

Ohio Tax

26th Annual

OhioTax

C O N F E R E N C E

Tuesday & Wednesday, January 24-25, 2017

Hyatt Regency Columbus, Columbus, Ohio

Workshop Z

Construction ... Sales &
Use Tax Implications in
OH, PA & WV

Tuesday, January 24, 2017

4:15 p.m. to 5:15 p.m.

Biographical Information

**Timothy D. Adams, Shareholder State and Local Tax
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Tim has more than 20 years of experience in public accounting, including more than 10 years with a national accounting firm.

His focus is in state and local tax matters, including multi-state income and franchise tax, sales and use tax, gross receipts tax, incentives/credits and unclaimed property.

Tim has successfully represented or assisted clients in state and local tax matters in nearly every state across the country, including audit representation and appeals, refund reviews, and multi-state consulting and planning that have yielded significant value to his clients.

- Executive Committee Member – PICPA Pittsburgh Chapter
- Member - PICPA State Tax Committee
- The Ohio Society of CPAs - Ohio Tax Reform Task Force
- Past Chair – Western Pennsylvania Tax Conference Committee
- Member – American and Pennsylvania Institutes of Certified Public Accountants
- Board Member – National Aviary
- Past President – Economic Club of Pittsburgh

Tim is a graduate of Grove City College with a B.S. in Accounting.

**Emery (Jack) Stewart, Senior Manager State and Local Tax
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Jack began his sales and use tax career with Chartwell Advisory Group in 1998 specializing in sales and use tax refund reviews for construction projects with exempt entities in Pennsylvania.

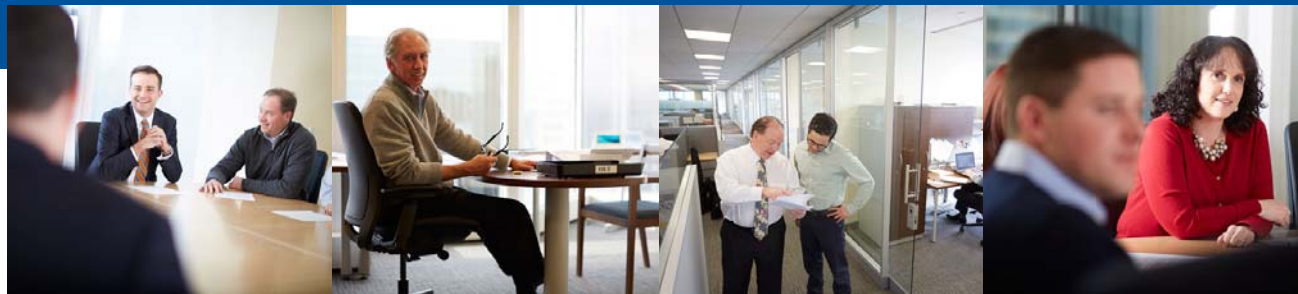
In 2001 Jack joined the state and local tax practice of PricewaterhouseCoopers in Pittsburgh, where he specialized in sales and use taxes providing services such as refund reviews, audit defense, taxability matrixes, managed audits, managed compliance agreements, and various tax appeals before various state agencies.

Jack joined the state and local tax practice of Schneider Downs and Co., Inc. in Pittsburgh, Pennsylvania in 2005. Jack continues to specialize in sales and use tax matters for a wide range of industries including construction, manufacturing, gas and oil as well as transportation.

Jack is a graduate of Rollins College with a B.A. in History and received a Post Baccalaureate in Accounting from Robert Morris University in Pittsburgh, Pennsylvania.



Construction and Sales and Use Tax Issues in OH, PA & WV



Ohio Tax Conference Tuesday, January 24, 2017

Big Thinking. Personal Focus.

Objectives

- Compare and contrast basic sales and use tax rules and how they apply in Ohio, Pennsylvania and West Virginia.
- Be aware of potential opportunities and pitfalls when crossing state lines to perform contracting services.



Current Environment



- Contractors crossing state lines performing various services.
- While there are some basic commonalities there are also significant differences between the states.
- When should contractors pay sales and use tax on their purchases?
- When should contractors charge sales and use tax to their customers?

Agenda



- Contractor Services – construction contracts and other services.
- Contractor Purchases – materials and machinery & equipment.
- Construction Contracts with Exempt Entities.
- Construction Contracts with Manufacturers, Public Utilities and Mining (Oil & Gas) Companies.

Construction Contracts - Ohio

- Rule 5703-9-14 Ohio defines a “construction contract” as “any agreement, written or oral pursuant to which tangible personal property is or is to be transferred and incorporated into real property, as defined in section 5701.02 of the Revised Code, so as to become a part thereof without regard to whether it is new construction or an addition to or alteration of an existing building or structure.” A “construction contractor” is any person who performs such an agreement, whether as a prime contractor or subcontractor.



Construction Contracts - Pennsylvania



- 61 Pa Code § 31.11 Pennsylvania defines construction activities as “any activity resulting from an agreement or contract under which a contractor attaches or affixes tangible personal property to real estate so as to become a permanent part thereof. Construction activities also includes the service of repairing real estate even though tangible personal property is not transferred by the contractor in conjunction with the repairs which he makes.”*

Construction Contracts - Pennsylvania

- In the absence of satisfactory evidence to the contrary, the following items are presumed to become part of the real estate:
 - Air, chiller
 - Air conditioning systems, central including filters, diffusers, grilles, registers
 - Air handler
 - Alarm systems (smoke, fire, burglar, security)
 - Asphalt
 - Awnings (other than cloth)



Construction Contracts – West Virginia



- WV Sec. 11-15-2(b)(3)(A) *“Contracting” means and includes the furnishing of work, for another (by a sole contractor, general contractor, prime contractor, subcontractor or construction manager) in fulfillment of a contract for the construction, alteration, repair, decoration or improvement of a new or existing building or structure, or any part thereof, or for removal or demolition of a building or structure, or any part thereof, or for the alteration, improvement or development of real property. Contracting also includes services provided by a construction manager so long as the project for which the construction manager provides services results in a capital improvement to a building or structure or to real property.”*

Other Services - Ohio



- Selling and installing tangible personal property that keeps its identity as tangible personal property upon installation.
- Sale and installation of the following are not construction contracts:
 - Carpeting, including carpet padding, tack strips, adhesive and similar materials that are integral and necessary components of a carpet installation.
 - Agricultural land tile as defined in division (b)(5)(a) of section 5739.01 of the Revised Code;
 - Portable grain bins as defined in division (B)(5)(b) of section 5739.01 of the Revised Code; and
 - Trees, shrubs, sod, seed, fertilizer mulch, and other tangible personal property transferred as part of landscaping and lawn care service as defined in division (DD) of Section 5739.01 of the Revised Code. Rule 5703-9-14 (c).

Other Services - Ohio



- Business Fixture – Tangible personal property that is permanently affixed to realty, but primarily benefits the business conducted on the premises. Business fixtures keep their identity as tangible personal property upon installation and are treated as a sale and installation of tangible personal property. Rule 5703-9-14 (B).
- Business fixture determinations and the sales/use tax implication are a controversial issue in Ohio. The Ohio 2020 Tax Policy Study Commission is recommending a review of the law saying that “Clarification is needed as to clearly delineate the difference between realty and business fixtures, especially since the last revision to ODT’s amended bulletin No. 290 to county auditors occurred on December 18, 2007.”

Other Services - Ohio



- Tangible personal property that is temporarily affixed during construction, such as temporary electricity or water service hook-ups, fencing, construction elevators, shoring lumber and concrete forms, is not incorporated into real property for sales and use tax purposes even if these items remain affixed after construction due to inadvertence, convenience or economic necessity.
- The transfer and affixation of personal property where title to the property does not transfer to the owner or lessee of the premises is a sale and not a construction contract. Since title does not transfer it is inferred that the personal property is not intended to be permanent. Rule 5703-9-14(B)

Other Services - Pennsylvania

61 Pa Code § 31.11

Sales Activities – Any activity resulting from an agreement or contract under which a contractor transfers tangible personal property so as not to become a permanent part of the real estate. In the absence of satisfactory evidence of the contrary, the following items are presumed not to become a permanent part of real estate:

- Air conditioner, window including filters
- Amplifiers
- Antenna, television
- Appliances (not built-in)
- Auditorium type seating
- Awnings (cloth)



Other Services – West Virginia



- Sales and installation of tangible personal property that keeps its identity as tangible personal property upon installation.
- Those services which do not result in a capital improvement.
- Capital improvement is any addition or alteration to real property which meets all three of the following requirements.
 - It substantially adds to the value of real property or appreciably prolongs the useful life of real property; and
 - It becomes part of the real property or is permanently affixed to the real property so that removal would cause material damage to the property or the article itself; and
 - It is intended to become a permanent installation or to remain there for an indefinite period of time. (WVSTD Publication TSD-310).

Other Services – West Virginia



- “Contracting” does not include the sale and installation of wall to wall carpeting, or the sale, hook-up and connection of mobile homes, window air conditioning units, dishwashers and other household appliances, drapery rods, window shades venetian blinds, canvas awnings, free standing industrial or commercial equipment and other similar items.

Construction - Taxability of Services



- Contractors do not charge their customers sales tax on construction contracts in Ohio and Pennsylvania. In West Virginia, contractors are not to charge sales tax on construction contracts that result in a capital improvement.
- Contractors do charge sales tax on both materials and labor on other contractor services in Ohio and Pennsylvania that are not classified as construction contracts or construction activities unless an exemption or exclusion applies.
- In West Virginia, services are generally subject to tax including contractor services which do not result in a capital improvement.

Construction - Taxability of Services



- The purchase of materials by a contractor to fulfill a construction contract or contracting services that result in a capital improvement are subject to sales/use tax unless an exemption or exclusion applies.
- While contractors do not charge their customer sales tax on construction contracts and contracting services that result in a capital improvement, they are permitted to recover the tax by including it in the cost of materials (bid process).
- Contractors may purchase materials exempt from tax, as a sale for resale, that they transfer to their customer in the performance of services that are not construction contracts or capital improvements and on which they will charge their customer sales tax.

Construction – Taxability of Purchases



- Contractors must pay sales or use tax on purchases, leases and rentals of machinery, equipment and tools that do not transfer to their customers in the performance of their contracts regardless of the type of contract, unless some exemption or exclusion applies.
- There may be some exemptions available related to rentals and leases of machinery and equipment that are used exclusively in a specially designated geographic area or industry project.

Construction - Example

- A customer requires the repair of a furnace
 - Ohio - construction service not subject to tax
 - Pennsylvania - construction activity not subject to tax
 - West Virginia - repair of tangible personal property subject to tax



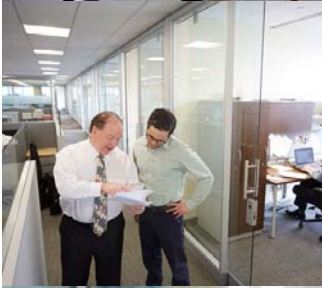
Ohio - Construction Contracts with Exempt Entities



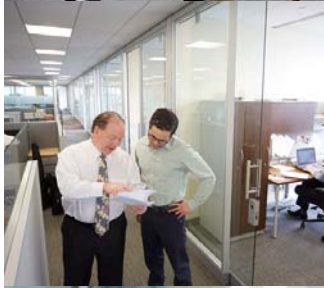
- Construction contractors may purchase exempt from tax materials and services that will be incorporated:
 - (a) Into real property under a construction contract with the United States government or its agencies, the state of Ohio, or an Ohio political subdivision;
 - (b) Into real property that is owned, or will be accepted for ownership at the time of completion, by the United States government or its agencies, the state of Ohio, or an Ohio political subdivision;
 - (c) Into a house of worship or religious education or a building used exclusively for charitable purposes by a nonprofit organization operated exclusively for charitable purposes as defined in division (B)(12) of section 5739.02 of the Revised Code;

Ohio - Construction Contracts with Exempt Entities

- (d) Into the original construction of a sports facility under section 307.696 of the Revised Code;
 - (e) Into real property in another state, if the materials or services, when sold to a construction contractor in that state for incorporation into real property in that state, would be exempt from tax;
 - (f) Into horticulture structure or livestock structure as defined as section 5739.01 of the Revised Code for a person engaged in the business of horticulture or producing livestock; or
 - (g) Into a hospital facility entitled to exemption under section 140.08 of the Revised Code.
- Rule 5703-9-14 (D)

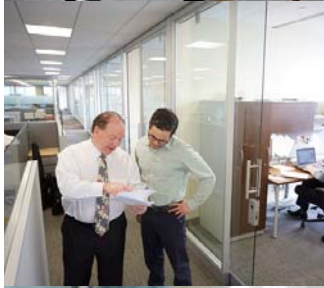


Ohio Construction Contracts with Exempt Entities



- Contractors exercising an “Exempt Entity” exemption need to retain a properly completed *Sales and Use Tax Construction Contract Exemption Certificate (Form STEC CC)* with the proper sections completed signed and dated.
- When exercising the exemption the contractee shall be deemed the consumer of all materials and services purchased under the claim of exemption and liable for the tax on incorporated materials or services in the event the tax commissioner ascertains that the contractee was not entitled to the exemption. Rule 5703-9-14(D)(2)
- Contractors may issue a *Sales and Use Tax Contractor’s Exemption Certificate (Form STEC CO)* with the appropriate sections completed, signed and dated.

Pennsylvania - Construction Contracts with Exempt Entities



- An exempt organization is defined as an organization which has a current valid exemption number issued by the Department for a charitable, volunteer fireman’s or religious organization or a nonprofit educational institution. Pa Code § 32.1.
- Exempt entities also include government entities such as the United States government, the Commonwealth of Pennsylvania and its political subdivisions.
- The only exemption available to contractors who enter into a construction contract with an exempt entity is “Building Machinery & Equipment” (“BM&E”).
- The exempt entity’s exemption does not transfer to the contractor.

Pennsylvania - Construction Contracts with Exempt Entities



- Exemption is limited to those purchases that fall within the category of “Building Machinery and Equipment” (“BM&E”).
- “Building Machinery and Equipment” consist of generation equipment, storage equipment, conditioning equipment, distribution equipment, termination equipment, which shall be limited to the following:

Pennsylvania - Construction Contracts with Exempt Entities



(BM&E Continued)

- (1) Air conditioning limited to heating, cooling, purification, humidification, dehumidification, and ventilation;
- (2) Electrical, but not wire, conduit, receptacles and junction boxes;
- (3) Plumbing, but not pipes, fittings, pipe supports and hangers and underground supports;
- (4) Communications limited to voice, video, data, sound, master clock and noise abatement;

Pennsylvania - Construction Contracts with Exempt Entities

(BM&E Continued)

- (5) Alarms limited to fire, security and detection;
- (6) Control systems limited to energy management, traffic and parking lot and building access;
- (7) Medical system limited to diagnosis and treatment equipment, medical gas, nurse call and doctor paging;
- (8) Laboratory system;
- (9) Cathodic protection system; or
- (10) Furniture, cabinetry and kitchen equipment.



Pennsylvania - Construction Contracts with Exempt Entities



- The Pennsylvania Department of Revenue has a published matrix of contractor's purchases and their taxability under BM&E.
- The matrix is not all inclusive, but covers many common contractor purchase.
- The guidance is for reference purposes only and is not binding on the taxpayer or the Department.

Pennsylvania - Construction Contracts with Exempt Entities

- In exercising the BM&E exemption contractors use Form REV-1220 and include the following statement on line 7:
 - “Property or services qualify as building machinery and equipment and will be transferred pursuant to a construction contract to (name of exempt entity).”



West Virginia - Construction Contracts with Exempt Entities



- West Virginia does not provide a general exemption for contractors making purchases under contracts with exempt entities.
- While certain exempt entities can make exempt purchases of building materials, that exemption is not transferable to a contractor performing contractor services that result in a capital improvement.

Ohio – Manufacturers, Public Utilities and Mining



- **Manufacturing** - manufacturing machinery and equipment eligible for exemption.
- **Public Utility** - property or service directly used in the rendition of a public utility service eligible for exemption.
- **Mining** - purchases consumed directly in the production of tangible personal property for sale by mining eligible for exemption.

Ohio – Manufacturers, Public Utilities and Mining



- The term "used directly in the rendition of a public utility service" means property that is to be incorporated into, and will become a part of, the consumer's production, transmission, transportation, or distribution system and that retains its classification as tangible personal property after such incorporation.

Ohio – Manufacturers, Public Utilities and Mining

- Mining exemption includes machinery, equipment and other property that is used or consumed in a mine or excavation of a mineral from the earth. It also includes property used to transport the extracted substance and extends to aggregate and other material used to build a temporary road to transport extracted substance from a mine to a plant.



Ohio – Documentation of Exemption



- Contractor obtain an exemption certificate (STEC B or STEC U) from the manufacturer, public utility or mining company.
- Contractor may request that the contractee certify what portions of the contract will be classified as personal property and which portions will be classified as real property. This must be stated in all relevant written contracts.
- Fixtures that are installed whose primary purpose is to benefit the business retain identity as tangible personal property.

Ohio - Example



- Contract engaged to perform construction or renovation of a restaurant including the kitchen.
- Items classified as “business fixtures” are treated as a sale and installation of tangible personal property (contractor charges sales tax on materials and labor)
 - Signs
 - Shelving

Ohio - Example



- Items eligible for manufacturing exemption the contractor purchases exempt from tax and does not charge tax to the customer.
 - Ovens
 - Fryers
- Items common to all buildings the contractor pays tax at time of acquisition but does not invoice the customer tax.
 - HVAC Systems
 - Plumbing

Pennsylvania - Manufacturers, Public Utilities and Mining



- **Manufacturing** - machinery and equipment and parts thereof predominately and directly used in manufacturing operations eligible for exemption.
- **Public Utility** - tangible personal property and taxable services that are directly used in providing public utility services eligible for exemption.
- **Mining** - tangible personal property and taxable services predominantly and directly used in mining operations eligible for exemption.



Pennsylvania - Manufacturers, Public Utilities and Mining

- *R.G. Johnson* – PA Supreme Court, It's not the identity of the person doing the work but the nature of the work that controls the exemption (case involved mining).
- Exemption limited to extraction and production activities and does not apply to site preparation and pre-production.
- Mining exemption applies to the extraction of natural resources from stockpiles. Thus equipment used for withdrawing natural resources from a storage facility may be exempt.

Pennsylvania – Documentation of Exemption

- Contractor obtains exemption certificate from the customer.
- Contractors exercising the exemption utilize Form REV-1220 Pennsylvania Exemption Certificate and complete line 1 for manufacturing or mining and line 5 for a public utility.



Pennsylvania – Documentation of Exemption

- Contractor issues a sale for resale exemption to their vendor. Contractor's exemption certificate should also include a certification listing the items to be purchased under the (manufacturing, public utility or mining) exemption with a statement that, upon installation, the items will be directly used in the exempt operations. The manufacturer/public utility/mining company should sign the certification.



Pennsylvania - Example



- Contractor is engaged to build a well pad for an oil and gas company in Pennsylvania.
- Well pad is constructed in accordance with relevant law.
- Contractor may purchase materials such as sand, stone and gravel exempt from tax.
- Equipment used to construct pad is still subject to tax.

West Virginia - Manufacturers, Public Utilities and Mining



- **Manufacturing** - materials, services, machinery, or supplies that will be directly used or consumed in the construction, alteration, improvement or repair of a new or existing structure or building eligible for exemption.
- **Public utility** - materials, services, machinery, or supplies that will be directly used or consumed in the construction, alteration, improvement or repair of a new or existing structure or building in the provision or operation of a public utility service; the transmission of electricity or liquid natural gas by wires or pipes; and the production, generation, sale or electric power eligible for exemption.

West Virginia - Manufacturers, Public Utilities and Mining



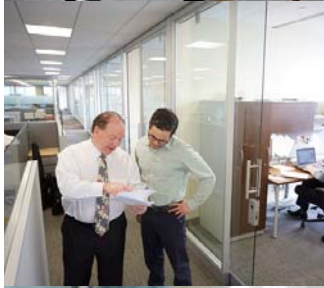
- Mining - materials, services, machinery, or supplies that will be directly used or consumed in the construction, alteration, improvement or repair of a new or existing structure or building in a business of natural resource production eligible for exemption.

West Virginia - Manufacturers, Public Utilities and Mining



- The tangible personal property must remain on the construction site after the project is complete.
- The rental of equipment to be used on the site as well as services that involve equipment with an operator are also eligible for the exemption.
- Exemption does not apply to gasoline or special fuels.

West Virginia – Documentation of Exemption



- Exemption available to contractor with regard to manufacturers, public utilities and miners is generally a refundable exemption. The contractor pays tax to its vendor then files a claim for refund with West Virginia State Tax Department.
- If the manufacturer has a direct pay permit the contractor may use *Special Contractors Exempt Purchases Certificate* (CST-286).

West Virginia - Example



- Contractor is engaged to build a pipeline to carry natural gas from public utility to consumers in West Virginia.
- Contractor may purchase materials such as pipe and related components exempt from tax.
- Rental equipment used in installing pipe is also eligible for exemption.

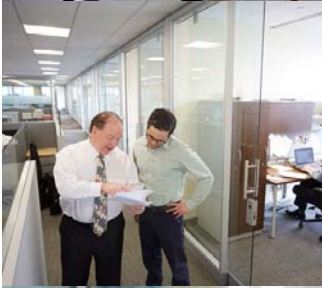
Best Practices and Observations

- Do not rely exclusively on your contractor's or vendor's taxability determination.
- Exposure
- Refund Opportunities



Best Practices and Observations

- Example
 - Permanent signage in Pennsylvania
 - Vendors typically charge tax
 - Board of Appeals consistently denies relief
 - Board of Finance and Revenue consistently grants relief



Best Practices and Observations

- WV Refund Claims for Capital Improvements
 - Filing a sales tax refund claim on the basis that the transaction was a “capital improvement” may subject your contractor or vendor to review by the Tax Department



Best Practices and Observations

- Selling to Contractors
 - Familiarize yourself with the rules and exemptions applicable to your customers.
 - Understand each state's requirements for exemption certificates, including good faith.
 - Review exemption certificates for basis and use claimed by customers.



Closing Thoughts

- Rules vary by state
- While there may be common themes between the states there are also some significant differences.
- Beware of exceptions to the general rule.
- Please note that information in this presentation is of a general nature for discussion purposes only. Please consult with your state an local tax professional regarding the taxability of specific transactions.



Questions



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