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Document No. 4004
DEPARTMENT OF REVENUE
CHAPTER 117
Statutory Authority: 1976 Code Section 12-4-320

117-314.11. Federal Government Construction Contracts

Synopsis:

The South Carolina Department of Revenue is considering adding SC Regulation 117-314.11 concerning the application of the sales and use tax exemption in Code Section 12-36-2120(29) to incorporate longstanding Department of Revenue policy concerning federal government construction contracts into SC Regulation 117-314. This policy is presently set forth in an advisory opinion issued by the Department – SC Revenue Ruling #04-9.

Instruction:

Add SC Regulation 117-314.11 concerning the application of the sales and use tax exemption in Code Section 12-36-2120(29) to incorporate longstanding Department of Revenue policy concerning federal government construction contracts in SC Regulation 117-314.

Text:

117-314.11 Federal Government Construction Contracts

Sales to, or purchases by, a construction contractor of tangible personal property for use in a federal government construction project in South Carolina for which the contractor has a written contract with the federal government are not subject to the sales and use tax under Code Section 12-36-2120(29) if the contract necessitating the purchase provides that title and possession of the property is to transfer from the contractor to the federal government at the time of purchase or after the time of purchase and such property actually transfer to the federal government in accordance with the contract or the property becomes part of real or personal property owned by the federal government or is to transfer to the federal government.

The purpose of this regulation is to address the application of Code Section 12-36-2120(29) to sales to, or purchases by, a construction subcontractor of tangible personal property for use in a federal government construction project in South Carolina for which the subcontractor has a written contract with a general contractor who has a written contract for the project with the federal government.

For purposes of this regulation, the following example and information will be used to illustrate the application of the exemption:

The federal government is constructing a building on a military base located in South Carolina. After following its contracting procedures, the federal government has entered into a written contract with a general construction contractor (“Contractor A”) to construct the building.

Contractor A has hired and entered into a written contract with a construction subcontractor (“Subcontractor B”) to construct a certain portion of the building.

Subcontractor B in turn hires and enters into a written contract with a construction subcontractor (“Subcontractor C”) to construct a certain portion of the building under its contract.

Contractor A, Subcontractor B, and Subcontractor C each purchase the material necessary to complete the project from various suppliers.

Based on the example and information, the exemption in Code Section 12-36-2120(29) for federal government contracts applies as follows:

1. Sales to, or purchases by, Contractor A of tangible personal property for use in a federal government construction project in South Carolina as described in the facts are exempt from the sales and use tax under Code Section 12-36-2120(29) if the written contract necessitating the purchase provides that title and possession of the property is to transfer from Contractor A to the federal government at the time of purchase or after the time of purchase and such property actually transfers to the federal government in accordance with the contract or the property becomes part of real or personal property owned by the federal government, or is to transfer to the federal government.

2. Sales to, or purchases by, Subcontractor B of tangible personal property for use in a federal government construction project in South Carolina as described in the facts are subject to the sales and use tax since Subcontractor B does not have a written contract with the federal government.

However, if Subcontractor B is an agent for the Contractor A, then sales to, or purchases by, Subcontractor B of tangible personal property for use in a federal government construction project in South Carolina as described in the facts are not subject to the sales and use tax if all other provisions of the exemption found in Code Section 12-36-2120(29) are met and all books and records support the existence of an agency relationship. (See information below concerning an agency relationship.)

3. Sales to, or purchases by, Subcontractor C of tangible personal property for use in a federal government construction project in South Carolina as described in the facts are subject to the sales and use tax since Subcontractor C does not have a written contract with the federal government.

However, if Subcontractor C is a subagent for Subcontractor B and Contractor A has specifically granted Subcontractor B the authority to appoint a subagent that can bind Contractor A, then sales to, or purchases by, Subcontractor C of tangible personal property for use in a federal government construction project in South Carolina as described in the facts are not subject to the sales and use tax if all other provision of the exemption found in Code Section 12-36-2120(29) are met and all books and records support the existence of an agency relationship. (See information below concerning an agency relationship.)

The Department will recognize the existence of an agency relationship with respect to the exemption in Code Section 12-36-2120(29), such a determination must be made a case-by-case basis and that if it is determined an agency relationship does not exist the Department will assess the applicable party (depending on the facts) under the sales and use tax law (supplier or contractor or subcontractor) for the tax due. (Note: Regardless of the facts and circumstances, the agency must be in writing.) However, the Department has established the following “safe harbor” for which it will recognize an agency relationship with respect to the above facts and the exemption in Code Section 12-36-2120(29):

1. Purchases by Subcontractor B: Contractor A has appointed, in writing, Subcontractor B as its agent when purchasing tangible personal property for the federal government contract and that as a result of this agency relationship Contractor A is liable for payment of such purchases if Subcontractor B fails to pay the supplier and is also liable for the payment of any sales and use tax for any property that was purchased by Subcontractor B in its capacity as agent and that does not qualify for the exemption in Code Section 12-36-2120(29) if Subcontractor B fails to pay the tax.

Purchases by Subcontractor C: Subcontractor B has appointed, in writing, Subcontractor C as its subagent when purchasing tangible personal property for the federal government contract and Contractor A has specifically granted Subcontractor B the authority to appoint a subagent that can bind Contractor A and that as a result of this subagency relationship Contractor A is liable for payment of such purchases if Subcontractor C fails to pay the supplier and is also liable for the payment of any sales and use tax for any property that was purchased by Subcontractor C in its capacity as subagent and that does not qualify for the exemption in Code Section 12-36-2120(29) if Subcontractors B or C fail to pay the tax.

2. The purchase order of Subcontractor B or Subcontractor C submitted to the supplier must clearly state that Subcontractor B or Subcontractor C is the agent of Contractor A in purchasing the property.

3. Contractor A has applied for and received an exemption certificate from the Department for purposes of the exemption in Code Section 12-36-2120(29). Copies of the application for the exemption, Form ST-10G, can be found on the Department's website at www.sctax.org. The federal contractor's exemption certificate that will be issued by the Department will be Form ST-404.

4. Contractor A must provide a copy of the exemption certificate to Subcontractor B and must have completed Section C of the copy indicating that Subcontractor B and Subcontractor C are its agents in purchasing tangible personal property for the federal construction project. Subcontractor B will in turn provide a copy to its subagent, Subcontractor C.

Note: Only Contractor A can complete Section C of the exemption certificate. Therefore, when Contractor A has specifically granted Subcontractor B the authority to appoint a subagent that can bind Contractor A, Subcontractor B will be required to inform Contractor A, who then must list Subcontractor C as its agent on a copy of the certificate.

5. Subcontractor B or Subcontractor C must provide a copy of the certificate to the supplier when purchasing tangible personal property exempt under Code Section 12-36-2120(29).

6. All books and records support the existence of an agency relationship.

Note: Sale or purchases of tangible personal property used or consumed by the purchaser (contractor or subcontractor) are subject to the tax. The exemption in Code Section 12-36-2120(29) only applies property where title and possession of the property transfers from the contractor or subcontractor to the federal government at the time of purchase or after the time of purchase or the property purchased becomes part of real or personal property owned by the federal government.

Fiscal Impact Statement:

There will be no impact on state or local political subdivisions expenditures in complying with this proposed legislation. There will be a minimal increase to general fund collections.

Statement of Rationale:

The proposal to add SC Regulation 117-314.11 is needed to ensure that taxpayers understand how the exemption in Code Section 12-36-2120(29) applies to the purchase of tangible personal property by a construction subcontractor for use in a federal government construction project in South Carolina for which the subcontractor has a written contract with a general contractor who has a written contract for the project with the federal government

The proposal to add this regulation is also reasonable in that it represents longstanding Department policy.