



## Testimony—

### Political Subdivision Taxation Committee

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### Introduction

Good afternoon Chairman Dockter and members of the Political Subdivision Taxation Committee. I am Blane Braunberger, Supervisor of the Sales and Special Taxes Compliance Section of the Tax Commissioner's Office. I have been asked to provide the committee some background information and examples of how sales and use tax apply to construction contractors when they contract with exempt entities.

### Background

Sales and use taxes are paid by the final user or consumer of taxable goods and services and the place where the tax applies is where the purchaser takes possession of the property. Retailers do not pay tax on goods purchased for resale, but the sales tax law makes them responsible for collecting tax from the purchaser on the selling price of goods sold to the final user.

In general, contractors are not retailers. They are the final users of materials when they purchase them for use in a construction contract. As a result, contractors may not purchase for resale, but must pay tax on the materials they use. In addition, § 57-40.2-03.3 of the use tax law makes contractors liable for use tax on property that is owned by others, including exempt entities, when the contractor uses that property in performance of a contract. This section of the use tax law was approved by the 1983 legislature to prevent exempt entities from avoiding sales tax on construction materials by purchasing the materials themselves and contracting separately with a contractor for installation.

There are a number of exceptions identified within § 57-40.2-03.3 that do not require contractors to pay tax on materials they have installed. Attached is a copy of this section of the use tax law. The exceptions are medical equipment purchased as tangible personal property by a hospital or long-term care facility (subsection 3) and purchases of materials for nine different types of exempt projects (subsection 4). The exemptions in subsection 4 are economic development incentives for projects such as new or expanding manufacturing plants or oil and gas processing facilities. Other than for the exceptions identified in § 57-40.2-03.3, contractors are always liable to pay sales or use tax on materials they use in performance of a construction contract including materials owned by another party. It should be noted that in the case of materials owned by another party, the contractor is liable for use tax only if the owner has not previously paid tax on the materials. Tax is only due once on the materials used.

## Examples

To demonstrate the application of tax to contractors, consider the following examples:

**Example 1:** An elementary school, which is exempt from paying sales tax on retail purchases, contracts with Contractor A to provide and install new playground equipment on the school grounds. The equipment is attached to the ground by bolting it to concrete footings. The contractor pours the concrete footings, purchases the equipment, assembles it and attaches it to the footings. Contractor A is liable for tax on its purchase of concrete and equipment used in performance of the contract. Contractor A may pay sales tax to the vendors they purchased from. If the vendors did not charge tax to Contractor A, Contractor A must report and pay use tax on the cost of the purchases on its sales and use tax return.

**Example 2:** Same facts as Example 1 except the elementary school purchased the playground equipment tax free by providing the vendor a copy of its sales tax exemption certificate. In this example, the contractor is still liable for the same amount of tax as in Example 1. Because Contractor A is installing under contract the playground equipment purchased by the elementary school, Contractor A must verify if the school paid use tax on the playground equipment. Because the school purchased the equipment tax free, the contractor must obtain cost information from the school and report and remit the appropriate use tax.

**Example 3:** County B purchases culverts from a local supplier and requests the supplier to deliver the culverts to property owned by the county. County B purchased the culverts tax free by providing its sales tax exemption certificate to the supplier. County B's employees' excavated openings through a county road, moved the culverts into place, and backfilled the holes using county equipment. No sales or use tax is due on these transactions because County B made a retail purchase of culverts and installed them with its own employees. No contract was involved in these transactions.

**Example 4:** Same facts as example 3 except County B contracted with Joe's Excavation to place the culverts in place and complete the backfill work. Joe's Excavation is liable for use tax on the cost of the culverts because he installed them under contract and County B did not pay sales or use tax on its purchase of the materials installed.

**Example 5:** Hospital C purchased new X-ray equipment for a new expansion within the facility. Hospital C purchased the equipment tax free by providing its tax exemption certificate to the vendor. Hospital C contracted separately with Contractor X to install the equipment by attaching it to the floor and connecting the electrical power supply and data network. Contractor X is not liable for tax on x-ray equipment purchased by Hospital C because contractors are exempt under 57-40.2-03.3(3) for medical equipment purchased as tangible personal property by a hospital.

## Summary

North Dakota law exempts retail sales to all levels of federal, state, and local governments, tribal governments, schools, hospitals, nursing homes, emergency medical providers, basic care facilities, intermediate care facilities, and assisted living facilities. However, contractors doing work for these exempt entities are generally not exempt when purchasing materials for construction projects owned by these exempt entities. Contractors are consumers of materials used under contract, not retailers. As a result contractors are liable for tax on purchases they make and materials purchased tax free by exempt entities but installed by the contractor.

### 57-40.2-03.3. Use tax on contractors.

1. When a contractor or subcontractor uses tangible personal property in the performance of that person's contract, or to fulfill contract or subcontract obligations, whether the title to such property be in the contractor, subcontractor, contractee, subcontractee, or any other person, or whether the titleholder of such property would be subject to pay the sales or use tax, such contractor or subcontractor shall pay a use tax at the rate prescribed by section 57-40.2-02.1 measured by the purchase price or fair market value of such property, whichever is greater, unless such property has been previously subjected to a sales tax or use tax by this state, and the tax due thereon has been paid.
2. The provisions of this chapter pertaining to the administration of the tax imposed by section 57-40.2-02.1, not in conflict with the provisions of this section, govern the administration of the tax levied by this section.
3. The tax imposed by this section does not apply to medical equipment purchased as tangible personal property by a hospital or by a long-term care facility as defined in section 50-10.1-01 and subsequently installed by a contractor into such hospital or facility.
4. The tax imposed by this section does not apply to:
  - a. Production equipment or tangible personal property as authorized or approved for exemption by the tax commissioner under section 57-39.2-04.2;
  - b. Machinery, equipment, or other tangible personal property used to construct an agricultural commodity processing facility as authorized or approved for exemption by the tax commissioner under section 57-39.2-04.3 or 57-39.2-04.4;
  - c. Tangible personal property used to construct or expand a system used to compress, process, gather, or refine gas recovered from an oil or gas well in this state or used to expand or build a gas-processing facility in this state as authorized or approved for exemption by the tax commissioner under section 57-39.2-04.5;
  - d. Tangible personal property used to construct or expand a qualifying oil refinery as authorized or approved for exemption by the tax commissioner under section 57-39.2-04.6;
  - e. Tangible personal property used to construct or expand a qualifying facility as authorized or approved for exemption by the tax commissioner under section 57-39.2-04.10;
  - f. Tangible personal property used to construct or expand a qualifying facility as authorized or approved for exemption by the tax commissioner under section 57-39.2-04.11; or
  - g. Telecommunications infrastructure that is capable of providing telecommunications service as authorized or approved for exemption by the commissioner under chapter 57-39.2.
  - h. Materials used in compressing, gathering, collecting, storing, transporting, or injecting carbon dioxide for use in enhanced recovery of oil or natural gas as provided in section 57-39.2-04.14.
  - i. Tangible personal property used to construct a qualifying fertilizer or chemical processing facility as authorized or approved for exemption by the tax commissioner under section 57-39.2-04.15.