

2011 HOUSE FINANCE AND TAXATION

HB 1201

# 2011 HOUSE STANDING COMMITTEE MINUTES

House Finance and Taxation Committee  
Fort Totten Room, State Capitol

HB 1201  
January 18, 2011  
#13050

Conference Committee

Committee Clerk Signature

*Mary Brucher*

## Explanation or reason for introduction of bill/resolution:

A Bill relating to a sales and use tax exemption for purchases made by a contractor, subcontractor, or builder on behalf of an exempt entity; and to provide an effective date.

## Minutes:

**Representative Damschen:** Sponsor. Support. A few years ago I was visiting with a contractor from my area and he told me a local park board had purchased some material for a building and then asked him to bid on erecting a building with the material that they had purchased. As a tax free entity they had not paid tax on that building material. He gave them a bid and his bid was accepted. He put up the building. After the job was complete he received notification he owed use tax to the state. I believe it was equal to the sales tax that the tax free entity didn't have to pay. He was not aware of that and I think he probably gave them a bit of a deal on his bid and I don't think he made any money on the job after he paid the use tax. I don't know that there are a lot of contractors that are aware of that provision of law that there is a use tax when they use materials that have been purchased tax free. When I had this bill drafted my request was to alleviate that issue. I had some confusion on the language of the bill and called back up to Legislative Council and asked them if this eliminated the tax for the contractor who completes the job for some tax free entity that has purchased the material and they said indeed it does do that. It also gives the contractor the authority to purchase the material tax free if he proves that the material is used for a project for a tax free entity. There may be some confusion or problems with the wording on the bill which I can't explain. My intent was primarily to cover the contractor who got a surprise bill. I think he was looking at about \$15,000 because it was a fairly big job he did. I hope you would give this bill consideration. I didn't see a fiscal note on this bill and am surprised there isn't. I support this legislation.

**Blaine Braunberger, State Tax Department:** Neutral. Once the material is purchased as exempt but further installed or attached to real property the contractor would be responsible then under the use tax chapter for the tax. It really doesn't follow through with the intent of the bill.

**Chairman Wesley R. Belter:** Have you run into this situation before? There must have been other cases of this happening or not?

**Blaine Braunberger:** Yes, this is a common occurrence where exempt entities will purchase materials and have a contractor then install them. Our department does have information/education material available to contractors. This is something that has been in law for a number of years so we publicize it as well as educate. Unfortunately through our audits the contractors know this is a requirement.

**Vice Chairman Craig Headland:** I'm not completely clear, did you say that it's an occurrence that happens quite regularly or this an uncommon occurrence?

**Blaine Braunberger:** I would have to say it's not every day but it's something that does occur with a contractor has a project where an exempt entity has purchased material and then is asked to attach it to real property. It affects exempt entities like governments as well as other types of eligible exempt entities, hospitals, nursing homes, and things of that sort.

**Vice Chairman Craig Headland:** Is the problem with the way contractors need to understand the process when they bid on a tax exempt project?

**Blaine Braunberger:** From our experience there are times when contracts are bid with a contractor and an exempt entity where there maybe statements in there when the contract has been drafted that the project is exempt and the contractor proceeds and there's no further tax liability they have to incur. However our findings are that it is incorrect because of the tax provision.

**Vice Chairman Craig Headland:** What I'm trying to get at is when we made the exemption on the sales tax was it the intent to exempt the use tax as well? Was it meant to exempt the whole project from taxation?

**Blaine Braunberger:** No, that was not the case. A number of sessions ago there was the action of the legislature that took away the opportunity for an exempt entity to have separate contracts where they could exempt the material and ask for labor on another therefore, exempt the use tax on it. The legislature chose there would still be the use tax provision that the state would still have the use tax to be paid on the materials.

**Representative Patrick Hatlestad:** If you pay the sales tax then there is no use tax?

**Blaine Braunberger:** That is correct.

**Representative Dwight Wrangham:** Can you give us some direction or furnish us with some information on the legislation you referred to stating the intent that the use tax was to be charged on a job that was completed?

**Blaine Braunberger:** Yes, we can get some further information for the committee.

**Chairman Wesley R. Belter:** Clarify for the committee; we are talking about use tax and sales tax. Can you clarify the difference under contract, what's under sales tax and what's under use tax?

**Blaine Braunberger:** Sales tax would be charged to the purchaser of the materials, with the exempt entity. They would pay no sales tax. However, under the use tax statute, the final user of the materials, the contractor would be responsible for use tax at the same rate as the sales tax on the cost of the materials that are attached to a property.

**Chairman Wesley R. Belter:** Can you give an example of what would be sales tax and what would be use tax?

**Blaine Braunberger:** If an exempt organization, I'll use an example of the sponsor Representative Damschen stated earlier of the Parks and Rec. If they bought playground equipment to put up in their city park, if they purchased it for \$50,000 there would be no sales due at that time. However, if they hired a contractor to come in and attach that equipment to the ground so it was immovable then the contractor would be liable for the use tax on the cost of the equipment, which is the \$50,000. They would have to incur the tax on that.

**Chairman Wesley R. Belter:** So the difference is if the contractor is buying it then it falls under use tax but if the tax exempt organization buys it then it falls under sales tax?

**Blaine Braunberger:** That is partially correct. If a contractor were to buy the material in performance of a contract he would still pay the sales tax to a retailer at the time of purchase. Then the use tax obligation wouldn't kick in because he's fulfilled the tax consequence at that time. If he were to buy it tax free for some reason or bought it from an out of state retailer at that time when he attaches it to real property then he is liable for the use tax at that time.

**Vice Chairman Craig Headland:** So in the example you gave with playground equipment, if a park purchased it then its sales tax exempt but the contractor who puts it in pays the use tax. If a business, for example, a daycare center, would purchase for profit the same playground equipment, they are paying a sales tax and then if they had the same contractor install he would also have use tax paid?

**Blaine Braunberger:** No, that is not correct. Once the taxes have been paid by the for profit daycare then there is no further tax to be paid. The law says the contractor is liable for the tax, regardless of who owns the material providing no taxes previously paid on it.

**Representative Mark S. Owens:** I just want to see if I get this straight now. 39.2 deals with sales tax and that there's a 40.2 that deals with use tax?

**Blaine Braunberger:** That is correct. The actual subsection that would have to be dealt with is 03.3. currently, there's a bill similarly that deals with exempting contracts involving nonprofit hospitals in the Senate (SB2959) and that has similar language for the use tax. However, I urge you caution if you use it because they've made some amendments to it. The main portion of that use tax area in that bill is something you could use in this committee.

**Representative Mark S. Owens:** To further clarify sales tax and use tax is in either situation?

**Blaine Braunberger:** That is correct. Use tax is a complimentary tax to sales tax. both at the same rate and it's never going to be the same. One thing that gets confused with the contractor is that while a purchase of material has a 5% sales tax charge and if the contractor pays that the contractor being a final user does not actually itemize the sales tax of the materials that he installs. It's considered to be an overhead cost as he is the final user. He just includes that as part of his contract price.

**Representative Mark S. Owens:** In this scenario, you're going to build a church. You already own the piece of property, the people come together to build the church. They buy all the materials and they invite people up from a mission from somewhere else to help them construct the walls and everything. Of course, there are still subcontractors that are needed for some things because of city code and what not. Yet they purchase tax free all the supplies necessary that go into the building. At that point, because they're nonprofit, it's tax free. But what you're saying is now that the contractor is going to install it into the real property they're going to pay use tax. Now if they're going to pay overhead and charge it back to the nonprofit as part of their fee haven't we just nullified the purpose of the tax exempt to the nonprofit? It seems like six of one, half dozen of the other to me.

**Blaine Braunberger:** That could be considered in this case. One correction in the case of the nonprofit, churches under state law are not considered an exempt entity even though they're a nonprofit for IRS tax purposes under the sales tax chapter, they are not exempt. Also, one other clarification, in the example of the park district situation or the church situation, if those entities were truly exempt and they purchased the materials and they have a labor force that they get volunteers for to come in we can still consider that to be tax exempt because they are not charging for the installation, they're just providing free labor. No difference if the organization themselves uses their personnel to attach it, we do not consider that to be use tax transaction.

**Representative Mark S. Owens:** Thank you. That's how I understand it.

**Representative Bette Grande:** In the park and recreation scenario to what advantage is it to ever take a bid for a nonprofit? Because if I'm a builder and had been given the contract to come put that equipment together, if I'm not going to charge my nonprofit for the materials because they were supposed to be exempt I have to eat that cost. The nonprofit is going to end up with the charge one way or another unless the builder eats the cost on that. So why would I bid on a nonprofit?

**Blaine Braunberger:** A contractor bidding on a nonprofit job could either do it several different ways; either furnish and install whether he purchased the material, he could pass that material on at his cost or in most cases he could choose to mark that up and he still would only be liable for tax on the cost where if they exempt entity were to buy it they could control that part of it. They are going to only have to pay the purchase price, there wouldn't potentially be any mark up or other charges the contractor could put into that contract.

**Representative Bette Grande:** If the exempt entity purchased the equipment and installs it themselves no taxes are ever collected? I'm looking at it as a competitive market piece then.

**Representative Lonny B. Winrich:** I want to try and understand what it does do. If a contractor enters into a contract with a nonprofit, an exempt agency of some sort, and under that contract needs to purchase materials for whatever is needed, the contractor can do so as an exempt entity. Does that have to be written into the contract in some way or is it just automatic if the contract is between a contractor and an exempt agency?

**Blaine Braunberger:** Subsection 2 of this bill does give the contractor the ability to buy the material on behalf of the exempt entity tax free. However, if they are going to install it then you still have the use tax issue. Under current law the contractor cannot escape the tax situation by going out and buying on behalf of the exempt entity. This subsection 2 would give them the authority if the authorization letter is provided that they are the purchasing agent for the exempt entity, they can then go out and buy it for them and work with a retailer to purchase that tax free.

**Representative Lonny B. Winrich:** But they're still responsible for the use tax?

**Blaine Braunberger:** If they attach it to real property.

**Representative Lonny B. Winrich:** So this really doesn't address the problem at all. Thank you.

**Representative Wayne Trottier:** Is the sales tax and use tax the same rate?

**Blaine Braunberger:** Yes, that is correct.

**Vice Chairman Craig Headland:** Representative Damschen, your intent with this bill is to have a nonprofit project exempted including the use tax portion that the contractor seems to be unaware of?

**Representative Damschen:** Yes, my intent was to make sure the contractor wouldn't get stuck in essence paying the sales tax of the tax free entity. Also, as Representative Owens brought out as a contractor I can add say 5% to my bid but then what does that do to the tax free status. It just is a hidden tax really. But my intent was to address both those issues.

**Chairman Wesley R. Belter:** I have a question for the tax department. If we're talking about a small park project that's one thing but we have tax exempt hospital versus for profit nursing home same situation. What are they doing when they have a multi-million dollar project, are they not paying any sales or use tax or how are they handling it?

**Blaine Braunberger:** Based on our experience as a department, on larger projects it can possibly happen where you have separate contracts. The tax advantage is not really there to go through that process. So our experience has been when those big projects are bid a lot of times use consultants and engineering firms and it's a furnish and install contract where the contractor does go out and buy the materials and then either pays the sales tax at that time or else accrues the use tax on the cost of the materials.

**Chairman Wesley R. Belter:** So you're saying on these major projects tax is probably being paid?

**Blaine Braunberger:** That is correct.

**Chairman Wesley R. Belter:** No further neutral testimony. Representative Damschen, would you be willing to get some amendments to make this bill do what your intent was?

**Representative Damschen:** I would be happy to do that.

**Chairman Wesley R. Belter:** Closed hearing on HB 1201.

# 2011 HOUSE STANDING COMMITTEE MINUTES

House Finance and Taxation Committee  
Fort Totten Room, State Capitol

HB 1201  
January 24, 2011  
#13321

Conference Committee

Committee Clerk Signature

*Mary Brucke*

## Explanation or reason for introduction of bill/resolution:

A Bill relating to a sales and use tax exemption for purchases made by a contractor, subcontractor, or builder on behalf of an exempt entity; and to provide an effective date.

## Minutes:

*See attached amendments*

**Chairman Wesley R. Belter:** Distributed proposed amendments from Representative Damschen (please refer to attached amendments). From my perspective I think this is a no win deal because if we're going to do what Representative Damschen then everything is virtually is going to become tax exempt and I'm not sure that is our intent. I think the original language for example was saying if a local club is putting in a playground in a small town and that could be done but if it becomes a nonprofit hospital that is planning to build \$100 million hospital they could through the use tax and become tax exempt. I don't know if that's where we want to go on this issue. Any discussion?

**Representative Glen Froseth:** In audible as speaker was not turned on.

**Representative Bette Grande:** Were you looking to have these amendments moved one way or another?

**Chairman Wesley R. Belter:** I have no interest in them.

**Representative Bette Grande:** I move a DO NOT PASS.

**Vice Chairman Craig Headland:** Seconded.

**A roll call vote was taken: YES 11 NO 1 ABSENT 2  
MOTION CARRIED—DO NOT PASS.**

**Vice Chairman Craig Headland will carry HB 1201.**

# FISCAL NOTE

Requested by Legislative Council  
01/21/2011

Bill/Resolution No.: HB 1201

**1A. State fiscal effect:** *Identify the state fiscal effect and the fiscal effect on agency appropriations compared to funding levels and appropriations anticipated under current law.*

	2009-2011 Biennium		2011-2013 Biennium		2013-2015 Biennium	
	General Fund	Other Funds	General Fund	Other Funds	General Fund	Other Funds
<b>Revenues</b>			(\$21,960,000)	(\$1,910,000)		
<b>Expenditures</b>						
<b>Appropriations</b>						

**1B. County, city, and school district fiscal effect:** *Identify the fiscal effect on the appropriate political subdivision.*

2009-2011 Biennium			2011-2013 Biennium			2013-2015 Biennium		
Counties	Cities	School Districts	Counties	Cities	School Districts	Counties	Cities	School Districts

**2A. Bill and fiscal impact summary:** *Provide a brief summary of the measure, including description of the provisions having fiscal impact (limited to 300 characters).*

HB 1201 creates a sales tax exemption for materials acquired by a contractor on behalf of an exempt entity.

**B. Fiscal impact sections:** *Identify and provide a brief description of the sections of the measure which have fiscal impact. Include any assumptions and comments relevant to the analysis.*

If enacted, HB 1201 is expected to reduce state general fund and state aid distribution fund revenues by an estimated \$23.87 million in the 2011-13 biennium.

**3. State fiscal effect detail:** *For information shown under state fiscal effect in 1A, please:*

**A. Revenues:** *Explain the revenue amounts. Provide detail, when appropriate, for each revenue type and fund affected and any amounts included in the executive budget.*

**B. Expenditures:** *Explain the expenditure amounts. Provide detail, when appropriate, for each agency, line item, and fund affected and the number of FTE positions affected.*

**C. Appropriations:** *Explain the appropriation amounts. Provide detail, when appropriate, for each agency and fund affected. Explain the relationship between the amounts shown for expenditures and appropriations. Indicate whether the appropriation is also included in the executive budget or relates to a continuing appropriation.*

<b>Name:</b>	Kathryn L. Strombeck	<b>Agency:</b>	Office of Tax Commissioner
<b>Phone Number:</b>	328-3402	<b>Date Prepared:</b>	01/27/2011

PROPOSED AMENDMENTS TO HOUSE BILL NO. 1201

Page 1, line 3, after the semicolon insert "to amend and reenact section 57-40.2-03.3 of the North Dakota Century Code, relating to a use tax exemption for purchases made by a contractor, subcontractor, or builder on behalf of an exempt entity;"

Page 2, after line 3, insert:

**"SECTION 2. AMENDMENT.** Section 57-40.2-03.3 of the North Dakota Century Code is amended and reenacted as follows:

**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~~ if 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 commissioner under section 57-39.2-04.2; ~~or~~
  - b. Machinery, equipment, or other tangible personal property used to construct an agricultural commodity processing facility as authorized or approved for exemption by the commissioner under section 57-39.2-04.3 or 57-39.2-04.4; ~~or~~
  - c. A contractor, subcontractor, or builder that acquires materials, supplies, or equipment for use in the performance of a contract with an exempt entity, as defined in section 1 of this Act."

Renumber accordingly

Date: 1-24-11  
Roll Call Vote # 1

2011 HOUSE STANDING COMMITTEE ROLL CALL VOTES  
BILL/RESOLUTION NO. 1201

House Finance and Taxation Committee

Check here for Conference Committee

Legislative Council Amendment Number \_\_\_\_\_

Action Taken:  Do Pass  Do Not Pass  Amended  Adopt Amendment  
 Rerefer to Appropriations  Reconsider

Motion Made By Rep. Grande Seconded By Rep. Headland

Representatives	Yes	No	Representatives	Yes	No
Chairman Wesley R. Belter	✓		Scot Kelsh	✓	
Vice Chair. Craig Headland	✓		Shirley Meyer	✓	
Glen Froseth	✓		Lonny B. Winrich	✓	
Bette Grande	✓		Steven L. Zaiser	AB	
Patrick Hatlestad	✓				
Mark S. Owens	AB				
Roscoe Streyle	✓				
Wayne Trottier	✓				
Dave Weiler		✓			
Dwight Wrangham	✓				

Total (Yes) 11 No 1

Absent 2

Floor Assignment Rep. Headland

If the vote is on an amendment, briefly indicate intent:

MOTION CARRIED

**REPORT OF STANDING COMMITTEE**

**HB 1201: Finance and Taxation Committee (Rep. Belter, Chairman) recommends DO NOT PASS (11 YEAS, 1 NAYS, 2 ABSENT AND NOT VOTING). HB 1201 was placed on the Eleventh order on the calendar.**