

Building Construction

What contractors should know about sales and use taxes

Contractors who work on buildings and other construction projects face a confusing array of sales and use tax rules, which vary from state to state.

Even if you become familiar with the rules in the state where you do most of your construction work, performing a contract in another state may subject you to a set of rules different from those familiar to you. Moreover, how you are taxed in a particular state often depends on the role you play in the construction contract.

Construction contractors need to be familiar with the sales and use tax laws in their home state, the state in which they purchase supplies and materials and the state in which they perform the construction project.

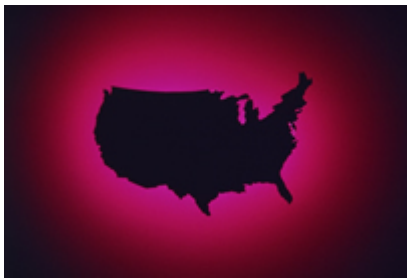
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This article focuses on sales and use tax, rather than income tax. Technically, a use tax is imposed on the consumer of taxable products or services, while a sales tax is imposed on the seller or provider of those products or services.

In most cases, a sales tax is passed through to the consumer. This article uses the term “sales and use tax” to describe both types of taxes.

Building or improving real property

In most states, a contractor who performs real property improvements is deemed to be a consumer of the supplies and materials incorporated into the project. As such, you are required to pay tax when you purchase the materials and supplies.



Paying tax at the time of purchase may actually be advantageous, because the state will generally not charge sales or use tax again at the completion of the project. So any markup you charge to your customer on the materials, supplies and labor will not be subject to sales and use tax.

A minority of states treat contractors like retailers. They let you buy materials and supplies for a job tax-free, provided you show the vendor a valid resale certificate. However, when you finish the job, the state will levy the sales and use tax on the gross price of the new construction. You may add this amount to your customer’s bill, but you are required to remit the taxes to the state.

Selling personal property as part of the contract

If you sell furniture or appliances, for example, as part of a remodeling or construction project, most states will treat you as a retailer of those items. Assuming you provide a valid resale certificate, you can purchase these items tax-free and collect the tax from your customer, based on the price you charge to the customer.

Repair contracts

Your sales and use tax treatment generally follows the treatment of the item being repaired. If the item is real property, you are generally deemed to be the consumer of the materials and supplies. If you are repairing an item of personal property, you are generally deemed to be a reseller of the items used in the repair process.

Off-site manufacturing

Occasionally, a contractor may assemble components at one location and incorporate them into its construction projects. The treatment of contractor-manufacturers is far from uniform among the states. Determining whether a particular state treats the contractor as a manufacturer or a reseller requires a careful review of each state's sales and use tax rules.

Prime contractor vs. subcontractor

Being the prime contractor means that you have the contract with the customer. As a subcontractor, your "customer" is the prime contractor. In either case, state laws will determine whether you are treated as the consumer of the materials and supplies or as a reseller.

If you are a subcontractor who is treated as a reseller, be sure to check out the state law requirements should the prime contractor fail to pay the tax. You may be responsible if the prime contractor goes bankrupt or otherwise does not fulfill its tax obligation.

Tax-exempt customers

If you have a customer that is exempt from sales and use tax, such as a charity or nonprofit civic organization, you may want to have your customer purchase the construction materials.

In some states, exempt organizations are allowed to buy materials and supplies for a construction project tax-free. Most states do not allow contractors to use a customer's exemption unless the contractor is the authorized agent of the exempt organization. Be sure to follow the local rules.

Out-of-state construction

Some states provide an exemption for purchases of materials and supplies that will be used for an out-of-state construction job. Even though you may avoid paying tax in your home state, you may still be liable for sales and use tax in the state where the construction project is being done.

Our tax professionals can assist you in complying with your sales and use tax obligations.

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