

CLIC ADVISORY

California Landscape & Irrigation Council, Inc.

10061 Riverside Drive, Suite 1028 ~ Toluca Lake, CA 91602 ~ Phone: 866.430.2542 ~ Fax:
866.404.2447

e-mail: clic@linkline.com ~ website: www.cliccontractors.com

CONSTRUCTION CONTRACTORS - UNDERSTANDING THE CALIFORNIA SALES TAX LAW WILL GIVE YOU A COMPETITIVE ADVANTAGE

Joseph F. Micallef

Associated Sales Tax Consultants, Inc.

Sacramento, California

Have you ever wondered how your competitors grind the last few dollars from their proposals to land that lucrative job you were sure would be yours? While re-evaluating your bid, did you discover that your competitor under-bid you by the amount represented by the sales taxes? How can your competitor get away with not adding that tax and ace you out of yet another job? It's time that you know what they know so you can level the playing field.

Proper understanding of the applications of the sales and use tax laws and regulations can improve a contractor's competitive advantage when submitting a bid. With sales and use tax rates generally ranging from 7¼% to 8½%, California contractors who are intimately familiar with the revenue and taxation code and related regulations are clearly at a competitive advantage when bidding for construction jobs in California. Contractors in California are allowed, within certain limits, to determine the amount of sales or use tax they owe on their construction contracts depending on how they bid and contract their jobs. For example, a contractor is allowed to pay tax on the "cost" of materials if the contractor entered into a lump-sum contract. Conversely, the identical item becomes subject to tax on the "full retail sales price" if the contractor entered into a time and material contract with tax reimbursement added to the separately stated price of materials. The advantage occurs when the educated lump sum contractor is required to only pay tax on "cost" while at the same time the unenlightened contractor is required to pay tax on the cost plus their mark-up on the time and material contract. Obviously, the greater the mark-up in terms of dollars, the greater the disadvantage when bidding for the job. More importantly, there is no requirement in California to enter into a time and material contract. It is the contractor's choice. Simply stated, as a contractor you increase or decrease your own tax liability based on the type of contract you enter into with your customer!

The varying types of construction contract agreements, coupled with the numerous billing procedures utilized in the construction industry, generally result in problems determining whether a contract is "lump sum" or "time and material." Sales and Use Tax Regulation 1521 defines both types of contracts as follows:

DISCLAIMER

Articles appearing in this publication were obtained from a variety of different sources. Their re-publication is intended to keep CLIC members abreast of developments in labor relations, legislation, business or politics which may have a positive or detrimental effect on their business operations. The views expressed, however, do not signify endorsement by the California Landscape & Irrigation Council. The material is presented merely to give our members a balanced point of view of some of the issues which may affect them.

Continued on Reverse

1. Lump Sum Contract - A lump sum contract means a contract under which the contractor, for a stated lump sum, agrees to furnish and install materials or fixtures or both. A lump sum contract does not become a time and material contract when the amounts attributable to materials, fixtures, labor or tax are separately stated on the invoice.

2. Time and Material Contract - A time and material contract means a contract under which the contractor agrees to furnish and install materials or fixtures or both and which sets forth separately a charge for the materials or fixtures and a charge for their installation or fabrication.

For clarification, Regulation 1521 classifies property installed on construction contracts into three general categories. The three categories are materials, fixtures, and machinery and equipment. For purposes of this discussion, we will only address those items defined as materials. "Materials" means and includes construction materials and components, and other tangible personal property incorporated into, attached to, or affixed to, real property by contractors in the performance of a construction contract and which, when combined with other tangible personal property, loses its identity to become an integral and inseparable part of the real property.

Generally, contractors who install materials are regarded as the consumer of materials used in the performance of a construction contract. The contractor is always the consumer of materials whether the contract is a lump sum or a time and material contract. With the contractor being the consumer of materials, the contractor's tax liability is limited to the "cost" of those materials to the contractor from their vendor exclusive of separately stated charges for common carrier freight-in.

On the other hand, the contractor who adds sales tax reimbursement to a time and material contract or discloses an amount of sales tax to the customer on a bid which reconciles to a lump sum contract, becomes the "retailer" of those same materials. When sales tax reimbursement is disclosed or separately stated, the contractor's tax liability changes from "cost" to the "retail selling price" which includes a mark-up. This can be where the sales or use tax that is added to a bid can make or break the deal.

In the past, it was the Board of Equalization's (Board's) position that if a contractor stated an amount for sales tax reimbursement in connection with a lump-sum construction contract for materials, the amount so billed would be considered excess tax reimbursement. Such excess tax reimbursement would have to be refunded to the customer or paid to the State. Moreover, the contractor would also be responsible for payment of tax on the cost of the materials.

This has now changed and under current guidelines, the Board has concluded that if a contract is originally set up as a lump sum contract and the contractor bills its customer a separately stated amount for sales tax, the contractor will still be regarded as the consumer as long as the total amount invoiced to the customer does not exceed the lump sum amount. To the extent the contractor invoices its customer in excess of the lump sum contract amount, that amount will be considered excess tax reimbursement.

Just the simple understanding of the type of contract that you submit to a potential client may mean the difference between getting the job or not. It's in your best interest to know the rules and how to play the

DISCLAIMER

Articles appearing in this publication were obtained from a variety of different sources. Their re-publication is intended to keep CLIC members abreast of developments in labor relations, legislation, business or politics which may have a positive or detrimental effect on their business operations. The views expressed, however, do not signify endorsement by the California Landscape & Irrigation Council. The material is presented merely to give our members a balanced point of view of some of the issues which may affect them.

game.

-End-

DISCLAIMER

Articles appearing in this publication were obtained from a variety of different sources. Their re-publication is intended to keep CLIC members abreast of developments in labor relations, legislation, business or politics which may have a positive or detrimental effect on their business operations. The views expressed, however, do not signify endorsement by the California Landscape & Irrigation Council. The material is presented merely to give our members a balanced point of view of some of the issues which may affect them.