

A yellow hard hat sits on a desk next to a laptop. In the foreground, a hand holds a black pen, writing on a document that features a pie chart and a bar chart. The scene is lit with warm, golden light, suggesting a desk lamp or window light.

# Multistate Sales Tax Issues for Contractors: *Tax Exemptions*

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# MULTISTATE SALES TAX ISSUES FOR CONTRACTORS

## I. TAX EXEMPTIONS.

In addition to the general exemptions outlined below, states may have specific exemptions for certain kinds of materials or services. These exemptions can be based on such things as: the type of contractor, the type of construction contract, the type of materials or services to be performed, etc.

The taxation of contractors is based upon statutory or regulatory provisions that impose a tax on transactions involving tangible personal property and taxable services, however, lawmakers in the various states have generally granted certain exemptions from tax that may apply to transactions involving contractors.<sup>1</sup>

It is, therefore, important to understand the difference between a “taxing” provision and an “exemption” provision. Many jurisdictions apply rules of construction to assist in interpreting and applying applicable statutes. Under these rules of statutory construction, “taxing” provisions are to be interpreted and strictly construed in favor of a taxpayer and against the taxing authority, whereas, “exemption” provisions are strictly

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<sup>1</sup> This may not always be the case. Idaho, for instance, takes the position that the fact that a “customer” is exempt from paying sales tax, the exemption doesn’t carry over to the contractor, even if: the customer is a government entity exempt from the Idaho sales and use tax; the customer is in an industry that is exempt under Idaho law; the customer is granted “direct pay” authority by the Idaho Tax Commission; and the customer did not pay a sales or use tax on the purchase for any reason.



construed in favor of the taxing authority and against the taxpayer.<sup>2</sup> The rationale for these rules of statutory construction is that legislative bodies should only tax by clear and precise provisions, and not by vague and ambiguous provisions, so taxpayers will be able to clearly discern whether they are subject to a tax. On the other hand, exemptions are exceptions to taxing provisions, granted as a matter of legislative grace, and a taxpayer should be required to qualify under the clear terms of an exemption before escaping the application of a tax.

Contractors are advised to identify, consider and determine their qualification for the exemptions available in their respective jurisdictions. These exemptions often include:

A.     Sales for Resale. If contractors purchase materials, equipment, or other items that do not lose their character as tangible personal property and will be resold as tangible personal property, they may generally purchase those items tax-free as sales for resale just as other retailers do. For contractors, these items are often sold under a “time and materials contract.” In these instances, contractors generally need to obtain a sales tax license and provide a reseller’s certificate to vendors when purchasing such items.<sup>3</sup> Like other retailers, contractors are liable for use tax on any items that were purchased tax-free as a purchase for resale but which were later used or consumed by the contractor.

B.     Ingredient or Component Part. Another common exemption is provided for products that are purchased for resale in the regular course of business, either in their

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<sup>2</sup> *Utah Code Ann.* § 59-12-1417(2)(2019).

<sup>3</sup> Rule R865-19S-58(3), *Utah Admin. Code*.

original form or as an ingredient or component part of a manufactured or compounded product.<sup>4</sup>

C. Religious and Charitable Organizations. States deal with construction contracts for exempt entities in a variety of ways.<sup>5</sup> For example, in Florida, all sales of construction materials to be used in a construction contract for a tax-exempt entity (i.e. a religious entity, a charitable entity, or a hospital) are taxable to the contractor.<sup>6</sup> The entity's exempt status is not relevant, because the exemption granted to such organizations applies only to sales of tangible personal property to the organization, and not to the contractor. The contractor, not the exempt entity, is considered to be the final taxable consumer of the materials the contractor purchases to use in performing that contract. *Id.*

At the other end of the spectrum, Illinois exempts all purchases of construction materials that will be incorporated into the property exclusively owned by charitable, religious, or educational organizations, and other specific types of non-profit organizations.<sup>7</sup> Contractors can obtain an exemption certificate from the state department

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<sup>4</sup> *Utah Code Ann.* § 59-12-104(25)(2019).

<sup>5</sup> In Utah, sales of construction materials or fixtures made to a religious or charitable institution are exempt only if they are sold as tangible personal property (1) directly to the religious or charitable institution, or (2) on behalf of the institution, in which case, the materials must be clearly identified and segregated and installed or converted to real property that is owned by the religious or charitable institution. Rules R865-19S-58(2) and R865-19S-43, *Utah Admin. Code*.

<sup>6</sup> Fla. Admin. Code Ann. §12A-1.051(15).

<sup>7</sup> Ill. Admin. Code 86 § 130.2075(d).

of revenue for tax-free purchases of materials. However, purchases of tools and other materials that are consumed by the contractor and not incorporated into the real property of the exempt entity are still subject to tax. *Id.*

Some states require a specific and express contractual/agency relationship between the contractor and the exempt entity. Once an agency relationship is established, the contractor may use either the exempt entity's exemption certificate or a project exemption certificate to purchase materials tax free. Strict compliance with the requirements to establish an agency relationship is often critical before taxing agencies will allow contractors to purchase materials tax-free on behalf of exempt entities relying on the exemption of the entity. Contractors are advised to review the requirements in each jurisdiction for establishing an agency relationship.

D. Governmental Entities. In states where state and federal government entities are exempt from paying state and local sales and use taxes, that exemption often only exempts purchases made by government contractors where the materials purchased will be incorporated into property that is owned by the governmental entity.<sup>8</sup> On occasion, governmental exemptions are express and available to any contractor involved

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<sup>8</sup> In Utah, sales to the state, its institutions, and its political subdivisions are generally exempt, however, with respect to “construction materials,” such materials are only exempt if: (1) the construction materials are purchased by or on behalf of “institutions of the public education system” and are clearly identified and segregated and installed or converted to real property owned by the institutions. With respect to the state, its institutions, or its political subdivisions, the exemption also only applies if the materials are installed or converted to real property by employees of the state, its institutions or political subdivisions. *Utah Code Ann.* § 59-12-104(2)(a)(2019).

in a construction contract with a governmental entity.<sup>9</sup> Where the governmental exemption is express, the contractor should apply to the state revenue department for an exemption certificate which will permit tax-free purchases of materials to be used in a project owned by an exempt governmental entity. *Id.*

Exemptions for government contractors, however, are not universally broad. Some states impose sales tax on purchased materials that will be incorporated into real property regardless who owns the property even where the governmental entities themselves are exempt from tax.<sup>10</sup> In these instances, materials may still be purchased tax-free if: 1) the government entity directly purchases the materials, or 2) state law allows the contractor to act as agent for the government entity. For an agency relationship to exist, state law usually requires at least the following:

1. the agency appointment was made before the purchase of materials;
2. the contractor acting as purchasing agent has the authority to bind the exempt entity contractually for the purchase of tangible personal property necessary to carry out the entity's contractual obligations;
3. title to all materials and supplies bought pursuant to the appointment immediately vest in the exempt entity at the point of delivery; and
4. the contractor acting as purchasing agent is required to notify all vendors and suppliers of the agency relationship and make it clear to those vendors and suppliers that the exempt entity is obligated to make payment, not the contractor-agent.

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<sup>9</sup> See e.g. Colo. Rev. Stat. § 39-26-708; *Conn. Agencies Regs.* § 12-426-18(c).

<sup>10</sup> See e.g. Ala. Admin. Code § 810-6-3-.77.

California does not provide an exemption for materials and fixtures purchased by U.S. government contractors even if an agency relationship exists,<sup>11</sup> but the contractor is considered to be the retailer of machinery and equipment if the property passes to the United States before the contractor makes any use of it.<sup>12</sup>

Each state may have special exemption provisions dealing with specific government or other entities.<sup>13</sup>

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<sup>11</sup> *Cal. Rev. & Tax Code* §§ 6006, 6201-6202.

<sup>12</sup> In California, U.S. construction contractors are the consumers of materials and fixtures furnished and installed in the performance of construction contracts with the U.S. government. Either the sales tax or the use tax applies to sales to U.S. construction contractors, or the use by the contractors. U.S. construction contractors are retailers of machinery and equipment furnished in the performance of a construction contract with the U.S. government. Sales to the U.S. government are generally exempt from tax. Tax does not apply to sales of machinery and equipment to U.S. contractors or subcontractors, provided title to the property passes to the U.S. government before the contractor makes any use of it. A title-passing clause must be included in the contract for this provision to apply.

<sup>13</sup> For instance, in Utah there are special rules governing construction contracts of “public transit districts” (*Utah Code Ann.* § 59-12-104(65)(2019), certain airport construction (*Utah Code Ann.* § 59-12-104(66)(2019); “senior citizen centers” (*Utah Code Ann.* § 59-12-104(2019); and construction of a new or expanding life science research development facility (*Utah Code Ann.* § 59-12-104(73)(2019);



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