

SC REVENUE RULING #04-9

- SUBJECT:** Federal Government Construction Contracts
(Sales and Use Tax)
- EFFECTIVE DATE:** Applies to all periods open under the statute.
- SUPERSEDES:** All previous advisory opinions and any oral directives in conflict herewith.
- REFERENCES:** S. C. Code Ann. Section 12-36-910(A) (2000)
S. C. Code Ann. Section 12-36-1310(A) (2000)
S. C. Code Ann. Section 12-36-60 (2000)
S. C. Code Ann. Section 12-36-110 (2000)
S. C. Code Ann. Section 12-36-2120 (29) (2000)
S. C. Code Ann. Section 12-36-2450 (2000)
- AUTHORITY:** S. C. Code Ann. Section 12-4-320 (2000)
S. C. Code Ann. Section 1-23-10(4) (Supp. 2002)
SC Revenue Procedure #03-1
- SCOPE:** The purpose of a Revenue Ruling is to provide guidance to the public and to Department personnel. It is a written statement issued to apply principles of tax law to a specific set of facts or a general category of taxpayers. A Revenue Ruling is an advisory opinion; it does not have the force or effect of law and is not binding on the public. It is, however, the Department's position and is binding on agency personnel until superseded or modified by a change in statute, regulation, court decision, or advisory opinion.

Questions:

1. Are 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 subject to the sales and use tax?
2. Are 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 subject to the sales and use tax?
3. Are 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 subject to the sales and use tax?

Conclusions:

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.)

While there may be other circumstances in which 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. Attached to this advisory opinion as Exhibit "A" is a sample of the federal contractor's exemption certificate that will be issued by the Department - 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.

Facts:

The federal government will from time to time enter into written contracts with construction contractors for the purposes of making improvements to real property owned by the federal government (e.g., construction of military barracks, airfields, federal office buildings, etc.). As with many construction projects, the general or prime contractor who has signed a contract with the federal government will then hire subcontractors to build or construct specific aspects of the project (e.g., electrical subcontractors, plumbing subcontractors, etc.)

The sales and use tax law only provides an exemption for purchases by a construction contractor who has a written contract with the federal government. Questions have been raised about the application of the exemption to purchases by subcontractors who have contracts with the general or prime contractor, but not with the federal government.

For purposes of this document, the following example and information will be used in addressing these questions.

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.

Discussion:

Code Section 12-36-910(A) imposes the sales tax and states:

A sales tax, equal to five percent of the gross proceeds of sales, is imposed upon every person engaged or continuing within this State in the business of selling tangible personal property at retail.

Code Section 12-36-1310(A) imposes the use tax and states:

A use tax is imposed on the storage, use, or other consumption in this State of tangible personal property purchased at retail for storage, use, or other consumption in this State, at the rate of five percent of the sales price of the property, regardless of whether the retailer is or is not engaged in business in this State.

Code Section 12-36-60 defines the term “tangible personal property” and states:

“Tangible personal property” means personal property which may be seen, weighed, measured, felt, touched, or which is in any other manner perceptible to the senses. It also includes services and intangibles, including communications, laundry and related services, furnishing of accommodations and sales of electricity, the sale or use of which is subject to tax under this chapter and does not include stocks, notes, bonds, mortgages, or other evidences of debt. Tangible personal property does not include the transmission of computer database information by a cooperative service when the database information has been assembled by and for the exclusive use of the members of the cooperative service.

Code Section 12-36-110 defines the terms “sale at retail” and “retail sale” in part as:

Sale at retail and retail sale mean all sales of tangible personal property except those defined as wholesale sales. The quantity or sales price of goods sold is immaterial in determining if a sale is at retail.

(1) The terms include:

(a) sales of building materials to construction contractors, builders, or landowners for resale or use in the form of real estate;

* * * *

(e) sales to contractors for use in the performance of construction contracts;

Based on the above, in order for the sales or use tax to apply, there must be a retail sale of tangible personal property. A retail sale includes sales to construction contractors.

However, Code Section 12-36-2120(29) exempts from the sales and use tax:

tangible personal property purchased by persons under a written contract with the federal government when 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. This exemption also applies to purchases of tangible personal property which becomes part of real or personal property

owned by the federal government or, as provided in the written contract, is to transfer to the federal government. This exemption does not apply to purchases of tangible personal property used or consumed by the purchaser;

While sales to construction contractor are subject to the tax¹, sales to construction contractors under a written contract with the federal government are exempt from the tax 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 or the property becomes part of real or personal property owned by the federal government or is to transfer to the federal government.

Therefore, it is the opinion of the Department that 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 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.

Now the question arises as to the taxability of 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.

Based on the above, it is the opinion of the Department that these sales and purchases are subject to the tax since the subcontractor does not have a written contract with the federal government.

However, for completeness, it must be determined if the subcontractor is the agent for the general contractor.

The following quotes from *3 Am. Jurs. 2nd, Agency* provide guidance:

Section 1: Generally, definitions

The term “agency” means a fiduciary relationship by which a party confides to another the management of some business to be transacted in the former’s name or on his or her account, and by which such other assumes to do the business and render an account of it.

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¹ To simplify the issues raised in this document, the questions addressed in this document only concern federal construction projects located in South Carolina. While the exemption in Code Section 12-36-2120(29) also applies to sales and purchases within South Carolina for federal construction projects in other states, sellers and construction contractors should also be aware of the exclusion found in Code Section 12-36-110(2) and the exemption found in Code Section 12-36-2120(36) with respect to an out-of-state construction projects.

In an agency relationship, the party for whom another acts and from whom such other derives authority to act is a “principal.” The one who acts for and represents the principal and acquires his or her authority from the principal is an “agent.” Pursuant to the grant of authority by the principal, the agent is the representative of the principal and acts for, in the place of, and instead of, the principal.

Section 7: Subagency

A subagent is a person employed by the agent to assist him or her in conducting the principal’s affairs.

Once a third party is validly appointed a subagent, the principal is liable for the subagent’s actions. ...

Section 15: Generally; consent of parties

The relationship between an agent and a principal is a contractual one, and the extent of the rights and duties of each is to be found in the express or implied terms of the agency contract. ...

Finally, with respect to the subcontractor as agent for the general contractor in purchasing tangible personal property for a federal government contract, the following must be considered.

Code Section 12-36-2540 states:

(A) Every person engaging in any business, for which a privilege or excise tax is imposed by this chapter, shall keep and preserve suitable records of the business, as considered necessary by the department, to determine the amount of tax due under this chapter. The taxpayer shall keep and preserve records, such as purchase invoices, for three years. Invoices must bear the name and address of the vendor.

B) Any person selling both at wholesale and at retail shall keep books which separately show the gross proceeds of wholesale sales and the gross proceeds of retail sales. If the records are not separately kept, all sales must be considered retail sales.

(C) Every seller and every person storing, using, or otherwise consuming, in this State, tangible personal property purchased from a retailer shall keep records, receipts, invoices, and other pertinent papers in the form the department requires.

The South Carolina Supreme Court has adopted the generally prevailing rule that exemptions in taxing statutes exist through legislative grace and one asserting an exemption must bring himself squarely within the statute authorizing the exemption. 85 C.J.S., Taxation 1099; Southern Weaving Co. v. Query, 34 S.E.2d 51, 206 S.C. 307 (1945). See Taxation Key No. 1031.

Based on the above, it is the opinion of the Department that if a construction subcontractor purchases tangible personal property for use in a federal government construction project in South Carolina for which the subcontractor has a written contract with the general construction contractor who has a written contract for the project with the federal government, then such purchases are not subject to the sales and use tax only if the subcontractor is an agent for the general contractor. In addition, purchases by a subcontractor of the subcontractor for use in a federal government construction project in South Carolina are not subject to the sales and use tax only if the general contractor who has the written contract with the federal government has specifically granted his agent the authority to appoint a subagent that can bind the general contractor.

While an agency relationship may be implied, the sales and use tax law specifically requires taxpayers to keep and maintain proper records and the exemption requires that the contract with the federal government be in writing. Therefore, in order to comply with both of these provisions, the agency agreements with the subcontractors (as agents or subagents) must be in writing to maintain a continuity of written agreements (contracts and agency agreements) so that the “written contract” requirement of the exemption is met. As such, the Department will consider a subcontractor to be an agent for a general contractor who has a written contract with the federal government with respect to the exemption under Code Section 12-36-2120(29) when the following conditions are met:

1. The general contractor has appointed, in writing, the subcontractor as its agent when purchasing tangible personal property for the federal government contract and that as a result of this agency relationship the general contractor is liable for payment of such purchases if the subcontractor 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 the agent in his capacity as agent and that does not qualify for the exemption in Code Section 12-36-2120(29) if Subcontractor B or C fail to pay the tax.
2. The subcontractor’s purchase order to the supplier must clearly state the subcontractor is the agent of the general contractor 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. Attached to this advisory opinion as Exhibit “A” is a sample of the federal contractor’s exemption certificate that will be issued by the Department - 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.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/Burnet R. Maybank III
Burnet R. Maybank III, Director

May 13, 2004
Columbia, South Carolina

EXHIBIT “A”

Sample Exemption Certificate

This exhibit is a sample federal contractor’s exemption certificate. It is not an official Department of Revenue exemption certificate. It is included in this advisory opinion to better explain how a federal contractor’s exemption certificate can be used when a subcontractor is an agent, as described in the advisory opinion, of a contractor who has a written contract with the federal government. The official certificates issued under this exemption (Code Section 12-36-2120(29)) may differ slightly and may change from time to time. To apply for a federal contractor’s exemption certificate, use Form ST-10G.

SAMPLE ST-404
EXEMPTION CERTIFICATE
FEDERAL GOVERNMENT CONTRACT

A. Contractor under Written Contract with the Federal Government

Name of Contractor: _____

Office Location: _____

Mailing Address: _____

Telephone Number: _____

B. Project Information

Project Name: _____

Project Number: _____ Building Permit or Other Identifying Number: _____

Project Location: _____

Expected Project Completion Date: _____

(Note: This certificate expires on this date and must be returned to the Department unless an extension is granted by the Department)

C. Agents of the Contractor

The following section will be completed by the Contractor listed in Section A above. The Contractor has appointed, in writing, the following subcontractors as its agents when purchasing tangible personal property for the federal government contract and agrees it is liable for payment of such purchases if such subcontractors fail to pay the supplier and is also jointly and severally liable for the payment of any sales and use tax for purchases by these subcontractors under this certificate that do not qualify for the exemption in Code Section 12-36-2120(29). The agency will be considered to end on the "Expected Project Completion Date" listed above.

Name and Address of Agents:

Contractor Must Sign and Date Here
As Recognition of Agency/Subagency

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Each purchase order submitted to the supplier must state that these subcontractors are purchasing the property as agent for the Contractor listed in Section A. The Contractor listed in Section A or the Agent listed in Section C certify that the purchases of tangible personal property made under this certificate are made in accordance with the exemption in Code Section 12-36-2120(29) and that in the event the property so purchased is used for purposes that do not qualify for the exemption, the purchaser assumes liability and must file a return and pay the tax due and the Contractor in Section A agrees to pay the tax if its agent fails to do so.