

## **Sales and Use Tax Compliance Industrial Development Agency Projects**

Outlined below is a brief overview of how contractors are generally required to comply with New York State sales and use tax reporting and following is a summary of the compliance procedures when various IDA incented exemptions and waivers are granted.

### **I. Non-IDA Incented Projects**

A general building contractor or down-stream sub-contractor is required to pay New York State Sales and Use Taxes (sales tax) on all materials, supplies and other tangible property that are purchased and used directly in the construction of a building project. The construction project can be either a turnkey shovel to open front door completed project, or a major renovation capital improvement project. Labor for the project is exempt from sales tax.

The contractor will invoice the customer for a lump sum contract amount and the contractor will not bill or itemize sales tax on the invoice or collect any sales tax from the customer. The sales tax is passed on to the customer as part of the contractor's cost of doing business. The sales tax is essentially added to the cost of materials and supplies used in the project. It is often assumed that no sales taxes are charged or are applicable to large contracts or capital improvements.

There are limited situations in which a contractor or sub-contractor may purchase materials, supplies and tangible personal property without paying sales tax. These purchases are covered by specific statutory exemptions. For example, materials and supplies used in governmental projects, not-for-profit institutional projects and certain farming operations may be exempt from sales taxes when purchased by a contractor. Also, tangible personal property used in manufacturing is generally exempt from sales taxes. In order to purchase the above items exempt from tax, a contractor who is registered with the New York State Department of Taxation and Finance, (DTF), can issue a "Contractor Exempt Purchase Certificate", Form ST-120.1, to a vendor in order to allow the vendor not to charge sales tax on the purchase.

### **II. Incented IDA Projects**

As discussed above, generally all construction projects are subject to the imposition of sales and use taxes on the materials and supplies included in the project. Generally, an Industrial Development Agency, (IDA), is authorized to enter into agreements with its clients or project owners to provide sales tax waivers as an incentive for a client or project owner to locate a business operation in its jurisdiction. The sales tax exemption agreement is acknowledged by DTF as a qualifying exemption when items are being purchased for the project.

In this scenario, a general contractor or sub-contractor will use this exemption agreement to purchase materials, supplies and tangible property for the project. The contractor will attach a copy of the exemption agreement to the Form ST-120.1 (discussed above) and will present it to a vendor to substantiate the exempt purchase. Also, the client or project owner will be able to use the exemption agreement when purchasing tangible personal property used in the project such as office furniture, fixtures and computer equipment.

The IDA exemption agreement will usually define the parameters of the sales tax waiver. The exemption can be for an entire project, for a fixed dollar amount or for purchases made during a definitive time period. For example, the IDA could allow that purchases made for furniture and equipment in the first six months from the date the project is completed could be exempt from tax.

Illustration:

Facts and Assumptions:

XYZ Company, the client or project owner, is granted a sales tax exemption by the IDA for the construction of a manufacturing plant and adjoining commercial office building. The IDA has agreed to grant a sales tax exemption for the construction of the entire manufacturing plant but only a flat \$200,000 sales tax exemption for the office building.

Project Costs:		Potential sales tax @ (8%)
Materials and Supplies – Factory building	\$ 3.5 MM	\$ 280,000
Labor	1.5 MM	-0-
Manufacturing Equipment	2.0 MM	-0-
Computer Equipment -Office	<u>1.0 MM</u>	<u>80,000</u>
Total	\$ 8.0 MM	\$ 360,000
Project Costs:		Potential sales tax @ (8%)
Materials and Supplies – Office building	\$ 5.5 MM	\$ 440,000
Labor	<u>1.5 MM</u>	<u>-0-</u>
Total	\$ 7.0 MM	\$ 440,000
Total project cost	\$15.0 MM	\$ 800,000

In this project, the client or project owner would have a total sales tax exemption of \$560,000. The exemption on the factory would be for the full \$360,000. The labor is exempt and the manufacturing equipment is already exempt from sales tax because of the general sales tax exemption for equipment used in manufacturing. The building project would only allow for a \$200,000 exemption as stated in the agreement and the labor is exempt.

There are also provisions in the sales tax laws that will allow the contractor or the project owner to obtain refunds for sales taxes paid in error or paid before an exemption agreement was granted for the project.

### III. Repairs and Maintenance v. Capital Improvements

In items I and II above, the discussion was based upon the fact that the project was a capital improvement. A capital improvement has the following characteristics:

- It substantially adds to the value of the property and prolongs the useful life of the property.
- It becomes an integral and permanent part of the property and removal of the component would cause material damage to the property.
- It is intended to become a permanent installation.

If the expenditures have the above characteristics, then the sales tax compliance would be treated as discussed as above.

Repairs and maintenance are expenditures that keep real property and equipment in the condition for which they were originally designed. These expenditures and also expenditures for installation of equipment and property are generally subject to sales tax for both the materials and labor itemized on the vendor invoice. However, the IDA could possibly provide exemption agreements for these types of expenditures as well.

In summary, the general sales tax statutes and laws are consistently applied to all construction projects and repair, maintenance and installation services. The difference is that for IDA incented projects, the contractor or project owner must be able identify which items are non-taxable as provided for in an IDA exemption agreement and then provide DTF with the properly completed exemption certificates and documentation required to support the exemption.