Application of Sales and Use Tax Laws to Construction Contractors

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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(3). 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. Ga. Reg. 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-.11(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 contractor (or subcontractor) must ascertain 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. First, this paper defines "contractor" and "subcontractor" for Georgia sales and use tax purposes. Second, this paper explains the sales and use tax obligations of "contractors" and "subcontractors."

II. CONTRACTOR AND SUBCONTRACTOR DEFINED

A. Statutory and Regulatory Definition

The Georgia Sales and Use Tax Act (the "Sales Tax Act") does not define the term "contractor" or the term "subcontractor." Rather, the respective statute in the Act, which references "contractors" and "subcontractors" in its title, 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). 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). The Department's contractors regulation clarifies that a **contractor** is any person, partnership, LLP, corporation or LLC who, among other things,

> enters into a contract involving the premises or property as designated by said contract, to perform services and/or furnish materials for the construction, alteration, or improvement of any real property or project.

Ga. Reg. 560-12-2-.26(2)(a). The regulation also defines a **subcontractor** as,

> contracts with the prime or general contractor, to perform all or

> any part of the contract of the prime or general contractor or who shall contract with a subcontractor who has contracted to perform any part of the contract entered into by the prime or general contractor.

Ga. Reg. 560-12-2-.26(3).

Under the applicable case law, “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. *See Strickland v. W.E. Ross & Sons, Inc.*, 251 Ga. 324, 325, 304 S.E.2d 719, 720 (1983). 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.

B. Other Guidance

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.

The materialmen and mechanics’ lien statute, O.C.G.A. § 44-14-361, and the cases that interpret this statute, provide insight. Further, fixture law can be helpful in determining whether the services actually “improve” real estate. Clarity can also be drawn from the Florida Department of Revenue regulations.

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,

> [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 . . . have a special lien on the 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 DOR 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).

III. CONTRACTORS' SALES AND USE TAX 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. 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. Reg. 560-12-2-.26(1).

A contractor is not a "retailer", as that term is defined in the Georgia Revenue Code, at O.C.G.A. § 48-8-2(7). A contractor's purchases are retail sales, because the contractor uses the materials it buys to perform its contracts. *See* O.C.G.A. § 48-8-2(6)(A). 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. Reg. 560-12-2-.26(1).

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).

A. Contractors' Registration 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. Reg. 560-12-2-.26(4)(a). Sales tax returns shall be filed monthly, unless otherwise authorized, using Form ST-3. Ga. Reg. 560-12-2-.26(4)(b). The application for Certificate of Registration (Form CRF-002) can be obtained online, at www.etax.ga.gov. The sales and use tax return, Form ST-3, too, can be obtained online.

B. 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 contract, by identifying the subcontractor and providing the contract amount. The information must be provided as to every such subcontractor, within 30 days of the execution of the subcontract. Ga. Reg. 560-12-2-.26(5). The information/notice is provided on Form S&UT 214-1.

NOTE: This rule could be amended in light of the amendment to O.C.G.A. § 48-8-63, which removes the requirement for withholding on payments due to subcontractors.

C. Nonresident Subcontractors

Prior to July 2006, a property owner, developer or general contractor had to withhold and retain any payment to a subcontractor. The law ensured that subcontractors complied with use tax obligations.

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 limits the withholding obligation to payments to *nonresident* subcontractors who perform contracting jobs in Georgia.

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;
- 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 equal to or greater than $250,000.00

The prime contractor must withhold up to 4% 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). **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 where the nonresident subcontractor provides a certificate (issued by the Department) showing 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). Such notice is sent to the prime contractor by the Department, on Form S&U T 214-6. 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. Reg. 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.

<u>NOTE</u>: 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. <u>Department's Withholding Regulation</u>

The regulation addressing contractors has not been updated to impose the withholding requirement only as to payments due to <u>*nonresident*</u> subcontractors. Rather, the regulation simply requires a 2% withholding on payments to <u>*all*</u> subcontractors. Ga. Reg. 560-12-2-.26(6)(a). The Department enforces the 2% withholding requirement.

If the nonresident subcontractor is paid in installments, a withholding requirement is imposed on <u>each</u> 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. Reg. 560-12-2-.26(6)(c).

<u>NOTE</u>: Because of the statutory changes, this regulation may be revised.

4. <u>Nonresident Subcontractor Bonds</u>

Withholding is not required where the nonresident subcontractor has posted a surety bond with the Department. O.C.G.A. § 48-8-63(f). *See also* Ga. Reg. 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; <u>**and**</u>
- 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. Reg. 560-12-2-.26(7)(c), although, as noted above, the regulation applies to *all* subcontractors.

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

5. Nonresident Subcontractor Filing Obligations

Each nonresident subcontractor must file an Application for Authorization to Perform Contract, Form S&UT-348.1. *See* O.C.G.A. § 48-13-32; Ga. Reg. 560-12-2-.26(8). *See also* Ga. Reg. 560-12-2-.43. Copies of the nonresident contractor forms can be obtained online at www.etax.dor.ga.gov or from the Department's contractors unit, by dialing (404) 417-6734.

IV. CONTRACTORS' PURCHASES FROM VENDORS LOCATED OUTSIDE GEORGIA

Georgia's sales and use tax laws require "consumers" (end users) of tangible personal property to report and pay use tax on purchases from vendors (1) located outside Georgia (2) who do not collect Georgia sales and use tax at the time of the sale. O.C.G.A. § 48-8-30(c). In particular, the consumer purchaser (or end user) must report the purchase and remit the applicable state use tax (4%) and local county use tax (1% - 4%), which varies from county to county (City of Atlanta imposes an additional 1%).

The obligation to pay the "consumer use" tax is not new. Indeed, it is nothing more than the complement to the "sales" tax. Payment of the consumer use tax ensures that out-of-state purchases do not go untaxed. Payment of use tax also ensures that purchases of property (i) sold by out-of-state dealers (ii) but used in Georgia do not go untaxed.

The "use" tax protects in-state businesses from unfair pricing advantage. For example, where a Lee County, Georgia resident buys a fax machine or telephone over the internet, from a seller that has no Georgia sales tax collection obligations, the Lee County resident should pay the same tax that he would otherwise pay if he bought the same fax machine or telephone from a local office supply store in Leesburg, Georgia. Interestingly, the purchaser cannot assume no sales tax is due based upon the out-of-state vendor's statement, "we will not charge you the sales tax because we are shipping it to you." The Georgia resident must still report and remit the "use" tax.

A. Case Law Underlying Liability for Payment of Use Tax

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.

1. 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.

2. Incidence of Use Tax and the Tax Base

a. 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. O.C.G.A. § 48-8-30(c)(1)

b. 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.

c. 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 ***cost*** price of the property

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

d. 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).

3. Statutory definitions

a. 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(12).

- *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(10).

b. *purchased at retail* – purchased for any purpose other than for resale. O.C.G.A. § 48-8-2(6)(A).

c. *cost 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(2).

B. Local Taxes

The total <u>state</u> sales and use tax rate is 4%. O.C.G.A. § 48-8-30(c). Counties, too, impose sales and use taxes, commonly known as "local" taxes. Local taxes include the following:

- MARTA 1% tax [Ga. Reg. 560-12-4-01 through 560-12-4-10]
- 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(b)(2)]

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. Thus, 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%.

Additional local use taxes <u>are</u> imposed and must be accrued, where the tax rate in the county of purchase is *less than* the rate in county of use. Thus, 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) 7% rate 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.

For example, a Cobb County subcontractor that buys materials from an out-of-state vendor and has the materials delivered to its business in Smyrna, Cobb County, pays the applicable sales and use tax at the time of purchase. The Cobb County subcontractor must accrue and remit a 6% tax on the purchase. O.C.G.A. § 48-8-30(c)(1). Specifically, 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).

When 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, then the Cobb County subcontractor must accrue an additional 1% local tax. Which 1% local tax should be accrued and paid for the DeKalb County use?

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 Form ST-3, the local taxes appear in

the following order: Marta, Local, Other Local, Special, Educational and Homestead (MLOSEH). Thus, the subcontractor should accrue and pay the Marta 1% tax.

As noted above, 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(b)(provides for ceiling on local taxes).

To ease the burden of accruing use tax two separate times is to 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.

V. DUAL OPERATORS

A. What is a "Dual Operator"

1. Department of Revenue designation for a dealer in the 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. Two Types of Dealers to Which "Dual Operator" Status may apply

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

      - Retailer purchases 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. O.C.G.A. § 48-8-2(6)(definition of "retail sale") and O.C.G.A. § 48-8-2(12)(definition of "use").

      - Retailer then withdraws items for use in performing a contract.

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

   b. One 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. O.C.G.A. § 48-8-39(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).

      - 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.

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

B. Incidence of Tax

1. Retail Sales – the retailer collects sales tax on the "sales price" of the item

2. Property Withdrawn from Inventory – sales tax must be paid on the "fair market value" of the item.

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 at retail 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. Contractor manufactured, transported and installed the asphalt in performing road work and owned equipment to do the work

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

    d. Occasionally, the 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 contractor into a retailer, that the paving contractor was required to pay sales tax on its raw materials purchases. Thus, when use it himself rather than sell it in the ordinary course of a retail business.

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. Department’s Dual Operator Regulation

As of March 10, 2008, the Department of Revenue has circulated a proposed regulation addressing dual operators. The proposed new rule, Rule 560-12-1-.14, entitled “Withdrawals from Inventory” explains when “dual operator” status will apply. In proposing the new rule, the Department also proposes to repeal the current dual operator regulation – Rule 560-12-1-.17. The proposed regulation can be viewed at the Department’s web site. A list of proposed and recently adopted Department regulations can be viewed at: http://www.etax.dor.ga.gov/inctax/index.aspx. This link takes you to the Taxpayer Services Division page, which has three columns. The middle column is labeled “Find It Fast.” Scroll down to the bottom of this column for the link to “Regulations.”

VI. 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, as 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. Reg. 560-12-2-.45. 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 therefor
   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. Reg. 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

VII. EQUIPMENT LEASING - WITH AND WITHOUT EQUIPMENT OPERATOR

Many 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.

A. Equipment Only - No Operator

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

2. Definition of "sale" includes "leases and rentals." *See* O.C.G.A. § 48-8-2(8).

3. Lease or rental – leasing or renting of tangible personal property and the possession or use of the property by the lessee or renter for a consideration without the transfer of the title to the property. *See* O.C.G.A. § 48-8-2(5).

4. Tax base: gross lease or rental charge. *See* O.C.G.A. § 48-8-30(d)(1); Ga. Reg. 560-12-1-.21.

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 rental charge 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. 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.

3. 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).

VIII. 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. New 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 - Effective July 1, 2005

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 legislation, 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. Not applicable with respect to use of TPP owned by United States.