

CORRIDOR

Contractors deal with confusing sales tax laws

By Pat Shaver

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State sales tax laws are especially confusing for those in the construction business.

Tom Kunz, CPA and tax partner with Bergan Paulsen, which has offices in Waterloo, Cedar Rapids, Cedar Falls and Coralville, often sees contractors who inadvertently overpay sales taxes. Mr. Kunz specializes in construction and real estate.

"In general, sales tax is paid by the ultimate consumer of the product or service; under Iowa law construction contractors are treated as consumers," he said. "Because of that, they generally pay sales tax when they purchase materials to be used in construction. When a contractor provides new construction services, they are not to charge sales tax to the owner or project on either labor or materials."

When a contractor provides repair services to the owner of project, they are required to charge sales tax on both labor and materials, Mr. Kunz added.

"It's very important to differentiate what constitutes new construction on one hand and repair services on the other," Mr. Kunz said.

The law defines new construction ser-

vices as reconstruction alteration, expansion or remodeling. The law defines a repair as mending restoring maintaining or replacing, Mr. Kunz said.

"So the differentiation of the two can become quite difficult," he said. "Because many contractors provide both new construction and repair services."

"There is a tremendous amount of ambiguity in Iowa sales tax law, and contractors have a very difficult time in dealing with it," Mr. Kunz said.

For example, if a mechanical contractor performs both new construction and repair services, that contractor has paid sales tax at the time building materials were purchased. If they use materials in a repair job, they are required to charge the owner sales tax on the full retail price of the material, Mr. Kunz said.

"In that example, the state has been paid twice, once on cost of materials, and again on the retail price of the materials," he said.

In another example, if a homeowner's furnace is broken and no longer operational, that's considered a repair. The full amount of labor and materials would be subject to sales tax, he said.

On other hand, if the furnace was still in operational condition, but the home owner upgraded to an energy efficient

new furnace, that would be considered new construction, so labor and materials would be exempt from sales tax.

"To avoid this unintended overpayment of sales tax, the contractor is entitled to take credit against their sales tax liability equal to sales tax paid on cost of materials consumed in a repair job," Mr. Kunz noted.

"We ran into a situation last year where a mechanical contractor had not been taking this credit and we were able to amend the open tax use and obtain a sales tax in the amount of \$75,000," he said.

If a contractor purchases materials from an out-of-state supplier and is not charged sales tax by the supplier, the contractor must voluntarily report 6 percent Iowa consumers use tax on that material.

If that isn't reported, the contractor remains liable for payment of that tax, he said.

Another common mistake that contractors make is paying sales tax on equipment rented for use in new construction. Common examples of equipment are lifts, back hoes, compressors and trailers.

"In such a situation, the contractor must provide the lessor of equipment with a sales tax exemption certificate to avoid being charged a sales tax," Mr. Kunz added.

A blank form for sales tax exemptions certificates can easily be found online, he

said. Many equipment rental companies also have them on hand.

Mr. Kunz advises contractors to get a copy of the Iowa Contractors Guide published by Iowa Department of Revenue. The free publication is available online at www.iowa.gov/tax/educate/78527.html. The information goes into detail about which products and services are subject to sales tax and which are not.

"I believe the solution is twofold; you can't count on tax laws of any kind being simplified. The contractor needs to educate themselves and also rely on their accounting firm for proactive advice in this area," he said. "The Iowa Department of Revenue does sponsor seminars specifically designed for contractors who face sales tax compliance challenges."

Mr. Kunz said a general bit of advice is when in doubt, charge sales tax.

"If it is in the grey area, and they're not sure if they are performing new construction or repair services, err on the side of considering it a repair service," he said.

"A business needs to be vigilant about whether it is delivering products and services in a local option sales tax district," Mr. Kunz said. "If they are in such a district the rate is 7 percent, if they are not, the rate is 6 percent." CBJ