APPLICATION OF
SALES AND USE TAX LAWS
TO CONSTRUCTION CONTRACTORS IN GEORGIA

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I. INTRODUCTION

Unlike retailers and dealers, who purchase goods for resale, construction contractors and subcontractors buy goods for use in fulfilling construction contracts. Thus, contractors and subcontractors face sales and use tax obligations that differ from traditional retailers or dealers who sell tangible personal property to the end user. Contractors and subcontractors must pay sales and use tax when they purchase the materials.

A **"dealer"** sells tangible personal property at retail. *See* Official Code of Georgia Annotated ("O.C.G.A.") § 48-8-2(8). The "dealer" must collect sales taxes from its customers, hold such monies in trust for the Georgia Department of Revenue (the "Department"), and remit such monies at the end of the month or quarter. A dealer may provide ancillary installation services. The dealer's installation services are not subject to sales tax, if such services are itemized and separately-stated. O.C.G.A. § 48-8-2(34)(B)(iv); GA. COMP. R. & REGS. r. 560-12-2-.88(2) (if labor or installation is not separately-stated, then the entire invoice price is subject to sales tax); GA. COMP. R. & REGS. r. 560-12-2-.09(6)(automotive services), 560-12-2-.24(1)(communication services); 560-12-2-.42(florists and nurserymen, but must be billed separately); 560-12-2-.66(monuments and memorial stones); 560-12-2-.111(5)(computer software installation).

A **"contractor"** provides services and uses materials in performing construction contracts. To this end, the "contractor" is the consumer of the materials. The "contractor" must pay sales and use tax on its purchases, even if the contractor passes on such taxes to the homeowner/developer. The "contractor" should not collect sales tax from parties with whom it contracts.

Noncompliance with the sales tax rules arises when a taxpayer's status is not clear. Noncompliance can lead to liability for back taxes, interest and penalties. A business facing these

issues must determine whether it is (i) a "dealer," who provides separate installation services, or (ii) a "contractor," who provides materials and services with regard to such materials.

This paper clarifies the confusion that may arise regarding a contractor's sales and use tax obligations. This paper defines "contractor" and "subcontractor" for Georgia sales and use tax purposes. This paper also explains the sales and use tax obligations of "contractors" and "subcontractors." Finally, this paper addresses other sales tax issues that arise in the construction industry.

II. CONTRACTOR AND SUBCONTRACTOR DEFINED

A. Imposition of the Sales/Use Tax Obligation on a Contractor/Subcontrator

1. Statute

The Georgia Sales and Use Tax Act (the "Sales Tax Act") provides for obligations imposed on a "contractor" or "subcontractor." The Sales Tax Act sets out the sales and use tax obligations of each person who:

> [o]rally, in writing, or by purchase order contracts to furnish tangible personal property and to perform services under the contract within this state.

O.C.G.A. § 48-8-63(b). In particular, such person:

> [s]hall be deemed to be the consumer of the tangible personal property and shall pay the sales tax imposed . . . at the time of purchase.

O.C.G.A. § 48-8-63(b).

2. Regulation - GA. COMP. R. & REGS. r. 560-12-2-.26

a. Mirrors the statute

b. Any person who contracts to furnish tangible personal property ("TPP") and perform services is deemed the consumer of the TPP used

in performing the contract.

c. Must pay tax at time of purchase, use, storage or consumption whichever occurs first.

3. Cases

a. *J.W. Meadors & Co. v. State*,80 S.E.2d 86 (Ga. App. 1954)

- Facts: Contractor hired to construct improvements to water works system in Macon claimed that he was purchasing materials "for resale" to City of Macon and that his purchases were not subject to sales and use tax.

- Holding: Georgia Court of Appeals held (1) that contractor was end–user, because he was using the materials to perform a contract with the City, and (2) that the contractor was required to pay sales/use tax on his purchases.

- Rationale

  – Even though the materials were transferred to the City, the materials were transferred as *improvements to realty* and not in the form of tangible personal property.

  – **The contractor was paid for a "completed installation."**

b. *Troup Roofing Co. v. Dealers Supply Co.*, 87 S.E.2d 358 (Ga. App. 1955)

- Facts: Supplier sued contractor in a suit on account (for nonpayment) for flues sold to contractor.

- Holding: Supplier right to sue contractor for unpaid sales taxes as he is entitled to recover any other debt. Building materials bought by contractor to be used in construction or repair of a home of the party who engages the contractor are not purchased for resale.

B. Definition of Contractor and Subcontractor

1. Statutory/Regulatory Definition of Contractor

- Person in busn of constructing, altering, repairing, dismantling or demolishing
  - Buildings
  - Roads
  - Bridges
  - Viaducts
  - Sewers
  - Water and gas mains
  - Streets
  - Disposal plants
  - Water filters
  - Tanks and towers
  - Airports
  - Dams
  - Water wells
  - Pipelines and
  - Every other type of structure, project, development or improvement coming within the definition of real property or personal property
  - including, but not limited to, constructing, altering, or repairing property to be held either for sale or rental
  - and all subcontractors so engaged.
- Note: Statute that imposes the obligation does not define "contractor"
- The above definition is found in O.C.G.A. § 48-13-30 and in GA. COMP. R. & REGS. r. 560-12-2-.43(1).

2. General or Prime Contractor GA. COMP. R. & REGS. r. 560-12-2-.26(2)

a. One who contracts with another

- any person, partnership, LLP, corporation, LLC; and
- who contracts with owner/lessee or other person with authority to enter into contract; and
- contract involves the premises or property designated by the contract; and
- contract calls for performing services and/or furnishing materials for construction, alteration, or improvement of any real property or project.

b. Develops Own Real Estate

- one who owns or leases real estate
- for purpose of developing the real estate other than for his own occupancy **AND**
- in the development of the real estate, contracts, alters or makes improvements to the real estate.

c. Owns Real Estate and Contracts for Another to Alter

- one who owns or leases real estate; AND
- in the development of the real estate, alteration or improvement of to the real estate or construction on the real estate; AND
- contracts with someone else to furnish tangible personal property and perform services.

d. Subcontractor

- person, partnership, LLP, corporation or LLC;
- who contracts with the prime or general contractor;
- to perform all or any part of the contract of the prime or general contractor
- or who contracts with a subcontractor who has contracted to perform any part of the contract entered into by the prime or general contractor.

3. Cases

a. "Contractors" and "subcontractors" are taxpayers who engage in construction projects relating to the premises or property that is the subject of the contract, by performing services and/or furnishing materials for the construction, alteration, or improvement of real property. *Strickland v. W.E. Ross & Sons, Inc.*, 251 Ga. 324, 325, 304 S.E.2d 719, 720 (1983).

b. Thus, whether the taxpayer is a "contractor" or "subcontractor" turns on the nature of the taxpayer's role vis-à-vis the specific real estate.

C. Other Guidance on Meaning of Contractor/Subcontractor

The definitions found in the statute, the regulations and the cases clarify whether a taxpayer is a "contractor/subcontractor". Where the classification of a taxpayer as a "contractor/subcontractor" is not clear from the above definitions, cases and statutes from other legal disciplines, as well as rules from other states, offer added guidance.

1. Materialman/Mechanic's Lien Law

Georgia law provides for a special lien on real estate for persons who perform work or provide materials to the real estate. Under the applicable law, the following have a special lien on real estate, factories, railroads or other property for which they furnish labor, services or materials:

> [a]ll contractors, all subcontractors and all materialmen furnishing material to subcontractors, and all laborers furnishing labor to subcontractors, materialmen, and persons furnishing material for the improvement of real estate .

O.C.G.A. § 44-14-361(a)(2). The right to a "materialman's lien" depends upon whether work is performed and/or material has been provided to the real estate. The materials furnished must actually go into and become a part of the finished structure. Such materials include lumber, nails, glass, hardware, etc. *See Pacific Southern Mortgage Trust v. Melton*, 151 Ga. App. 593, 594, 260 S.E.2d 910, 911 (1979). Supplying curtains is not, however, an improvement to real estate, and a

lien cannot attach for nonpayment of such materials. *Skandia Draperies Mfg. Co. v. Augusta Innkeepers, Ltd.*, 157 Ga. App. 279, 280, 277 S.E.2d 282 (1981)(draperies are fully removable and not attached to any improvements in any way other than by the normal curtain rod and hook method). Services must enhance the value of the real estate. Thus, removal of debris from real estate increases the value of the real estate and supports the right to a lien that attaches to the real estate. *McDaniel v. Hensons, Inc.*, 229 Ga. App. 213, 216, 493 S.E.2d 529, 532 (1997). Indeed, a materialman's lien is proper where grading services are provided. *Thompson v. Crouch Contracting Co.*, 164 Ga. App. 532, 297 S.E.2d 524 (1982).

2. <u>Fixtures Law</u>

A review of "fixtures" law is helpful in determining whether the taxpayer is a contractor/subcontractor. Materials used in fulfilling a real estate construction contract become a part of the real estate at which the contract is performed. The materials lose their identity as tangible personal property, once installed at the job site. They become "fixtures." Specifically, under Georgia law,

> (a) Anything which is **intended** to remain permanently in its place even if it is not actually attached to the land is a fixture which constitutes a part of the realty and passes with it.
>
> (b) **Machinery** which is not actually attached to the realty but is movable at pleasure is not a part of the realty.
>
> (c) Anything **detached** from the realty becomes personalty instantly upon being detached.

O.C.G.A. § 44-1-6. Where the items/materials become fixtures, the person who provides such materials and performs services is more likely to be a contractor/subcontractor.

3. Florida Department of Revenue Regulations

The Georgia "contractors" regulation does not identify the activities that constitute "construction, alteration, or improvement of real property." The "contractors" regulation of a neighboring state, Florida, helps in determining whether the activities improve real estate and the taxability of such activities. Fla. Admin. Code 12A-1.051. The Florida regulation classifies those activities considered to be the "construction, alteration, or improvement of real property," by defining "Real Property Contract." Fla. Admin. Code 12A-1.051(2)(h).

The Florida regulation lists various activities considered "real property contractor activities." The list is found in Fla. Admin. Code 12A-1.051(17). The list includes, *inter alia*, closet system installation and glass and mirror installation if installed in a permanent manner. Fla. Admin. Code 12A-1.051(17)(i), (r). The Florida regulation also lists those activities that are not considered "real property contractor activities." Such activities are listed in Fla. Admin. Code 12A-1.051(18).

4. Look at the Document Memorializing the Transaction

The Florida Department of Revenue regulation also describes the various types of constructions contracts. Based on the regulation, contractors engaged in contracts described below **do not resell tangible personal property. They use the property themselves to construct the improvement to the real estate.** They should not charge tax to their customers, but they should pay tax on all materials used, even if they itemize the materials.

a. Lump Sum Contracts – contractor/subcontractor agrees to provide all material and labor for a single (lump-sum) price.

b. Cost plus or Fixed Fee - contractor/subcontractor agrees to provide all material and labor in exchange for reimbursement of cost, plus a fee that is fixed up-front. Sometimes the fee is computed based on a percentage of the costs.

c. Upset or Guaranteed Price Contracts - contractor/subcontractor agrees to provide all material and labor based on costs, plus fees but with a maximum price that may not be exceeded.

d. Time and Materials Contracts – contractor/subcontractor agrees to provide all material and labor for a price that will be determined as the sum of the contractor's cost or a marked-up cost for materials to be used, plus an amount for services to be based on the time spent performing the contract. May also include a guaranteed maximum price that may not be exceeded. Materials are not identified and itemized, and property owner is contracting for a finished job and not the purchase of materials.

Based on the Florida regulation, contractors that enter into "retail sale plus installation" contracts **do sell tangible personal property**. **They should collect sales tax from their customers.** A "retail sale plus installation" contract is one by which the contractor/subcontractor agrees to:

- Sell specifically described and itemized materials and supplies;
- Sell the items at an agreed price or the regular retail price; AND
- Complete the work either for an additional agreed price or on the basis of time used.

All material must be itemized and set out in the contract before any work commences. Sale of the materials is separate from installation, so purchaser must assume risk of loss at time that the items are delivered (and not when work is completed).

5. Georgia Sales and Use Tax
Informational Bulletin # 2007-2-13 HVAC Contractors

Dated February 17, 2007, this publication provides information regarding businesses that sell, install and service HVAC equipment. The bulletin can be found on the Department's Web site and offers guidance for other industries.

Sales without Installation. A person who sells HVAC equipment but does not install the equipment into real property is a "dealer." He must register as a "dealer" and collect sales tax from purchasers, where the purchases are for distribution, storage, use or consumption in Georgia. Tax is due on the "sales price" of the equipment. "Sales price" is defined in O.C.G.A. § 48-8-2(34)(A).

Deemed Contractor and Liable for Tax. A person who contracts to supply and install into real estate HVAC equipment is a contractor. He must pay the sales and use tax. Tax is due on the fair market value of the equipment purchased, used or consumed in performing the contract. He must also pay tax on any supplies used in performing the contract. Tax is due at the time of purchase. If the purchases are from out-of-state sellers, then the contractor must accrue and pay use tax.

Contractors who are Registered as Dealers. Such persons can buy tax-free all repair parts that are used to perform repair services. They must collect sales tax from the customer on the sale of the part used in the repair job. They do not have to collect tax on the repair service. If the parts and the labor are not separately-stated, however, then the ***entire invoice*** is subject to sales tax. *See also* GA. COMP. R. & REGS. r. 560-12-1-.14(7)(c)(1).

6. Georgia Sales and Use Tax Informational Bulletin Related to Mobile, Manufactured, and Modular Homes

Dated December 5, 2006, this publication provides information regarding businesses that sell and install mobile, manufactured and modular homes. The bulletin can be found on the Department's Web site.

Verify Ownership Documentation. Where the home retains the character of tangible personal property, sales and use tax is due on the sale or rental of the item. Such homes are "titled" property. When the ownership of the home is reflected by a warranty deed, then the home is not tangible personal property.

Sales Tax Base. "Sales price" includes charges for transportation, dealer preparation fees, import duties, consumer fees, furniture and other charges tied to the sale. Other charges, when separately stated, are not part of the "sales price." The bulletin provides a list of the other charges.

Items Used to Set Up Manufactured Homes. Such items are used by the dealer and not sold to the consumer/purchaser. The dealer is considered the consumer of such items, because the items become part of the real estate. The dealer must pay sales tax to its supplier or accrue and remit use tax (if the supplier is out-of-state and does not collect the tax). Examples of items used to set up mobile homes (and on which the dealer must pay tax) include concrete pads; blocks; pinning materials; steps, decks or porches; sewer and electrical connections.

7. Publications and Rules from Other States

Many state regulations and publications contain in-depth discussion on the taxation of contractors. These regulations and publications can be found on the taxing authority's Internet site.

III. CONTRACTORS' SALES AND USE TAX OBLIGATIONS

A. Contractor's Obligations v. Dealer's Obligations

Once the identity of a taxpayer as a "contractor" or as a "subcontractor" is established, the taxpayer must understand his/her/its sales and use tax obligations. As noted above, the obligations differ from the collection duties imposed upon a traditional "retailer" or "dealer."

Generally, a "dealer" who sells tangible personal property must collect from the purchaser the applicable sales tax imposed on the sale and then remit the sales tax to the Department. O.C.G.A. § 48-8-33, § 48-8-34, § 48-8-35. A purchaser may also have to report and pay use tax. O.C.G.A. § 48-8-30. No tax is imposed on separately-stated installation charges. *See* O.C.G.A. § 48-8-2(34)(B)(iv)("sales price" does not include separately-stated installation charges); GA. COMP. R. & REGS. r. 560-12-2-.88(2) (if installation charges are not separately-stated, then the entire invoice is subject to sales tax).

Construction contractors/subcontractors are consumers of the materials that are used to fulfil contracts and that are installed as part of the contracts. The materials become real estate when it is incorporated into or affixed to real estate (land, buildings and improvements). Thus, contractors'/subcontractors' purchases of such materials are taxable as retail sales or uses; contractors/subcontractors do *not* collect tax from the developers/owners/customers. *See* O.C.G.A. § 48-8-63 and GA. COMP. R. & REGS. r. 560-12-2-.26(1).

A contractor is not a "retailer", as that term is defined in the Sales Tax Act, at O.C.G.A. § 48-8-2(32). A contractor's purchases are retail sales, because the contractor uses the materials it buys to perform its contracts. Thus, contractors/subcontractors should remit sales and use taxes on projects, by paying sales and use tax on materials purchases. O.C.G.A. § 48-8-63(b). Under the regulation:

> Any person who contracts to furnish tangible personal property and perform services thereunder in constructing,

> altering, repairing or improving real property in this State is deemed to be the consumer of all tangible personal property used or consumed in performing such contract and shall pay the tax thereon at the time of purchase, use, storage or consumption in this State, whichever occurs first.

GA. COMP. R. & REGS. r. 560-12-2-.26(1).

B. Use Tax (Consumer Use Tax)

1. <u>General Rules on Use Tax</u>

Most states that have a sales tax also have a complementary use tax. The purpose of the use tax is to stop the avoidance of the sales tax. *See Independent Publishing Co. v. Hawes*, 119 Ga. App. 858, 168 S.E.2d 904 (1969). Thus, Georgia law imposes a tax on the purchase of tangible personal property outside the state from an out-of-state seller, where the seller is not required to collect and remit to the Department a sales tax on the purchase. *Law Lincoln Mercury, Inc. v. Strickland*, 246 Ga. 237, 271 S.E.2d 152 (1980). The Georgia use tax supplements the sales tax; it is intended as a collection device. *Williams v. Suwannee Mfg.*, 97 Ga. App. 431, 103 S.E.2d 123, *aff'd*, 214 Ga. 613, 106 S.E.2d 797 (1959).

A purchaser of goods over the Internet may feel that the imposition of the use tax on the goods that are delivered in Georgia violates the Commerce Clause. Such a purchaser may feel that the State is illegally taxing a purchase over interstate commerce. This argument, however, carries no weight. Indeed, such challenges to the imposition of the use tax have failed. *See Independent Publishing Co. v. Hawes*, 119 Ga. App. 858, 168 S.E.2d 904 (1969)(tax is not imposed on the operations of interstate commerce but upon the privilege of use after commerce has ended and does not violate the Commerce Clause of the U.S. Constitution).

A consumer may be allowed to offset the amount of Georgia state and/or local county use tax by like taxes paid to another state. This right arises when a Georgia resident visits another state, buys an item and takes possession of the item while in the other state, and then returns home to Georgia. This often occurs while traveling on vacation. Where a Georgia resident pays tax to the other state on the purchase and then brings the item into Georgia, use tax is due. Georgia may, however, grant a credit for some or all of the like taxes paid to the other state.

2. Liability for Use Tax in Georgia

In a contractor context, liability for payment of use tax arises where the contractor or subcontractor buys materials, for use in fulfilling a contract, from an out-of-state supplier that does not collect the sales and use tax.

3. Incidence of Use Tax and the Tax Base

a. Occasions where purchaser fails to report and pay tax

(1) Out-of-state seller is not obligated to collect Georgia tax.

(2) Purchaser (perhaps on vacation) pays sales tax in another state at the moment of purchase, returns home with the purchased item, but, knowing that some tax has already been paid, honestly believes no tax is due to Georgia.

(3) Even though the seller is in another state and the buyer is aware of the obligation to pay use tax, the buyer intends to resell the purchased item, and, in this regard, does not report and remit use tax in Georgia. This is not a withdrawal from inventory (on which obligations exist under O.C.G.A. § 48-8-39 and such a transaction is a "deemed retail sale").

b. Imposition of use tax and the tax base
O.C.G.A. § 48-8-30(c)(1)

(1) Use tax is imposed on the first instance of use, consumption, distribution, or storage in Georgia of tangible personal property bought outside of Georgia and purchased at retail.

(2) The amount subject to tax (the tax base) depends upon when the article was purchased relative to when the article is first brought into Georgia. O.C.G.A. § 48-8-30(c)(2)

- Less than 6 months - 4% of the ***purchase*** price of the property

- More than 6 months – 4% of ***lesser of*** purchase price or fair market value

Note – "purchase price" has the same meaning as "sales price"

(3) Ultimate liability is on purchaser – ultimate liability for use tax is upon purchaser, not seller, who is merely the state's collecting agent. *Independent Publishing Co. v. Hawes*, 119 Ga. App. 858, 168 S.E.2d 904 (1969).

c. Statutory definitions

(1) use, consumption, distribution, or storage

- *use* - the exercise of any right or power over tangible personal property incident to ownership of the property. O.C.G.A. § 48-8-2(40).

- *storage* – keeping or retention in Georgia of tangible personal property for use or consumption in the state or for any other purpose other than sale at retail in the regular course of business. O.C.G.A. § 48-8-2(35).

(2) *purchased at retail* – purchased for any purpose other than for resale, sublease or subrent. O.C.G.A. § 48-8-2(31).

(3) *Purchase price/sales price* – the actual cost of the article, without any deductions for the cost of materials used, labor costs, service costs, transportation charges, or any other expenses of any kind. O.C.G.A. § 48-8-2(30)("purchase price" means "sales price"); O.C.G.A. § 48-8-2(34)(A)("sales price" means the total amount of consideration for which the property is sold, leased or rented).

4. Rates – State Rate and Local County Taxes

a. State rate - 4% [O.C.G.A. § 48-8-30(c)]

b. Counties rates

- MARTA 1% tax [GA. COMP. R. & REGS. r. 560-12-4-.01 through 560-12-4-.09]
- Local Option 1% tax [O.C.G.A. § 48-8-80 *et seq*.]
- Special Purpose 1% tax [O.C.G.A. § 48-8-110 *et seq*.]
- Educational Local Option 1% tax [O.C.G.A. § 48-8-141 *et seq*.]
- Homestead Option 1% tax. [O.C.G.A. § 48-8-101 *et seq*.]
- City of Atlanta 1% tax [O.C.G.A. § 48-8-6(a)(2)]

c. The maximum sales and use tax that can be imposed upon a transaction is 7% or 8% (4% state, plus 3% local taxes, except an additional 1% City of Atlanta tax when within Atlanta city limits). O.C.G.A. § 48-8-6.

Example: a DeKalb County contractor who buys materials from an out-of-state supplier must accrue and pay over a 7% sales and use tax on the purchase (4% State, 1% Marta, 1% Educational and 1% Homestead). If the DeKalb County contractor takes the materials to another county for use in a project, the contractor is not obligated to accrue any additional use tax (except if taken to City of Atlanta). The contractor has already paid the maximum 7%.

d. Accrual of additional local use taxes

(1) Additional local use taxes are imposed and must be accrued, where the tax rate in the county of purchase is *less than* the rate in county of use.

(2) A problem, and, perhaps, a mathematical and bookkeeping nightmare, arises for a contractor who accrues use tax or pays sales tax in a county that does not have the maximum rate (of 7%) and then uses the materials in a county that has a higher rate. In such a case, the contractor's obligations do not end at the time of purchase of the materials. They continue until the maximum 7% (or 8% if used in City of Atlanta) is paid.

(3) Example: Cobb County subcontractor buys materials from out-of-state vendor and has the materials delivered to its business in Smyrna, Cobb County

- At Delivery in Cobb - Cobb County subcontractor pays the applicable sales and use tax at the time of purchase. Cobb County subcontractor must accrue and remit a 6% tax on the purchase. O.C.G.A. § 48-8-30(c)(1) -- the Cobb County subcontractor pays State tax of 4% and the applicable local taxes - Special Local Option (1%) and Educational Local Option (1%). O.C.G.A. § 48-8-30(c)(1), § 48-8-113 (administration of local taxes).

- Removal for job in DeKalb –the time that the Cobb County subcontractor removes the materials from its Smyrna warehouse and takes the materials to perform a contract in DeKalb County, which has a 7% rate. The Cobb County subcontractor must accrue an additional 1% local tax.

- Which 1% local tax should be accrued and paid for the subcontractor's use in DeKalb County?

  - DeKalb's 1% local taxes include Marta, Educational and Homestead.

  - The Cobb County subcontractor need only pay one DeKalb local tax.

  - The subcontractor must decide which of the three DeKalb local taxes, Marta, Educational or Homestead, must be paid.

  - The Cobb County subcontractor has already paid Educational (in Cobb County).

  - Should it pay Marta or Homestead?

  - In deciding whether to pay the Marta or Homestead, the Cobb County subcontractor should pay the tax that appears first on Form ST-3.

  - On prior versions of Form ST-3, the local taxes appeared in the following order: Marta, Local, Other Local, Special, Educational and Homestead (MLOSEH).

- Thus, the subcontractor should accrue and pay the Marta 1% tax.

- The Cobb County subcontractor is not required to accrue and remit more than 7%, unless the materials are used within the City of Atlanta. The City of Atlanta 1% local tax has been in effect since October 2004. The rule of accruing tax until the maximum 7% rate is reached produces harsh bookkeeping results, especially for a small subcontractor. *See* O.C.G.A. § 48-8-6 (provides for ceiling on local taxes).

e. To ease the burden of accruing use tax two separate times, the contractor/subcontractor should have the materials delivered by the out-of-state supplier directly to the job site (in DeKalb County). While the subcontractor will have to pay 7% sales and use tax for use in DeKalb County, the subcontractor will not have to wrestle with accruing and paying sales and use tax twice.

5. Developer Purchases Construction Materials

In some situations, the owner or developer of the construction project purchases the construction materials and provides the materials to the contractor for use in fulfilling the construction project. In such a scenario, the contractor must pay use tax, if no tax has been paid on the purchase of the materials (by the owner or developer). O.C.G.A. § 48-8-63(c). Use tax is computed on the fair market value of the materials, even if the contractor does not get title to the materials. O.C.G.A. § 48-8-63(c).

6. Using the Property Owner's Tax Exemption Certificate

One way to try to avoid paying sales tax on the materials used to perform the construction contract is to use the property owner's exemption certificate. This strategy is not successful, as one contractor learned in *Resourcing Services Atlanta v. Ga. Dept. of Revenue*, 288 Ga. App. 532, 654 S.E.2d 649, *cert. denied* (2007).

In *Resourcing Services Atlanta*, the purchasing agent for a hospital authority performed services for the hospital. The purchasing agent used the hospital authority's tax-exempt

certificate to buy the materials tax-free from suppliers. The Georgia Court of Appeals held that the purchasing agent was liable for all sales taxes on its purchases. The Court reasoned that the purchasing agent had no "derivative" exemption from sales and use tax based on the purchasing agent's agency relationship with the hospital authority.

7. Construction Contracts and Governmental Entities

A contractor may build a jail for a county or building for a state agency or a school gymnasium for a local board of education. Legislation enacted in 2005 that affects such contracts should be carefully examined to ensure that contractors do not have to pay unnecessary sales taxes.

a. Prior Law

Under the prior law, where a contractor was retained by the State or by a local government, the government may have opted to buy all the materials and asked the contractor to simply use the materials to fulfill the construction contract. This was done, because the government could purchase the materials for use in the project "tax-exempt." The government did not have to pay sales and use tax on the purchases of the materials.

Once the contractor used the materials in the project, the contractor was immediately liable for a use tax in the county where the building was being erected. Thus, under the prior law, where a contractor had a "labor only" contract with a state agency, county government, municipality, local board of education, etc., and the respective governmental entity purchased the materials, the moment the contractor used the materials the contractor was liable for use tax under O.C.G.A. § 48-8-63. Further, contrary to laws in other states, the contractor could not buy the materials tax-free as an agent for the governmental agency (which can buy tax-free).

b. 2005 Legislation

In the 2005 legislative session, the Georgia General Assembly added a subsection addressing materials purchased by state and local agencies. The legislation became effective on July 1, 2005. *See* O.C.G.A. § 48-8-63(h).

Under the O.C.G.A. § 48-8-63(h), the governmental agency must notify the contractor in writing of the tax due on the materials purchases.

(1) Application of Rule

- Any governmental entity
- That furnishes tangible personal property to a contractor
- For incorporation into a construction, renovation, or repair project
- Where project is conducted per a contract with the governmental entity

(2) Rule:

- Governmental entity shall issue advance written notice to such contractor of the amount of tax owed for such tangible personal property.
- Failure of governmental entity to issue advance written notice to the contractor of such tax liability shall render such governmental entity liable for such tax.

(3) Statute is not applicable with respect to the use of TPP owned by United States.

C. Contractors' Registration and Filing Requirements

A contractor cannot buy materials tax-free. A contractor must pay sales and use tax on all materials, at the time of purchase or use. Thus, a contractor/subcontractor must register as such with the Department. Under the Department's regulation,

> [e]very contractor or subcontractor improving real property in [Georgia] shall file an application for a Certificate of Registration as a contractor prior to his first construction activity in [Georgia].

GA. COMP. R. & REGS. r. 560-12-2-.26(4)(a). Sales tax returns shall be filed monthly, unless otherwise authorized, using Form ST-3 (on-line at The Georgia Tax Center). GA. COMP. R. & REGS. r. 560-12-2-.26(4)(b). The application for Certificate of Registration (Form CRF-002) can be obtained online, at www.etax.ga.gov.

D. Notice Requirements for Contracts Equal to or Exceeding $250,000

A general/prime contractor who contracts with a subcontractor must notify the Department of the subcontract, by (1) identifying the subcontractor and (2) providing the contract amount. The information must be provided as to every such subcontractor, within 30 days of the execution of the subcontract. GA. COMP. R. & REGS. r. 560-12-2-.26(5).

The information/notice is provided on Form S&UT 214-1. One notice per year suffices. The general/prime contractor may have another contract with a subcontractor during the calendar year. But the prime/general contractor does not have to file another notice on contracts with the same subcontractor for the same calendar year. GA. COMP. R. & REGS. r. 560-12-2-.26(5).

E. General Contractor Payments to Nonresident Subcontractors

Prior to July 2006, a property owner, developer or general contractor had to withhold and retain any payment to any subcontractor. The law ensured that all subcontractors (resident and nonresident) complied with use tax obligations. The general contractor released the retained amounts when authorized by the Department to do so.

During its 2006 legislative session, the Georgia General Assembly passed legislation limiting the withholding obligation to payments to *nonresident* subcontractors. House Bill 111 was signed by Governor Perdue on April 6, 2006. It became effective on July 1, 2006.

The new law now limits the withholding obligation to payments to *nonresident* subcontractors who perform contracting jobs in Georgia. However, the Department of Revenue regulation has not been revised to reflect the 2006 amendment to the statute. Under the Department regulation, the general/prime must still withhold where the total of the contract with the subcontractor equals or exceeds $250,000.00. GA. COMP. R. & REGS. r. 560-12-2-.26(6)(a). Interestingly, the Department's Web site states that withholding is required only on payments to **nonresident** subcontractors.

1. Definition of Nonresident Subcontractor

The amended statute defines "nonresident subcontractor," for purposes of the withholding requirement. Under the statute, a "nonresident subcontractor" is a person:

- who does not have a *bona fide* place of business in Georgia through maintaining a permanent domicile or business facility in Georgia; AND
- who is engaged in contracting real property work; AND
- who contracts with a prime or general contractor or who contracts with a subcontractor who has contracted to perform any part of the contract entered into by the prime or general contractor.

O.C.G.A. § 48-8-63(a).

2. Statutory Withholding Requirement on Payments to Nonresident Subcontractors

To ensure that applicable sales and use taxes are paid/remitted by a nonresident subcontractor, a general or prime contractor must withhold part of the payment owed to the nonresident subcontractor under the subcontract. Withholding is required where:

- nonresident subcontract(s) involved
- total amount of subcontracts on any given project equals or exceeds $250,000.00

The prime contractor must withhold 2% of the payments due the nonresident subcontractor "in satisfaction of any sales or use taxes" owed to the state. *See* O.C.G.A. § 48-8-63(e) (as amended by H.B. 932 in the 2012 session). **IF THE PRIME OR GENERAL CONTRACTOR FAILS TO WITHHOLD, SUCH PRIME OR GENERAL CONTRACTOR SHALL BE LIABLE FOR ANY SALES OR USE TAXES DUE OR OWED TO THE DEPARTMENT BY THE NONRESIDENT SUBCONTRACTOR**. O.C.G.A. § 48-8-63(e)(2).

The prime or general contractor may release the withheld funds only after the nonresident subcontractor proves that all sales taxes accruing by reason of the contract between the nonresident subcontractor and the prime or general contractor have been paid. O.C.G.A. § 48-8-63(e)(2). To get the release of the retainage, the subcontractor must also file with the Department Form ST-C 214-9-RR (Request for Retainage). At that time, the Department will send the prime contractor a Certificate Authorizing General or Prime Contractor to Cease Withholding Payments (previously Form 214-6). GA. COMP. R. & REGS. r. 560-12-2-.26(6)(b). The notice is sent to the prime contractor, after the nonresident subcontractor notifies the Department that the work has been completed and that all applicable sales and use taxes due the Department have been paid by the nonresident subcontractor. *See* GA. COMP. R. & REGS. r. 560-12-2-.26(6)(b). The prime contractor receives such notice within 5-7 working days after the Department receives notice from the

nonresident subcontractor.

NOTE: The prior law imposed the withholding obligation on payments to ALL subcontractors and the Department's regulations are written as such. The prior law did not distinguish between resident and nonresident subcontractors. Because of the statutory changes, this regulation may be revised.

3. Department's Withholding Regulation

The regulation addressing contractors has not been updated to impose the withholding requirement only as to payments due to *nonresident* subcontractors. Rather, the regulation simply requires a 2% withholding on payments to *all* subcontractors. GA. COMP. R. & REGS. r. 560-12-2-.26(6)(a). The Department enforces the 2% withholding requirement, and the statute has now been amended to require withholding of 2%.

If the nonresident subcontractor is paid in installments, a withholding requirement is imposed on each payment. The general or prime contractor must notify the Department of the total amount withheld, when the amount has been withheld for 60 days after the subcontractor's sales and use tax reporting period. GA. COMP. R. & REGS. r. 560-12-2-.26(6)(c).

NOTE: Because of the statutory changes, this regulation may be revised.

4. Nonresident Subcontractor Bonds

Withholding is not required where the nonresident subcontractor posts a surety bond with the Department. O.C.G.A. § 48-8-63(f). *See also* GA. COMP. R. & REGS. r. 560-12-2-.26(6)(a). Specifically, withholding is not required where:

- nonresident subcontractor posts a bond with the Department;
- bond is issued by an authorized surety company; **and**
- bond is for an amount as prescribed by the Commissioner (less than $50,000 but must greater than $5,000).

See O.C.G.A. § 48-8-63(f). The amount of the bond is based upon the nonresident subcontractor's projected yearly gross receipts. The various levels of bond amounts are set forth in GA. COMP. R. & REGS. r. 560-12-2-.26(7)(c).

NOTE: Because of the statutory changes, this regulation may be revised.

IV. NONRESIDENT CONTRACTORS

Specific requirements are imposed on "foreign and nonresident contractors and subcontractors." O.C.G.A. § 48-13-30 through O.C.G.A. § 48-13-38 (together, comprise the Nonresident Contractors Act); GA. COMP. R. & REGS. r. 560-12-2-.43. The Nonresident Contractors Act does not define the terms "resident" or "nonresident." Thus, the plain and ordinary meaning of the terms refers to residency and not domicile. A person can have two residences but only one domicile. *ADC Const. Co. v. Hall*, 381 S.E.2d 76 (Ga. App. 1989)("If the legislature wanted a contractor's domicile to determine his liability under the [Nonresident Contractors]Act, it would have used that word or defined "residence" as meaning "domicile").

A. Registration Requirements

Each nonresident contractor must file an Application for Authorization to Perform Contract, Form ST-C 348-1. *See* O.C.G.A. § 48-13-32; GA. COMP. R. & REGS. r. 560-12-2-.26(8). *See also* GA. COMP. R. & REGS. r. 560-12-2-.43. A nonresident contractor that fails to register with the Department has no access to Georgia courts, even if the nonresident contractor obtained a certificate of authority to transact business issued by the Georgia Secretary of State. *George C. Carroll Constr. Co., Inc. v. Langford Const. Co.*, 355 S.E.2d 756 (Ga. App. 1987). *See Underground Festival, Inc. v. McAfee Eng. Co.*, 447 S.E.2d 683 (Ga. App. 1994)(failure to comply with Nonresident Contractors Act is an affirmative defense that can be asserted by property owner in a nonresident subcontractor's action for payment). *But see Clover Cable of Ohio, Inc. v. Heywood*, 392 S.E.2d 855 (Ga. 1990)(late registration and payment of all taxes and revenues owed to the State is substantial compliance and removes bar to maintaining an action on contract).

A nonresident contractor must also register with the Department of Revenue for each contract that is performed in Georgia and exceeds $10,000.00. O.C.G.A. § 48-13-31; GA. COMP. R.

& REGS. r. 560-12-2-.43(2).

B. Bond Requirement

The Department requires a bond before the nonresident contractor can perform a contract in Georgia where the contract exceeds $10,000.00. The bond must be issued by a surety company that is authorized to do business in Georgia. O.C.G.A. § 48-13-32. The Department may require a master or blanket bond when the nonresident contractor is engaged in continuing service under several contracts or is performing services on a contingent or unit basis (and the contract price is not determinable until after performance). O.C.G.A. § 48-13-32(c)(2)(A). The bond must be an amount no less than $10,000.00 with respect to all contracts performed during the current calendar year. O.C.G.A. § 48-13-32(c)(2)(B).

By March 1 of each year, the nonresident contractor must report and register all contracts of $10,000.00 or more completed during the prior calendar year and must pay a fee of $10.00 for each contract. O.C.G.A. § 48-13-32(c)(2)(C). If the nonresident contractor fails to provide the bond, the contractor will be denied the right to perform the contract (until he complies). O.C.G.A. § 48-13-33.

After the nonresident contractor posts the bond, the Department issues a Qualification Acknowledgement. The form must be available at the job site (to show that required fee has been paid and surety bond posted). GA. COMP. R. & REGS. r. 560-12-2-.43(3).

The bond can be released after all work is completed. O.C.G.A. § 48-13-34. The nonresident contractor should request release using Form ST-C 348-9-NRC (bond cancellation request form). A contract is not considered completed until written notice of contract completion (Form ST-C 348-9) is provided by the contractor and included with an affidavit from the Georgia Commissioner of Labor that confirms that all fees related to the contract (*e.g.*, unemployment insurance taxes owed to Department of Labor) are paid in full. O.C.G.A. § 48-13-34.

The nonresident contractor must consent (Form ST-C 348-4-NRC) at the time it registers with the Department that it will appoint the Georgia Secretary of State as an agent for service of process for state and local taxes due as a result of the contract. O.C.G.A. § 48-13-35. A separate consent form is used depending upon the form of the nonresident contractor's business. (sole proprieter, corporation, LLC or partnership).

Copies of the nonresident contractor forms, including registration forms, can be obtained online at www.etax.dor.ga.gov or by contacting the Department at tsd-sales-tax-contractors@dor.ga.gov.

V. WITHDRAWALS FROM INVENTORY -- CONTRACTORS THAT ARE ALSO RESELLERS OR MANUFACTURERS

A. Seller that Withdraws from Inventory - O.C.G.A. § 48-8-39

Some withdrawals from inventory of product held for sale are considered "deemed retail sales" where the withdrawal is not for "retention, demonstration or display." The "deemed retail sale" occurs where the a person does not pay sales and use tax on his purchases (the items purchased tax-free as purchases for resale or industrial materials for further processing). The person then makes use of the property in a manner that results in the "deemed" sale.

1. Withdrawals of Purchased Inventory

a. O.C.G.A. § 48-8-39(a) applies to a purchaser who sells tangible personal property at retail and also withdraws inventory to use in performing contracts.

b. The dealer buys items for resale and does not pay sales tax on the purchase. By definition, the sales and use tax applies to sales to ultimate consumer.

c. The dealer then withdraws items for use in performing a contract.

d. Example – seller of air conditioners at retail withdraws a unit and installs the unit in performing a construction contract.

e. The person must pay tax on "**purchase price**" of the item used to perform the contract.

2. Withdrawals of Manufactured Inventory

a. O.C.G.A. § 48-8-39(b) applies to a person who processes, manufacturers or converts industrial materials into tangible personal property for sale and also makes use of the property outside of demonstrating it for sale.

b. Manufacturer buys raw materials tax-free under O.C.G.A. § 48-8-3(35)(A)(i), (ii) (exemption on manufacturer's purchases of industrial materials to be converted into a final product for sale).

c. Manufacturer then withdraws uses the raw materials not to create a product for sale but to create a product to use in performing a contract.

d. Example - asphalt manufacturer buys materials tax-free and uses the materials in manufacturing asphalt for sale and then uses asphalt to perform construction contracts.

e. Manufacturer owes sales tax on the "**fair market value**" of the manufactured property.

B. "Dual Operator" Regulation - GA. COMP.R. & REGS. r. 560-12-1-.17

1. Meaning – a dealer in business of selling tangible personal property who, in addition to selling at retail, withdraws tangible personal property from inventory for use in performing contracts. *Ingalls Iron Works Co. v. Chilivis*, 237 Ga. 479, 228 S.E.2d 866 (1976).

2. Purchases by Dual Operator – can purchase tangible personal property tax free by providing exemption certificate to seller.

3. Retail Sales by Dual Operator – must collect tax on sales price.

4. Uses of Property Bought Tax Free – must pay use tax on fair market value of TPP used in performing a contract.

5. Fair Market Value – means "fabricated cost" of the TPP at the time of its first use in performing a contract.

NOTE: This regulation conflicts, in part, with the Department's "Withdrawal from Inventory" regulation adopted in 2008. The Department was supposedly going to repeal the "dual operator" regulation, but did not repeal it. Further, the Department's audit unit still relies on the "dual operator" regulation.

C. Effect of Being Labeled as a "Dual Operator"

1. O.C.G.A. § 48-8-39 assumes that the taxpayer has either purchased property for resale or has purchased industrial materials to manufacture items for sale.

2. The statute addresses the use of such inventory other than retention, demonstration or display (of the inventory) – a "fictional retail sale occurs."

3. This begs the question – can a business that manufactures a product for its own use and then sells some of the product on the side be converted from a "contractor" to a "retailer" and "dual operator" such that it will then have to

pay sales tax not on the raw materials purchases but on the retail sales price of the product?

4. *Strickland v. W.E. Ross & Sons, Inc.*, 251 Ga. 324, 304 S.E.2d 719 (1983)

   a. Asphalt paving contractor produced its own asphalt for use in performing paving contracts for state highways.

   b. The paving contractor manufactured, transported and installed the asphalt in performing road work and owned equipment to do the work.

   c. The paving contractor made the asphalt only in performance of a paving job.

   d. Occasionally, the paving contractor made more asphalt than needed, and the contractor sold the excess (about 9%) at retail

      - Sold it "as available" basis
      - No salesmen
      - No overnight storage facilities
      - No advertising
      - Fired up the production plant only when it needed asphalt for own use

   e. Department claimed that paving contractor was really an asphalt manufacturer and seller of asphalt that also used some of its product in performing paving contracts for a job – a dual operator.

   f. Court ruled that selling less than 10% "on the side" did not convert the asphalt paving contractor into a retailer, that the paving contractor was required to pay sales tax on its raw materials purchases.

   g. *See also Collins v. Prince Street Technologies Ltd.*, 220 Ga. App. 492, 469 S.E.2d 700 (1996)(fair market value of carpet samples made from material held for sale is "zero"); *Ingalls Iron Works Company v. Chilivis*, 237 Ga. 479, 228 S.E.2d 866 (1976)(taxpayer bought industrial materials for use in manufacturing final product for sale outside Georgia and then imported the items into Georgia for use in construction contracts within Georgia).

D. Has the "Withdrawals from Inventory" Regulation Replaced the "Dual Operator" Regulation?

On July 16, 2008, the Department of Revenue circulated a proposed regulation addressing scenarios contemplated by O.C.G.A. § 48-8-39 and the "dual operator" regulation. After a hearing in September 2008, the Department withdrew the proposed regulation, circulated another proposed regulation on September 29, 2008, and held a hearing on November 5, 2008. GA. COMP. R. & REGS. r. 560-12-1-.14, entitled "Withdrawals from Inventory," was adopted on December 21, 2008.

The Department's Web site has a copy of the "Withdrawals from Inventory" regulation. All proposed and adopted regulations can be viewed at the Department's Web site under the "Tax Policy" drop-down menu.

The "withdrawals from inventory" regulation explains the mechanics of computing sales/use tax due on withdrawals from inventory. The regulation also identifies those circumstances to which rules like those found in the "dual operator" regulation apply. The "withdrawals from inventory" regulation, however, does not contain the term "dual operator." Moreover, sales and use tax auditors still rely on the "dual operator" regulation in assessing taxpayers.

1. Withdrawals of Purchased Inventory
GA. COMP. R. & REGS. r. 560-12-1-.14(4)

a. Applies to a dealer that buys property tax-free using a resale certificate with intent to resell the property, such as a retailer that buys office supplies and places the office supplies in its retail inventory for sale (pencils, pens, notebooks, paper, computer accessories, office furniture, and break room supplies).

b. Rule – A dealer that withdraws property from inventory held for sale and uses it for any taxable purpose must pay use tax on the dealer's "cost price" of the property. GA. COMP. R. & REGS. r. 560-12-1-.14(4)(a).

(1) Note on use of the term "Cost Price" in the Regulation

(a) the term "cost price" appeared in the prior version of O.C.G.A. § 48-8-39.

(b) "cost price" has been replaced in the statute by "purchase price." HB 1221, § 11 (2009-2010 Reg. Session).

(c) The regulation will likely be revised to reflect this change.

(d) "Purchase price" applies to the measure or amount subject to use tax and has the same meaning as "sales price." O.C.G.A. § 48-8-2(30).

(e) "Sales price" is defined at O.C.G.A. § 48-8-2(34).

(2) Taxable purpose – any use other than retention, demonstration, or display while holding property for sale in regular course of business. Term does not include withdrawing item the property to sell it or withdrawing for further manufacturing/processing. GA. COMP. R. & REGS. r. 560-12-1-.14(2)(j).

(3) Retention, Demonstration or Display GA. COMP. R. & REGS. r. 560-12-1-.14(2)(h)

(a) Demonstrating or displaying the property's characteristics while holding the property in resale inventory.

(b) Using the property in the day-to-day operations of a business is not retention, demonstration or display.

(c) Employees using property is not retention, demonstration or display.

(d) Does not include use of property listed as an asset other than "inventory."

(4) Cost price – actual cost without deduction for labor costs, service charges or transportation charges. GA. COMP. R. & REGS. r. 560-12-1-.14(2)(b). As noted above, this term will likely be changed to "purchase price."

c. What if the "use" of the property is the rental or lease of the property?

(1) Suppose a car dealer removes a car from inventory to rent out to customers or to transport persons for hire.

(2) Dealer does not have to accrue use tax.

(3) Dealer can collect sales tax on the rental charges.

d. What if the "use" of the property is giving the items to sales representatives to show to customers?

(1) Use tax due on "cost price" of the property. The term "cost price" will likely be changed to "purchase price."

(2) Even if the sales representatives use the property only for demonstration or display. GA. COMP. R. & REGS. r. 560-12-1-.14(4)(c).

e. Withdrawal followed by retail sale

(1) Where dealer removes property from resale inventory for a "taxable purpose" and then sells the property at retail.

(2) Two separate taxable events. GA. COMP. R. & REGS. r. 560-12-1-.14(4)(d)

(a) Use tax due on cost price (which will likely be changed to "purchase price") – at moment of withdrawal.

(b) Sales tax due on sales price – at moment of sale to retail purchaser.

f. Dealer that buys samples from a manufacturer or distributor
GA. COMP. R. & REGS. r. 560-12-1-.14(4)(e)

(1) Dealer does not purchase samples for resale

(a) Use tax due, if manufacturer/distributor does not collect sales tax, on the cost price (which will likely be changed to "purchase price") of the samples.

(b) If dealer then sells the sample at retail, dealer must collect/remit sales tax on the sales price (unless retail sale is tax-exempt).

(2) Dealer purchases samples for resale then withdraws from inventory

(a) To give to customer, for example.

(b) Dealer must pay use tax on cost price (which will likely be changed to "purchase price") at time of removal.

g. Inventory withdrawn outside Georgia and used/consumed in Georgia
GA. COMP. R. & REGS. r. 560-12-1-.14(4)(f)

(1) Use tax due, based on cost price (which will likely be changed to "purchase price") of the item (withdrawal, even though outside Georgia, is a "deemed retail sale)"

(2) Conditional Credit: credit given for any legally due and paid in other state on withdrawal that occurred in the other state. Other state must reciprocate the credit. *See* Georgia Department of Revenue Policy Statement SUT 2011-05-26: *Reciprocal Use Tax Credit for Taxes Legally Paid to Other State or Local Jurisdictions*, for information on the obtaining the credit.

(3) The section of these materials entitled "Credit for Taxes Paid to Other States" contains more discussion on the credit.

h. Inventory transfer
GA. COMP. R. & REGS. r. 560-12-1-.14(4)(g) and (h)

(1) Inventory <u>in</u> Georgia transferred to an inventory <u>outside</u> Georgia

(a) Must be continued to be held for sale at new location.

(b) No Georgia use tax due, if items are subsequently withdrawn post-transfer to the location outside Georgia.

(c) No withdrawal, use or consumption occurred in Georgia.

(2) Inventory <u>outside</u> Georgia transferred to inventory <u>in</u> Georgia

(a) Must be continued to be held for sale in Georgia.

(b) No use tax due, unless and until item is withdrawn from inventory in Georgia (withdrawn, used or consumed).

2. Withdrawals of Self-Produced Inventory
<u>GA. COMP. R. & REGS. r. 560-12-1-.14(5)</u>

a. Applies to a manufacturer, processor or converter who buys industrial materials tax-free with intent to convert or process the industrial materials into property for sale to third parties.

b. Rule – a dealer that withdraws finished product from inventory and uses it for any taxable purpose must pay use tax on the "fair market value" of the property withdrawn. GA. COMP. R. & REGS. r. 560-12-1-.14(5)(a).

(1) <u>Taxable purpose</u> – any purpose other than retention, demonstration, or display while holding the property for sale in regular course of business. Does not include withdrawal for further processing or for sale. GA. COMP. R. & REGS. r. 560-12-1-.14(5)(a).

(2) What is "fair market value"?

(a) The amount that a knowledgeable buyer would pay for the property and a willing seller would accept for the property at arm's length bona-fide sale. Ga. Comp. R. & Regs. r. 560-12-1-.14(2)(e).

(b) The sales price that the product is offered for sale in the regular course of business at the time that the item is withdrawn.

(c) What if discounts are offered "in the regular course of business"? such discounts may be deducted in computing the amount on which to compute the tax.

(d) What if property is offered at various values based upon volume discounts, close-out pricing or other factors? Use average price at which product was sold over the past 12 months.

(e) What if no ready market exists for the property? Taxpayer or the Department may provide additional information that is reasonable, relevant and useful to determine the fair market value.

Note: The Department originally proposed the "fabricated cost price" as the default tax base when fair market value cannot be determined. The "fabricated cost price" was proposed to be the enhanced cost price of the property – including industrial materials purchased and allocated overhead (direct and indirect) and any other production costs.

(3) Example - diaper manufacturer that withdraws diapers from finished-goods inventory.

c. What are "industrial materials"?

(1) Materials purchased for future processing, manufacture or conversion into articles of tangible personal property for resale (including raw materials). GA. COMP. R. & REGS. r. 560-12-1-.14(2)(f).

(2) Need not be part of the final product held for sale

(a) Materials can become a component part of the finished product **OR**

(b) Materials can be coated upon or impregnated into the product at any stage in the processing, manufacture or conversion, although the materials do not remain a component part of the finished product.

d. What if the manufacturer withdraws "industrial materials"?

(1) Must accrue/pay tax on cost price (which will likely be changed to "purchase price") of the industrial materials withdrawn.

(2) Cost price (which will likely be changed to "purchase price") – actual cost without deduction for labor costs, service charges or

transportation charges. GA. COMP. R. & REGS. r. 560-12-1-.14(2)(b).

e. Samples of a manufacturer, processor or converter

(1) Samples sold to dealers – sales tax must be collected from dealer on sales price. GA. COMP. R. & REGS. r. 560-12-1-.14(5)(c)

(2) Samples given away without charge GA. COMP. R. & REGS. r. 560-12-1-.14(5)(c)

(a) Use tax due on fair market value of property (samples) distributed without charge.

(b) Such samples are deemed to be withdrawn from inventory and used as promotional materials. GA. COMP. R. & REGS. r. 560-12-1-.14(5)(c)(i) and 560-12-1-.14(5)(i)(example (i)).

(3) Samples given to sales representative GA. COMP. R. & REGS. r. 560-12-1-.14(5)(d)

(a) Use tax due on fair market value, if the property will not be returned to resale inventory.

(b) Even if the sales representative uses the property for demonstration or display only.

(4) Contractors that buy property for use during performance of services GA. COMP. R. & REGS. r. 560-12-1-.14(5)(e)

(a) Liable for use tax on cost price (which will likely be changed to "purchase price") of property, even if the property is subsequently manufactured, processed or converted before it is used.

(b) Reason – property is not manufactured, processed or converted for retail sale, so the proper base for the tax is cost price (which will likely be changed to "purchase price").

(5) Transfer of inventory

(a) Withdrawn from inventory outside Georgia for use in Georgia GA. COMP. R. & REGS. r. 560-12-1-.14(5)(f)

- Use tax due on "fair market value"
- Reason – withdrawal outside Georgia is a deemed retail sale and the subsequent use occurred in Georgia.
- Credit – if taxes are legally due and paid to state in which the inventory is withdrawn, a credit is allowed in Georgia, but other state must provide reciprocal credit.

(b) Transfer from inventory in Georgia to inventory outside Georgia GA. COMP. R. & REGS. r. 560-12-1-.14(5)(g)

- No Georgia use tax due if the item is subsequently withdrawn from "inventory" in the other state.
- Reason – item remained inventory at time of transfer.
- However, item must continue to be held for sale in the other state after the transfer from Georgia.

(c) Transfer from inventory outside Georgia to inventory in Georgia GA. COMP. R. & REGS. r. 560-12-1-.14(5)(h)

- No Georgia sales or use tax due until the item is either sold or withdrawn from inventory.
- However, the item must continue to be held for sale after transfer into Georgia.

3. Withdrawals of Inventory Held for Rental or Lease
GA. COMP. R. & REGS. r. 560-12-1-.14(6)

a. Applies to a dealer who buys property tax-free with intent to lease or rent the property to customers.

b. Rule – A dealer must pay use tax due on fair rental value each time the dealer withdraws the property from rental inventory and uses it for any taxable purpose.

c. Dealer must return the item to rental inventory after each use.

d. If withdrawal from rental inventory is permanent, then use tax is due on the cost price (which will likely be changed to "purchase price") of the property. GA. COMP. R. & REGS. r. 560-12-1-.14(5)(d)(ii).

e. Dealer who periodically removes item from rental inventory can, at any time, pay sales tax on the original cost price (which will likely be changed to "purchase price") of the item.

(1) No further use tax due on dealer's subsequent withdrawal for use of the withdrawn item.

(2) Dealer gets no credit for any prior use tax paid on withdrawal from rental inventory.

4. Withdrawals of Inventory by Service Providers
GA. COMP. R. & REGS. r. 560-12-1-.14(7)

a. Background on taxation of services

(1) General rule - no sales tax on services

(a) Georgia law imposes sales tax only on enumerated services. O.C.G.A. § 48-8-1.

(b) Professional, insurance or personal service transactions which involve sales as inconsequential elements for which no separate charges are made are exempt from sales tax. O.C.G.A. § 48-8-3(22).

(c) Fees or charges for services by repairmen for which a separate charge is made (charge separate from the charge for property) are exempt from sales tax. O.C.G.A. § 48-8-3(23); GA. COMP. R. & REGS. r. 560-12-2-.88(3)(item repaired must be returned to the customer).

(2) Fabrication labor

(a) Sales tax is imposed on fabrication of tangible personal property for a consumer who directly or indirectly provide the materials used in the fabrication. O.C.G.A. § 48-8-2(33)(A)(i)(definition of "sale"). GA. COMP. R. & REGS. r. 560-12-2-.88(1).

(b) This means that a manufacturer cannot separately-state "labor" from "materials" when it sells a product. *See* O.C.G.A. § 48-8-2(34)(A)(ii)(definition of "sales price" includes the actual cost of tangible personal property without any deductions for, among other things, labor costs). *See also Colonial Pipeline v. Undercofler*, 115 Ga. App. 58, 153 S.E.2d 592 (where vendor provides services incidental to the sales of tangible property and makes no separate charge for such services, then the services are included in the "sales price" or "cost price" of the property).

b. Service providers may buy property for resale and for use in performing services.

(1) All property can be purchased tax-free.

(2) Must provide vendors with properly executed Certificate of Exemption (Form ST-5)

c. Service provider is the consumer where it does not separately charge for item.

(1) Including property that loses its identity when used and consumed, such as wood used by a home builder or remodeler.

(2) A service provider who buys the item tax-free and places the item into inventory held for resale may withdraw the item and use to perform a service, such as remodeling a kitchen.

(3) The service-provider is the consumer and must pay use tax on the "cost" price of the property that is withdrawn from inventory.

d. Repairmen

(1) Repairmen buy replacement parts, materials, supplies that are used/consumed in repairing tangible personal property.

(2) Example: a car mechanic

(3) Repairman can buy property tax-free.

(4) Repairman must collect sales tax from the owner of the tangible personal property repaired.

(a) Invoice does not separately-state: If the items used in repairing the owner's property are not separately-stated on the invoice, then sales tax applies to the total charge on the invoice (labor and parts).

(b) Invoice separately-states: If the items used in repairing the owner's property are separately-stated on the invoice, then the sales tax applies to the retail sales price of the parts only and not the labor.

e. Warranties

(1) Manufacturer's or retail dealer's warranty

(a) Items held for sale and removed from inventory to repair under terms of a warranty that was included in the original sales price of the item.

(b) Manufacturer or dealer is not subject to tax on the removal from inventory.

(c) The items, presumably repair parts, are deemed to have been part of the original sale price of the warranty.

(2) Optional or extended warranty or maintenance agreement

(a) That is not included in the original sales price of the item.

(b) Person performing the repair work (manufacturer or dealer) must pay use tax on "cost price" of item removed from resale inventory.

(c) Otherwise, the person performing the repair work must charge tax and collect from the purchaser on the invoice. Must be separately-stated from labor, or the labor is not exempt.

VI. CREDIT FOR TAXES PAID TO OTHER STATES

A. Georgia allows the taxpayer a credit for any taxes that have been paid to other states.

B. Conditions to getting the credit

1. Tax paid to the other state for which credit is sought in Georgia must have been a legally imposed tax in the other state. Thus, should the Department of Revenue believe that the taxpayer had no obligation to pay the tax to the other state, then the Department of Revenue may disallow reduction in Georgia tax.

2. Other state must provide for reciprocal credit. Thus, if the other state does not allow a credit for taxes paid to Georgia, then Georgia will not allow the credit, even if legally paid to the other state.

C. Policy Statement SUT 2011-05-26: *Reciprocal Use Tax Credit for Taxes Legally Paid to Other State or Local Jurisdictions*

1. Available at http://www.etax.dor.ga.gov/policystatements/stpage.aspx

2. Information in the policy statement

a. Rules for determining whether credit is available in Georgia for similar tax paid to another state or local jurisdiction.

b. Computing the credit

VII. FREIGHT AND DELIVERY CHARGES

Where tax is collected by the supplier, charges tied to "freight and delivery" may be subject to tax, even if separately stated on the seller's invoice. Thus, a contractor should be aware of the relevant rules for tax on transportation charges.

Generally, transportation services are not subject to sales tax, because charges for transporting goods are exempt from sales tax. *See* O.C.G.A. § 48-8-3(18). This rule becomes unclear where the transportation charges are tied to the sale of the materials – where the seller uses its own delivery truck or where the seller arranges for transportation of the materials with the common carrier. In such circumstances, the purchaser must turn to GA. COMP. R. & REGS. r. 560-12-2-.45, entitled "Freight, Delivery and Transportation." The moment of sale of the materials determines whether the transportation charges are subject to sales tax.

A. Sale Occurs Before Charge for Freight and Delivery - "F.O.B. Shipping Point" Basis

1. Transportation costs NOT subject to sales and use tax where ---
    a. purchaser assumes risk of ownership at seller's dock
    b. freight and delivery charges do NOT appear on invoice as a charge
2. Prepaid transportation costs
    a. ***ARE*** subject to sales tax where –
        - seller prepays the transportation charges
        - prepaid charges appear on invoice as an added charge or a separate charge is made therefore
    b. ***NOT*** subject to sales tax where -
        - seller secures transportation as purchaser's agent
        - but a satisfactory showing must be made that seller was acting as buyer's agent in getting the

transportation

Planning Tip: this can be accomplished by notations on the purchase order – "prepay and bill" *or* "ship best way"

3. Where invoice allows for credit for transportation charges paid by or to be paid by purchaser, tax computed on invoice charge ***after*** allowance of the credit.

4. "Use" tax is not imposed on any charges for "freight and delivery" where the transportation charges are paid to the carrier by the user, or by the seller as the user's *bona fide* agent. GA. COMP. R. & REGS. r. 560-12-2-.45(6).

B. Sale Occurs After Charge for Freight and Delivery "F.O.B. Destination Point" or "Delivered" Basis

1. Transportation costs are part of the sales price and are taxable.

2. Whether seller arranges for delivery or actually delivers himself, to purchaser's dock.

3. Even where seller bills the purchaser separately for the costs.

VIII. EQUIPMENT LEASING - WITH AND WITHOUT EQUIPMENT OPERATOR

Many construction contractors use heavy-duty equipment in performing their jobs. The contractor may lease the equipment from an equipment rental company. The equipment may or may not come with an operator. The existence of an operator impacts the tax consequences of the transaction. Also, the relationship of the parties may affect the taxation of the rental.

A. Equipment Only - No Operator

1. Lessee/contractor must pay sales tax on the lease price.

2. Definition of "sales price" includes the amount paid for personal property that is sold, leased or rented." *See* O.C.G.A. § 48-8-2(34)(A).

3. Lease or rental – any transfer of possession or control of tangible personal property for a fixed or indeterminate term; may include future options to purchase or extend. *See* O.C.G.A. § 48-8-2(17).

4. Tax base is the sales price. See O.C.G.A. § 48-8-30(d)(1); Note – the Department of Revenue will likely revise the applicable regulation, GA. COMP. R. & REGS. r. 560-12-1-.21 (Leases or Rentals), under which tax is imposed on the "gross rental lease or charge."

5. Long-term leases – where term of equipment lease is 10 or more years, the lessee can discharge its sales tax obligation by payment of 4% of the fair market value of the property at the beginning of the lease agreement; any renewals are subject to tax. O.C.G.A. § 48-8-30(d)(3).

6. Option to purchase – tax is imposed on the sales price at the time of the sale.

7. Leases outside Georgia – tax due on first use of property leased outside Georgia and brought into Georgia, subject to credit for taxes paid to other states, and tax is due on the sales price (rental) paid to out-of-state lessor. O.C.G.A. § 48-8-30(e.1)(1).

8. Even if later removed – tax due if property is delivered into Georgia, even if later removed to another state. O.C.G.A. § 48-8-30(e.1)(1).

9. Common Ownership - the lease or rental of property by an entity that acquires the property from another entity where both entities are under common ownership, is exempt from the tax, but only if sales and use tax was paid or credit given for taxes paid to another state. O.C.G.A. § 48-8-3(42).

B. Equipment and Operator – Exclusive Control Test

1. Contractor that provides both the equipment and an operator does not have to charge sales and use tax, as long as the contractor maintains *exclusive control* over the equipment.

2. The 2011 Revisions to the Sales Tax Act Excludes Lease or Rental with Operator

    a. "Lease or rental" does not include providing tangible personal property **with an operator** for fixed or indeterminate period of time. O.C.G.A. § 48-8-2(17)(C).

    b. Conditions

        (1) Operator is necessary for the equipment to perform as designed **AND**

        (2) Operator must do more than maintain, inspect, or install the tangible personal property.

3. Under O.C.G.A. § 48-8-63(d), if the machinery will not be under the contractor's exclusive control, then the contractor must collect sales and use tax on --

    - the rental value of the machinery ***or***

    - the entire contract price, if labor and other charges are not separately stated from the rental charge.

4. Exclusive control test – if the equipment operator refuses to operate the equipment, who gets the equipment operating again? If only the contractor can make the operator continue to work (as opposed to the recipient of the services, such as the homeowner or the prime contractor), then equipment is under the exclusive control of the contractor providing the service. *See Southeastern Maritime Co. v. Collins*, 258 Ga. 725, 374 S.E.2d 197 (1988).