



Construction Industry Webinar
Sales and Use Tax Considerations
That Can Impact Your Bottom Line

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PEOPLE | IDEAS | SOLUTIONS

Agenda

1. Hot Topic Areas

- Optimizing Talent
- Lease Accounting Update

2. Sales Tax Implications in the Bidding Process

- Determining how to properly classify the services being performed under a contract
- Understanding who your customer is and why it matters for sales and use tax
- Learning how the way you bill your customer can ultimately affect sales and use tax responsibilities



Construction Industry Hot Topics

Polling Question



All Business Problems Are People Problems

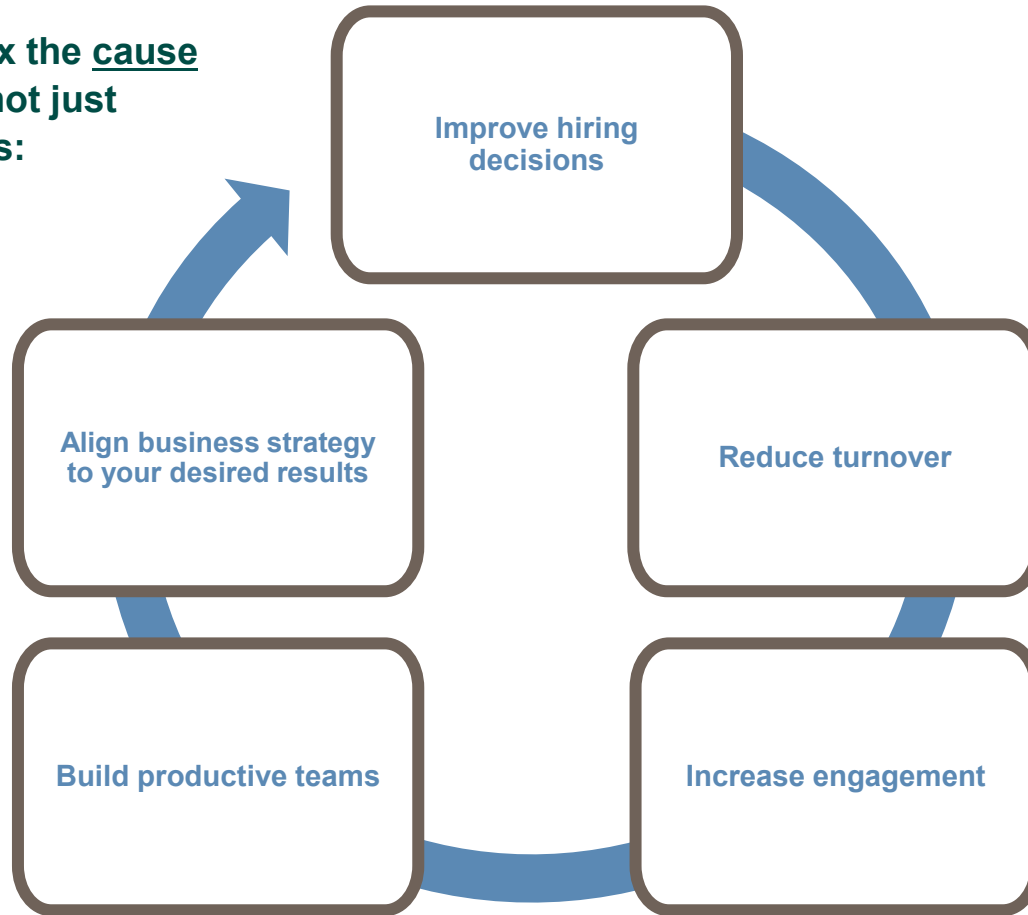
The construction industry is in “good” company:

- **We are having trouble attracting the best talent (especially among underrepresented groups).**
 - The average cost of a **poor hiring decision** can **equal 30%** of that hire’s first year’s earnings
- **We need to retain the talent we already have.**
 - **Turnover costs employers 50-250%** of an employee’s salary (salary + bonus +benefits)
 - **37% of employees** say “working with a **great team**” is their primary reason for staying with their employer
- **We want people to enjoy what they do.**
 - **Disengaged employees** can cost companies **up to 34%** of their salary
- **We know that our talent is the key to our financial success.**
 - **75% of executives** say that the Great Resignation has impacted their **financial stability**
 - Companies with strong cultures have seen a **4x increase in revenue growth**



People Problems → People Solutions

It is important to fix the cause of people issues, not just treat the symptoms:



We Can Help!

“What makes your **dream job**? You gotta love **what** you do.
Who you do it **for**. And who you do it **with**.”

~ Tom Tumelty



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Stay in Touch!

Learn how you can create high-performing teams, unlock productivity, and boost employee retention with a talent optimization program.



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Bobbi leads Kreischer Miller's Talent Advisory practice. Utilizing a proprietary framework, she equips business leaders with the tools and data they need to create an intentionally-designed people plan that increases productivity, builds a winning culture, and creates the flexibility a company needs to adapt to change over time.

Bobbi implemented this talent optimization framework for Kreischer Miller, saving the firm more than \$1 million in employee turnover and engagement costs over the past four years. Kreischer Miller has also been named a Top Workplace by The Philadelphia Inquirer for multiple years, ranking number one in the mid-size employer category for 2019 and 2021.



Lease Accounting Adoption Challenges

- Discount rate determination
- Lease term
- Related party leases
- Lease accounting platform



Discount Rate – Deeper Dive

There are three options for determining the discount rate

1. Implicit Rate (IR)

This is defined as the interest rate on a given date that generates the aggregate present value of the lease payments, and the amount a lessor expects to derive from the underlying asset following the end of the lease term.

In practice, it is not likely that the lessee will have the inputs required for this calculation readily available. You would need to know the fair value of the asset leased and the residual value.



Discount Rate – Deeper Dive

There are three options for determining the discount rate

2. Incremental Borrowing Rate (IBR)

This is defined as the interest rate a lessee would have to pay to borrow, on a collateralized basis, an amount equal to the lease payments over a similar term and in a comparable economic environment.

Among the ways to calculate an IBR are using your rate on existing debt or recent loan; the borrowing rate of similar entities with comparable credit risk; or an interest rate quoted by your lender if you were to borrow funds to purchase a similar asset.



Discount Rate – Deeper Dive

There are three options for determining the discount rate

3. Risk-Free Rate (RFR)

The RFR is the rate of a zero-coupon U.S. Treasury instrument using a period comparable with the lease term. This provides a practical expedient alternative for private companies.



Term Considerations

- An entity shall determine the lease term as the non-cancellable period of the lease, together with all of the following:
 - Periods covered by an option to extend the lease if the lessee is *reasonably certain* to exercise that option
 - Periods covered by an option to terminate the lease if the lessee is *reasonably certain* not to exercise that option
 - Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the lessor



Related Party Agreements

- Related party real estate leases
- Related party equipment entities



Lease Accounting Platform?

- Excel, internally developed or from other sources
- Internally developed Macros or software
- Off the shelf software
 - KM has secured a platform with Trullion



Contact the Presenter



Mark A. Guillaume, CPA, CCIFP
Director, Audit & Accounting and
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Mark provides audit & accounting and business advisory services to clients in a variety of industries, including construction, distribution, investment management, and manufacturing. He assists businesses in acquisition due diligence, internal control evaluations, corporate governance, succession planning, and financing.

Mark has significant experience in the construction industry and is Kreischer Miller's Construction Industry Group Co-Leader where he develops and provides internal and external training on construction-related topics. In addition to providing traditional audit services, he assists with bonding/credit analysis, benchmarking, accounting department assessments, and other consulting services to general contractors, specialty contractors, heavy and highway, architects and engineers, material suppliers, and equipment dealers.

Mark has also been actively presenting, writing, and consulting with clients on the implementation of ASC 606, Revenue from Contracts with Customers and ASC 842, Leases since the standards were released. He has been assisting companies in the development of accounting policies and processes in order to be in compliance with the revenue recognition and lease accounting standards.



Sales and Use Tax Considerations That Can Impact Your Bottom Line

Polling Question



Sales Tax and The Bottom Line – Agenda

- What is the scope or nature of the project?
 - Sales Activities vs. Construction Activities
 - New Construction/Capital Improvement vs. Repair and Maintenance
 - Real Property vs. Tangible Personal Property
- Who is the customer?
 - Tax Exempt Entity?
 - Manufacturing Business?
 - What support is available during the bid process?
- How will the project be billed?
 - Lump Sum vs. Time and Material



What Are We Doing Under This Contract?

General Rules

- Contractors are primarily engaged in 2 activities
 - Contractors performing construction activities
 - Contractors performing sales activities



What Are We Doing Under This Contract? – Construction Activities

General rule for contractors performing **construction activities**

- All purchases are taxable, unless there is an exempt use or exempt purchaser
- Purchases include materials, equipment, and supplies used in performance of the contract
- No tax on labor



What Are We Doing Under This Contract? – Sales Activities

General rule for contractors performing **sales activities**

- The only activity that constitutes a sales activity for a contractor is the purchase of property that will NOT be installed by the contractor
- Purchases in connection with a sales activity are not subject to tax because they will be resold
- Items resold are subject to sales tax unless there is a specific exemption
- Tangible personal property and services of repairing or maintaining personal property are subject to tax unless there is a specific exemption



Polling Question

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Pennsylvania – Construction Activities

Pennsylvania specific guidelines – **construction activities**

- A Contractor as a contractor/sub-contractor is subject to sales tax on all of its purchases and/or leases
- All purchases with a point of sale in Philadelphia will be subject to the additional 2% local sales tax
- All purchases with a point of sale outside Philadelphia but delivered to a point within Philadelphia are subject to the additional 2% local tax
- All purchases with a point of sale within Philadelphia but delivered to a location outside PA are not subject to the PA or Philadelphia sales tax. The other state sales tax may apply



Pennsylvania – Sales Activities

Pennsylvania specific guidelines – **sales activities**

- What constitutes sales activity?
 - Tangible personal property not permanently installed in real estate
 - Performing repair/replacement/maintenance work on tangible personal property
 - A Contractor will purchase these items for resale and will not pay tax
 - Sales tax should be charged to customers on all charges (parts, labor and freight) if there is not a valid exemption certificate



Pennsylvania – Sales Activities

Pennsylvania specific guidelines – **sales activities**

- Purchases of maintenance supplies are taxable and sales tax should be charged to the customer
 - Repair, replacement and maintenance of tangible personal property NOT used directly in an exempt activity are taxable and sales tax should be charged
 - Repair and replacement of realty is not a sales activity and a Contractor should pay sales tax on its purchases
 - Repair and replacement sales activities for tax exempt entities is driven by Act 45 guide for contractors



New Jersey – Construction Activities

New Jersey specific guidelines – **construction activities**

- The rules generally follow the PA rules with some key differences.
- Key differences are as follows:
- Purchases made in connection with contracts with NJ tax exempt entities are not taxable. However, a Contractor must obtain an ST 5 from the exempt organization
- a Contractor will issue an ST 13 to its vendors when dealing with tax exempt entities



New Jersey – Construction Activities

New Jersey specific guidelines – **construction activities**

- The rules generally follow the PA rules with some key differences.
- Key differences continued:
 - Purchases of machinery and equipment that will be used in an exempt activity, such as manufacturing, refining and/or public utility service, are purchased by a Contractor as a resale using NJ ST 3. The customer must provide a Contractor with an ST 4, exempt use certificate
 - NJ taxes labor on capital improvement contracts, unless a Contractor has obtained an ST 8 from the customer



New Jersey – Sales Activities

New Jersey specific guidelines – **sales activity (Property sold does not become permanently affixed to real estate)**

- Rules generally follow the PA rules
- KEY DIFFERENCE
- Maintenance and repair materials are generally taxable if it does not have a useful life of more than one year



Polling Question



Tangible Personal Property vs. Real Property – Pennsylvania

- Pennsylvania does not have a bright-line test that decisively separates real property from tangible personal property
- Items not directly mentioned in the code, the Pennsylvania Supreme Court has said that the parties' intent as to whether an item is permanently attached to reality is not the proper test. Rather, the focus should be on **the character of the object, its ability to be installed and removed, its degree of portability, and whether it maintains its functional integrity after installation.**



Tangible Personal Property vs. Real Property – New Jersey

- Nontaxable real property includes any structure or appurtenance permanently affixed to land + any personal property affixed to real property such that it cannot be removed without causing material injury to the personal property or real property it is affixed to
- The installation by a contractor of tangible personal property which results in an increase in the value or significant increase in the useful life of the real property into which it is installed is exempt from New Jersey sales and use tax as an exempt capital improvement, with enumerated exceptions.-



Tangible Personal Property vs. Real Property – New Jersey

New Jersey Repairs vs. Capital Improvement

- In some situations, the difference between a repair and a capital improvement is the extent of the work that is done. For example, replacing a few loose bath tiles or a portion of a leaky roof is a repair to the existing real property. However, replacing all of the tiles or the entire roof with upgraded or improved materials would be an exempt capital improvement.



Who is the Customer?

- Tax Exempt Entity?
- Manufacturing Business?
- What support is available during the bid process?



Pennsylvania – Exemption Certificates

Pennsylvania specific guidelines – **construction**

- Contractor must use good faith
- Common exemptions that will permit a Contractor to purchase materials without paying sales tax
- Most common exemptions for a Contractor are:
- Manufacturing – only on machinery, equipment and parts used directly in manufacturing
 - You must ask yourself what is the use of the equipment purchased.
 - If equipment purchased is for the general comfort of the employees (think HVAC or lighting) it is taxable to a Contractor
 - If the equipment is for non-manufacturing activities, such as administration, sales or marketing, it is taxable



Pennsylvania – Exemption Certificates

Pennsylvania specific guidelines – **construction**

- Most common exemptions for a Contractor are:
- Tax exempt entities (government and other tax exempt entities) only purchases that constitute building machinery and equipment is non-taxable
- Act 45 guide must be strictly followed when making taxable and non-taxable determinations
- Only building machinery and equipment listed in the guide as non-taxable is exempt from tax. All other purchases are subject to sales tax when purchased by a Contractor



Pennsylvania – Exemption Certificates

Pennsylvania exemption certificates

- If a Contractor is performing a construction activity for a manufacturer, public utility, or tax exempt entity they should obtain an REV 1220 with the appropriate box for the exemption being claimed checked.
- If a Contractor is performing a construction contract and makes purchases that are for an exempt use or for a tax exempt entity, it will provide its vendor with an REV 1220 with box 7 checked to note that the purchase is in connection with an exempt use



Pennsylvania Acceptance of Exemption Certificates

Pennsylvania specific guidelines – **sales activity**

- Valid exemptions common to a Contractor for sales activity:
 - Manufacturing
 - Research and Development
 - Exempt Organization



Pennsylvania – Exemption Certificates

Examples of exempt purchases for manufacturing and public utility customers are:

- Machinery, parts and foundations directly used in the exempt activity
- Repair parts that are installed in machinery used directly in an exempt activity
- Replacement parts that are installed in machinery used directly in an exempt activity
- Operating supplies that are continuously used in the operation of the exempt machinery, such as lubricants and fuel



Polling Question



New Jersey – Exemption Certificates

- New Jersey specific guidelines/examples
- **Exempt Use Certificate (Form ST-4)**
 - Under New Jersey law, certain items are exempt from sales tax if they are purchased for a particular use. A contractor may issue Form ST-4 only when purchasing certain “exempt-use” items. When used for such a purchase, the ST-4 must show the names and sales tax registration numbers of the contractor and any other party to the contract. The certificate must also state the nature of the job and the date the work will start.
 - A common use of Form ST-4 is by a contractor under contract with a utility company to purchase machinery for use in the production, generation, transmission, or distribution of gas, electricity, refrigeration, steam, or water for sale.



New Jersey – Exemption Certificates

- **Exempt Organization Certificate (Form ST-5)**
 - A Contractor would request/receive for customers who have been granted exempt status by the Division of Taxation.
- **Contractor's Exempt Purchase Certificate (Form ST-13)**
 - A Contractor issues Form ST-13 to the supplier when making purchases of materials, supplies, or services for use in performing work on the real property of an exempt organization, a New Jersey or Federal governmental entity, or a qualified housing sponsor.
 - To document the sales tax exemption, a qualified exempt organization provides a copy of its Exempt Organization Certificate (Form ST-5) to the contractor. New Jersey or Federal governmental entities must give the contractor a signed purchase order or contract, and a qualified housing sponsor will issue a Housing Sponsor Letter of Exemption.



How Are We Billing This Project?

Two Most Common Types of Construction Contracts

- Lump-Sum
- Time and Material



How Are We Billing This Project?

Lump Sum Contracts

- Generally one agreed upon price for the entire project. Includes the following:
 - Materials
 - Labor
 - Overhead
- Pros
 - Simple billing
 - Profits are not easily visible to customer
- Cons
 - Potential less opportunity for planning for applicable exemptions



How Are We Billing This Project?

Time and Material Contracts(T&M)

- Generally bill reflects separate charges for each item under the contract
- Pros
 - Allows for potential purchase for resale
 - Allows for planning opportunities to utilize potential applicable exemptions
- Cons
 - Adds potential administrative steps for those sales that are considered retail sales
 - Not all sales are retail sales for resale- requires diligent review of detail to make proper determination on a state by state basis



Polling Question

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Questions?

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Contact the Presenter

Reed Brown
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Reed is a Manager in Kreischer Miller's State and Local Tax group. As an experienced multi-state tax professional, Reed has developed a solid understanding of state and local tax concerns and he assists businesses in anticipating issues and developing solutions to minimize administrative burdens and exposures. He has a wide range of experience providing services in the areas of multi-state income/franchise tax and sales and use tax, as well as audit defense, tax planning, and state tax controversies in the manufacturing, construction, distribution, and professional services industries.

Reed is actively involved with Kreischer Miller's Construction Industry Group, and he is a frequent writer and speaker on state and local tax topics that impact construction contractors. He is also an instructor for the firm's internal training program for team members.



Contact the Presenter

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Kate has a wide range of experience providing tax and business advisory services to privately held businesses and their owners. Kate serves the industries of construction, distribution, and manufacturing – working with owners and key personnel to assist with various matters including tax planning, tax compliance, cost segregation studies, research and development tax credits, business growth and succession planning. Kate is member of Kreisler Miller’s Construction and Distribution Industry Groups, and assists in developing professional training for in-house presentations on topics relating to both industries.



About Kreischer Miller

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