor. *Id.* This is a significant change, because normally the contractor is liable for any tax, interest and penalties assessed by the Department. In my experience, the Department audits the contractors and never the government entities.

Furthermore, when the Department assesses the contractor for unpaid tax, the government entity is unwilling to reimburse the contractor for any of its obligations to the Department. This can be especially burdensome to a contractor, because they generally do not experience any savings from not having paid or remitted the tax. The contractors would have charged higher fees to the government entity to cover the tax, but now are not in a position to take this action because the project is well underway or complete. It can also be difficult to recoup these costs on subsequent projects because of the highly-competitive, low-bid nature of how public works contracts are awarded. Once this new legislation becomes effective, it will be interesting to see whether government entities are willing to issue Certificates of Entitlement, and thus alleviate a large concern for many public works contractors.

Endnotes:

1 Authorized Florida counties may levy an additional discretionary surtax on transactions occurring within the county that are subject to the state sales tax. Fla. Stat. § 212.0306. Therefore, depending on the county, the overall sales tax rate may be more than 6 percent.

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