

STATE OF COLORADO

DEPARTMENT OF REVENUE

State Capitol Annex
1375 Sherman Street, Room 409
Denver, Colorado 80261
Phone (303) 866-3091
FAX (303) 866-2400



John W. Hickenlooper
Governor

Barbara J. Brohl
Executive Director

PLR-13-004

August 8, 2013

XXXXXXXXXXXXXXXXXX
ATTN: XXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXX

Re: Private Letter Ruling

Dear XXXXXXXXXXXX,

You submitted on behalf of your client ("Company") a request for a private letter ruling to the Colorado Department of Revenue ("Department") pursuant to Regulation 24-35-103.5. This letter is the Department's private letter ruling.

Issues

1. Are Company's charges for installation, repair, or inspection of Systems that are built into real property subject to sales tax when billing Clients on a time and material basis for work performed by a subcontractor engaged by Company on real property located in the State of Colorado?
2. Are Company's payments to third party subcontractors for work performed pursuant to the Systems contracts subject to sales tax in the state of Colorado?

Conclusions

1. Company's charge for installation, repair, or inspection of Systems built into real property are subject to sales tax when billing Clients on a time and material basis for work performed by a subcontractor on real property located in the State of Colorado.
2. Company's payments to third party subcontractors for work performed pursuant to the Systems contracts are not subject to sales tax in the State of Colorado

Background

Company contracts with national multistate companies to install, repair and inspect fire sprinkler systems and fire alarm and detection systems ("Systems") built into buildings of

Company's customer ("Clients") locations. The general terms of the contracts cover multiple buildings where the Systems must be maintained. Some contracts also cover expansion plans of Company's Clients, and include the original installation of the Systems or reconfigurations of existing Systems to a building. Company meets the overall terms of the contracts through a network of third party subcontractors.

Company operates from a single location outside of Colorado,¹ and manages a Client service / response center from this location. When an emergency or standard Client service call is received, the most appropriate third party subcontractor is dispatched to resolve the issue. The third party subcontractor performs all the work (i.e., electrical, water pipe installation, fire sprinkler head installation, etc.) related to the contract obligations.

After work at a Client's location is complete, Company prepares a sales invoice and bills their Client, generally on a time and material basis, marking up charges that they have received on the purchase invoice from the subcontractor. Company exclusively uses subcontractors to perform the work on customer buildings and does not perform any of the construction, repair, or installation work on the Systems. Systems are an integral and inseparable component of the realty and would cause substantial damage if removed.

Discussion

Colorado levies sales and use tax on the sale, use, consumption or storage of tangible personal property in Colorado.² Department Regulation 39-26-102.15 defines tangible personal property to exclude property that is a fixture to real property:

... tangible personal property that loses its identity when it becomes an integral and inseparable part of the realty, and is removable only with substantial damage to the premises.

The application of this tax to tangible personal property installed in real property arises most often in the case of contractors. Contractors include plumbers, electricians, and heating and ventilation installers.³ Contractors collect sales tax from the real property owner when the contractor bills on a time and material basis.

¹ Although the question of nexus was not specifically raised, we note that Company has nexus with Colorado because it employs subcontractors to perform work on its behalf to fulfill its contractual obligations to Clients. See, *Tyler Pipe Indus. V. Washington State Dept. of Revenue*, 107 S.Ct. 2810, 2821 (1986).

² §§39-26-104(1) and 202, C.R.S.

³ See Department Special Regulation 10(1) "Contractor" ("Contractor" includes building contractors, road contractors, grading and excavating contractors, electrical contractors, plumbing and heating contractors, and also includes any other person engaged, under a contractual arrangement, in the construction, reconstruction, or repair of any building, bridge or structure. For the purpose of this rule, "subcontractor" has the same meaning as "contractor.") This regulation can be viewed at www.colorado.gov/revenue/tax > Tax Library > Regulations > Final Regulations > Sales and Use.

The contractor who invoices separately for labor and materials must charge sales tax on the marked up billing price of all materials.⁴

In such cases, the sale is deemed to occur prior to the installation of the tangible personal property into the real property.

When the contractor bills on a lump sum contract, the contractor does not collect sales tax from the homeowner.

(2) ... All contractors, as defined in (1) above, who purchase in this state tangible personal property which is to be built in by them into some building or structure, are regarded for purposes of the Act as retail purchasers and must pay sales tax to the vendors.

Contractors must pay tax on all tangible personal property used in their business or on their jobs if the delivery, storage, use or consumption of the property is in Colorado. The contractor must pay the use tax directly to the state. Sales or use tax is payable on all purchases of equipment, material, supplies, tools, etc.

...

(3) ... If the contractor bills with a lump sum contract, all supplies and materials are taxable on the contractor's cost.⁵

In the case of a lump sum contract, the sale is deemed to occur after the property is installed and has become part of the real property and, therefore, there is no sale of tangible personal property to the homeowner. In this case, the contractor must pay sales or use tax when it acquires the building materials or supplies.

Company argues that the decisions in *Raynor Door v. Department of Revenue*⁶ and *Noble Energy v. Department of Revenue*⁷ indicate that sales tax does not apply to Company's contracts with Clients. In *Raynor Door*, a garage door manufacturer and installer was assessed sales tax on its contract price with the homeowner. The Department argued that Raynor Door fell within an "over-the-counter retailer" exception to the contractor rule for lump sum contracts. The over-the-counter retailer exception states that a contractor is a retailer, not a contractor, if the contractor sells and installs over-the-counter (i.e., not custom-made) property. For example, a retailer who sells and installs dishwashers or hot water heaters must charge the homeowner sales tax even if the retailer uses a lump sum contract. The Court in *Raynor Door* concluded that Raynor Door did not fall within the "over-the-counter retailer" exception and, therefore, did not owe sales tax on the sale of the garage door because the door was no longer tangible personal property when installed into the home.

⁴ Id, at paragraph (3).

⁵ Id, at paragraphs (2) and (3).

⁶ *Raynor Door v. Department of Revenue*, 765 P2d 650 (Colo. 1988)

⁷ *Noble Energy v. Department of Revenue*, 232 P.3d 293 (Colo. 2010)

Noble Energy involved the use of sand as part of oil and gas extraction. The Department argued that the contract between Noble Energy and the real property owner was a “mixed” transaction of a sale of tangible personal property (sand) and of services (fracking). Noble Energy argued that the sale of services was inseparable from the sale of the tangible personal property and that the “true object” of the “bundled” sale was the sale of a service, not the sale of tangible personal property. Noble Energy argued in the alternative that, if the Court found that the sale of services and sale of sand were separable, then the sale of sand is not taxable because it is incorporated into real property and, as such, is no longer tangible personal property. The Court ruled that the sales of services and sand were inseparable and that the true object of the transaction was the sale of a service.

The Department believes that neither case is dispositive of this ruling. With respect to *Raynor Door*, the Court was never asked to consider, nor did it rule upon, the application of the “time and material” exception (presumably because Raynor Door used a lump sum contract). The *Noble Energy* case is similarly not dispositive because it does not address the “time and material” exception. Moreover, *Noble Energy* was resolved on the issues of separability and the true object test; the discussion of Noble Energy’s alternative theory regarding Department Regulation 39-26-102.15 was unnecessary and dicta. Finally, we are reluctant to view *Noble Energy* as dispositive given its reliance on *Raynor Door* which, as noted above, did not address the application of the “time and material” exception.

Assuming the Systems are fixtures, the application of sales and use tax will depend on the type of contract Company, as a contractor, uses with the owner. Contractors who charge the owner a lump sum amount do not collect sales tax from the owner. Instead, the contractor (or subcontractor) pays sales tax when it acquires the building materials from the supplier or manufacturer. If the Systems manufacturer does not collect sales tax from Company when Company acquires the Systems, then Company must pay use tax. The use tax is calculated on the price paid to the Systems manufacturer and the use tax calculation does not include Company’s, or their subcontractors, labor costs for installation.

Additionally, Company engages subcontractors to perform the necessary installation, maintenance and repair work. Company states that these subcontractors bill Company on a time and material basis. The price paid for materials is a sale of tangible personal property by the subcontractor to Company. However, Company is not liable for sales tax on such sales because Company is reselling the materials to Clients.

Miscellaneous

This ruling applies only to sales and use taxes administered by the Department. Please note that the Department administers state and state-collected city and county sales taxes and special district sales and use taxes, but does not administer sales and use taxes for self-collected home rule cities and counties. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes. Visit our

web site at www.colorado.gov/revenue/tax for more information about state and local sales taxes.

This ruling is premised on the assumption that Company has completely and accurately disclosed all material facts. The Department reserves the right, among others, to independently evaluate Company's representations. This ruling is null and void if any such representation is incorrect and has a material bearing on the conclusions reached in this ruling. This ruling is subject to modification or revocation in accordance to Department Regulation 24-35-103.5.

Enclosed is a redacted version of this ruling. Pursuant to statute and regulation, this redacted version of the ruling will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted version of the ruling.

Sincerely,

Neil L. Tillquist
Colorado Department of Revenue
Tele: (303)866-5627
Email: neil.tillquist@state.co.us
