



# Memo

To: Fee Masters Committee  
From: Jim Wedding, Revenue Manager   
Date: December 5, 2014  
Subject: Construction Use Tax – Contractors for Tax-Exempt Organizations

## Issue

A question has arisen on the City's application of use tax on building materials related to projects for tax-exempt organizations. In the recent past it appears the City has accepted a copy of the tax-exempt certificate of the exempt organization when presented by a for-profit contractor to exclude use taxes from the building permit. This procedure is non-compliant with State of Colorado statutes and regulations as well as City of Loveland ordinances.

## Basis for the determination of non-compliance

The first step is to understand, who is the "user" of the materials used on the project? The prevailing Colorado court case is *Craftsman Painters & Decorators, Inc. v. Carpenter*

*Contractors purchasing items to install deemed users and liable for tax. When painting and electrical contractors purchase items of personal property and build them into a structure as an integral part of their entire contract, and then dispose of the completed work to the owner, they are users and consumers and not "retailers" to the owner of each item, and they are liable for the sales tax. Craftsman Painters & Decorators, Inc. v. Carpenter, 111 Colo. 1, 137 P.2d 414 (1942).*

This case makes it clear that in construction projects, the contractor is the user, not the eventual owner of the property. Therefore, unless the contractor is a tax-exempt organization, they are not eligible for the exemption of sales or use tax regardless of who they are doing the work for.

## **Prevailing, Statues, Ordinances and Regulations**

Both the State of Colorado and the City of Loveland exempt the United States government or the state, or its institutions or political subdivisions, in their governmental capacities only, or by religious or charitable corporations in the conduct of their religious or charitable functions through Colorado Revised Statues (C.R.S.) 39-26-708(1)(a)(b) and (c) and Loveland Municipal Code (LMC) §3.16.050(D) respectively.

In order for the contractors that are performing work for a tax-exempt organization to obtain a building permit without paying the City and County use tax deposit, they must obtain a state issued "certificate of exemption", also known as an 89-number.

The state outlines the procedure for obtaining a certificate of exemption in their statute;

*Colorado Revised Statues (C.R.S.) 39-26-708(3) On application by a purchaser or seller, the department of revenue shall issue to a contractor or subcontractor a certificate of exemption indicating that the contractor's or subcontractor's purchase of construction or building materials is for a purpose stated in subsection (1) of this section and is, therefore, free from sales tax. The department shall provide forms for*

*the application and certificate and shall have the authority to verify that the contractor or subcontractor is, in fact, entitled to the issuance of the certificate prior to such issuance.*

The Colorado Department of Revenue further outlines the procedure through the “Code of Colorado Regulations (CCR).

*Regulation 39-26-708.3: Every contractor or subcontractor shall apply for a certificate of exemption prior to the time the work is started. Said contractor or subcontractor shall also obtain the exemption number from the exempt organization for whom the work is performed.*

And;

Colorado Department of Revenue FYI Sales 1 - TAX-EXEMPT CONSTRUCTION PROJECTS (See Attached)

*Building materials for construction work on property owned by tax-exempt organizations – religious, charitable and governmental – may be purchased tax-free. However, the purchaser must have an Exemption Certificate. To obtain the certificate, the contractor must submit an Application for Exemption Certificate (DR 0172) to the Department of Revenue.*

*The sales and use tax exemption applies to materials that become part of the structure, highway, road, street or other public works owned and used by the tax-exempt organization. Also, electricity and most fuels consumed in performing real property construction are exempt. The purchase or rental of equipment, supplies and other materials by the contractor is taxable.*

Through the authority of LMC §3.16.540 Administration by City Manager; rules and regulations,

*The administration of all provisions of this chapter is hereby vested in and shall be exercised by the City manager who shall prescribe forms and formulate and promulgate reasonable rules and regulations in conformity with this chapter for the making of returns, for the ascertainment, assessment and collection of taxes imposed and for the proper administration and enforcement thereof. (Ord. 4263 § 8 (part), 1997)*

The City posts our regulations on the City web site, and the regulation titled “How to Document Sales to Retailers and Tax-Exempt Organizations” (attached) addresses tax-exempt construction projects with the following statement;

*Building materials for construction work on property owned by tax-exempt organizations (religious, charitable and governmental) may be purchased tax free. However, the purchaser must have an Exemption Certificate. To obtain the certificate, the contractor must submit an “Application for Exemption Certificate” this form is issued by the Department of Revenue.*

*The sales and use tax exemption applies to materials that become part of the structure, highway, road, street or other public works owned and used by the tax-exempt organization. Also, electricity and most fuels consumed in the construction of exempt constructions projects are exempt. The purchase or rental of equipment, supplies and other materials by the contractor is taxable.*

With the exception that equipment, supplies and materials purchased by the contractor, which they use or will retain upon the completion of the project will remain taxable (which should be pointed out to contractors when they obtain their permits) once the contractor obtains a certificate of exemption from the State, the contractor is entitled to the exemption on their permit for the project to which certificate of exemption applies.

## **Sales and Use Tax Credits**

From time to time there may be instances where the City chooses not to collect City sales and use taxes. This authority is provided through LMC §3.16.590

*Notwithstanding any other provision in this Chapter to the contrary, the City Council may grant by resolution to any person a sales tax and/or use tax credit against the collection of such taxes equal to the amount of tax credited. However, any such credit shall not exceed the amount of tax that would otherwise be collected under this Chapter. The Council may grant the credit on such terms and conditions as it determines is in the best interest of the City provided that it also determines and finds in the resolution that granting the credit will serve a public purpose, which purpose may include, without limitation, providing the public with significant social, economic or cultural benefits. (Ord. 5267 § 1, 2007; Ord. 4857 § 1, 2004)*

When City Council approves use tax credits on projects, the contractor must remember that the City only has the authority to credit/waive the City's tax. The contractor will still need to pay County use tax on the permit and state sales tax where they purchase their materials, unless they have a certificate of exemption from the state.

## **Summary**

The City's Building Department should collect use tax on all building permits regardless of who the owner of the project is, unless:

- The contractor meets the definition of a tax-exempt entity as defined in C.R.S. 39-26-708 and LMC §3.16.050
- The contractor presents a certificate of exemption containing an "89 number" issued by the Colorado Department of Revenue
- The project is covered by a resolution passed by the City Council granting a use tax credit.
  - Only the City of Loveland's portion of use tax may be waived by City Council action.

Upon issuance of the certificate of occupancy, the contractor is still required to file a reconciliation to the City's Revenue Division in the same manner as any other project, to insure that sales and use tax was paid on any purchase or rental of equipment, supplies and other materials used by the contractor that are not passed on to the owner of the property.



## Sales 1

# How to Document Sales to Retailers, Tax-Exempt Organizations and Direct Pay Permit Holders

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The information contained in this FYI is for vendors who must determine whether a customer is eligible to purchase taxable goods without paying sales tax.

### GENERAL INFORMATION

In general, the circumstances in which a customer is not required to pay sales tax are:

- businesses purchasing goods for resale.
- charitable or religious organizations that use the goods in the course of their regular charitable or religious functions.
- federal, state and local governmental agencies that use the goods in the course of their regular governmental functions.
- businesses purchasing goods with a “direct pay permit” issued by the Colorado Department of Revenue.

If there is a dispute between the buyer and the seller as to whether a transaction is exempt from taxation, the seller must collect sales tax and the buyer must pay it. The buyer may then apply to the Colorado Department of Revenue for a refund of the taxes under dispute with a Claim for Refund (DR 0137). The statute of limitations for these refund applications is: three years after the twentieth day of the month following the date of purchase. [§39-26-703(2) (d), C.R.S.] Remember, it is the **vendor** who is ultimately responsible for collection of sales taxes.

### PURCHASES FOR RESALE

Purchases by a retailer who resells the goods as part of the retailer’s regular business activity are not taxable to the retailer, but are taxable when the retailer resells the goods to the consumer. The retailer must pay sales taxes on purchases if the retailer intends to use the goods before they are resold. The buyer does not have the option of later paying consumer use tax on purchases for business or personal use.

The seller must take reasonable measures to verify that the sales tax account number provided by the buyer is valid. The seller should establish an account for buyers who purchase items for resale. The seller must record the sales tax account number and check that the license is not expired. The seller can also verify the sales tax account at [www.Colorado.gov/RevenueOnline](http://www.Colorado.gov/RevenueOnline). If the buyer has a business outside Colorado and does not have a business location in Colorado, the seller may accept the license number from the buyer’s home state, but should also record the license number and check for an expiration date if available. (See, General Information Letter (GIL) 07-028 for more information.)

It is the seller’s responsibility to collect sales tax in questionable situations.

*For example, if the buyer is purchasing office supplies and the buyer’s business does not sell office supplies, the seller should collect the sales tax and not permit use of the buyer’s resale tax account number to purchase tax-free.*

If a buyer has a “direct pay permit” from the Colorado Department of Revenue, the seller is required to obtain a copy of the direct pay permit and keep it on file. The purchases must be paid for directly from the qualified buyer’s (the business) funds, not the funds of an individual.

### PURCHASES BY CHARITABLE AND RELIGIOUS ORGANIZATIONS

If the Department of Revenue has granted an organization exemption from paying sales tax, the organization will possess a Colorado tax exemption number. These are 7 or 8-digit numbers beginning with “98” or “098”. The license will have the words “CHARITABLE LICENSE” printed on the license. The purchaser must present this number to vendors when making tax-exempt purchases. For each sale, vendors must record this number, date of sale, item(s) or service(s) purchased, and name of the organization. Keep this record in your permanent files for audit purposes.

### Determining Exempt Purchases

Not all purchases made by tax-exempt organizations are nontaxable. [§39-26-704, C.R.S.] You may sell tangible personal property or taxable services tax free only if the following requirements are met:

1. **If the purchase totals less than \$100:** The purchaser must show a copy of the exemption certificate (or have a copy of the certificate on file with the vendor), and must sign an affidavit declaring the purchase is made from the organization's funds.
2. **If the purchase totals \$100 or more:** Payment for the item or service must be made with the organization's check or credit card, and not via cash or an individual's check or credit card, and the organization will not be reimbursed by any person(s) for the use or consumption of the item or service.
3. The item or service is used by the organization in conducting its **regular** religious, charitable, scientific, literary, or educational business. This may also include fundraising activities. See FYI Sales 2, Sales Tax Exempt Status for Charitable Organizations: Application Requirements.

*For example, a church that has tax-exempt status would have to pay applicable sales and lodging taxes to a hotel or motel if church members are on a ski vacation, even if the lodging services are paid with a church check, because the ski vacation of its members is not considered part of the churches regular religious function. If, however, the church members are attending a religious seminar, the lodging would be tax exempt if paid with a church check or credit card bearing the church's name, and individuals are not reimbursing the church. See Security Life & Accident Co. v. Temple, 492 P.2d 63 (Colo. 1972) and Colorado Department of Revenue v. City of Aurora, 32 P.3d 590 (Colo. App. 2001)*

If you, the vendor, have any doubts about whether a sale meets the above criteria, collect tax on the sale and advise the purchaser to file a Claim for Refund (DR 0137).

### Sales to Out-of-State Tax-Exempt Organizations

Such organizations will not have a Colorado tax exemption number, and may or may not have a tax exemption number from their home state. Determine whether the sale reasonably meets the eligibility criteria for a nontaxable sale, as explained above. If it does, have a representative sign the form Sales Tax Exemption Certificate: Multi-Jurisdiction (DR 0563). You may keep copies on hand for use when approached by out-of-state groups claiming tax-exempt status.

This procedure places the burden of proof on the organization's representative and protects the vendor should the department discover that the organization falsely claimed tax-exempt status or that the item or service purchased did not meet either or both of the requirements for tax-exempt sales.

Because not all states issue tax exemption numbers, the vendor may want to request and record additional information, such as a driver's license number, to positively identify the person who signs the affidavit.

### PURCHASES BY GOVERNMENT AGENCIES

Sales to the United States government and to the State of Colorado, its departments and institutions, and its political subdivisions (cities, counties, school districts, state higher education institutions and special taxing districts) are exempt by statute. [§39-26-704 (1), C.R.S.] Governmental agencies need not obtain an exemption number from the state. Sales to federal credit unions are exempt under federal government rules.

Purchases must be made for use within the agency's governmental capacities and be paid for by warrant, check, or qualifying government credit cards drawn on governmental funds. (For more information regarding the use of government credit cards see FYI Sales, 63 Government Purchases Exemptions). Evidence of this must be retained in the seller's records. A purchase by government employee using cash or a personal check, even if the employee presents a tax exemption number and plans to be reimbursed, is not tax-exempt.

For a detailed discussion of tax-exempt sales to government entities and foreign diplomats, see FYI Sales 63, Government Purchases Exemptions.

### TAX-EXEMPT CONSTRUCTION PROJECTS

Building materials for construction work on property owned by tax-exempt organizations – religious, charitable and governmental – may be purchased tax-free. However, the purchaser must have an Exemption Certificate. To obtain the certificate, the contractor must submit an Application for Exemption Certificate (DR 0172) to the Department of Revenue.

The sales and use tax exemption applies to materials that become part of the structure, highway, road, street or other public works owned and used by the tax-exempt organization. Also, electricity and most fuels consumed in performing real property construction are exempt. The purchase or rental of equipment, supplies and other materials by the contractor is **taxable**.

#### **PURCHASES MADE WITH A DIRECT PAY PERMIT**

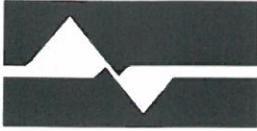
Vendors making sales to qualified purchasers who have a direct pay permit are not required to collect the state and local taxes due on such sales provided the qualified purchaser has a valid direct pay permit number.

These numbers will either begin with 90 or 090 followed by five digits **OR** the number will be an 8-digit number followed by a dash and four digits. **The permit will have the words Direct Pay Permit in the upper left corner.** Vendors can verify the direct pay permit number at [www.Colorado.gov/RevenueOnline](http://www.Colorado.gov/RevenueOnline).

The purchase must be paid for directly with funds of the qualified purchaser (not the personal funds of an individual). However, the direct pay permit is not applicable to county lodging tax and/or county rental tax and is not applicable to self-collected and administered municipal sales taxes. [§§ 30-11-107.5 and 30-11-107.7, C.R.S.] Contact these municipalities directly for their rules or direct pay procedures. **The vendor is required to keep on file a copy of the qualified purchaser's direct pay permit.** Refer to FYI Sales 78, Direct Pay Permit for Colorado Sales Tax, for more information.

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FYIs provide general information concerning a variety of Colorado tax topics in simple and straightforward language. Although the FYIs represent a good faith effort to provide accurate and complete tax information, the information is not binding on the Colorado Department of Revenue, nor does it replace, alter, or supersede Colorado law and regulations. The Executive Director, who by statute is the only person having the authority to bind the Department, has not formally reviewed and/or approved these FYIs.



## How to Document Sales to Retailers and Tax-Exempt Organizations

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### GENERAL INFORMATION

Who is eligible to purchase goods without paying taxes? Listed below are a few circumstances in which a customer is not required to pay sales tax.

- ◆ Businesses purchasing goods for resale.
- ◆ Charitable or religious organizations that use the goods in the course of their regular charitable or religious functions.
- ◆ Federal, state and local government agencies that use the goods in the course of their regular governmental functions.

If there is a dispute between the buyer and the seller as to whether a transaction is exempt from taxation, the seller must collect the sales tax and the buyer must pay it. The buyer may then apply for a [refund](#) with the City of Loveland.

It is the **vendor's** responsibility to collect sales tax.

### PURCHASES FOR RESALE

Purchases where the buyer will re-sell the goods as a part of the buyer's regular business activity are exempt from sales tax. Sales taxes **must** be paid on all purchases for business or personal uses.

The seller must keep on record the wholesalers/ resale certificate issued by their state for all sales to vendors for resale. If the buyer has a business outside of Loveland and does not have a business location in Loveland, the seller may accept the license number from the buyer's municipality. The buyer must meet the requirements for sales tax exemption outlined above.

It is the seller's responsibility to collect sales tax in questionable situations. For example, if the buyer is purchasing office supplies and the buyer's business does not sell office supplies, the seller should collect the sales tax and not permit use of the buyer's resale tax account number to purchase tax-free.

### PURCHASES BY CHARITABLE AND RELIGIOUS ORGANIZATIONS

The City of Loveland does not issue an exempt number; however, we will accept the State of Colorado tax exemption. If the Colorado Department of Revenue has granted an organization

exemption from paying sales tax, the organization will possess a Colorado tax exemption number. This number will begin with "98". The purchaser must present this number to vendors when making tax-exempt purchases. For each sale, vendors must record this number, date of sale, item(s) or service(s) purchased, and name of the organization. This information must be kept in your permanent files for audit purposes.

### **Determining Exempt Purchases**

Not all purchases made by tax-exempt organizations are non-taxable. You may sell tangible personal property or taxable services tax free **only** if **both** of the following requirements are met:

1. Payment for the item or service must be made with the organization's check or credit card, and not via cash or an individual's check or credit card, and the organization will not be reimbursed by any person(s) for the use or consumption of the item or service.
2. The item or service is used by the organization in conducting its **regular** religious, charitable, scientific, literary, or educational business. This may also include fundraising activities. See Tax Reg "Sales Tax Exempt Status for Charitable Organizations"

For example, a church that has tax-exempt status would have to pay applicable sales tax to a hotel or motel if the church members are on a ski vacation, even if the lodging services are paid for with a church check. If, however, the church members are attending a religious seminar, the lodging would be tax exempt if paid with a church check or credit card bearing the church's name, and individuals are not reimbursing the church.

### **Sales to Out-of-State Tax-Exempt Organizations**

Such organizations will not have a Colorado tax exempt number, and may or may not have a tax exempt number from their municipality. Determine whether the sale meets the eligibility requirements listed above. If it does, have a representative, sign a statement or affidavit (see last page of this Tax Regulation).

By having the vendor sign this affidavit it places the burden of proof on the organization's representative and protects the vendor should the city discover that the organization falsely claimed tax-exempt status or that the item or service purchased did not meet all requirements for tax-exempt sales.

Because not all states issue tax exempt numbers, the vendor can accept the 501(c) (3) exemption letter and may want to request and record additional information, such as a driver's license number, to positively identify the person who signs the affidavit.

You may also want to use the affidavit procedures for Colorado tax exempt organizations as an additional protection for your business.

### **PURCHASES BY GOVERNMENT AGENCIES**

Sales to the United States government, City of Loveland, the State of Colorado, its departments and institutions, and its political subdivisions (cities, counties, school districts, state higher

education institutions and special taxing districts) are exempt by statute. [§39-26-704.1 C.R.S.] Governmental agencies need not obtain an exemption number from the state. Sales to federal credit unions are exempt under federal government rules.

Purchases must be made for use within the agency's governmental capacities and be paid for by warrant, check, or qualifying government credit cards drawn on governmental funds (For more information see Tax regulation "Government Purchases Exemptions." Evidence of this must be retained in the seller's records. A purchase by government employee using cash or a personal check, even if the employee presents a tax exemption number and plans to be reimbursed, is not tax-exempt.

### TAX-EXEMPT CONSTRUCTION PROJECTS

Building materials for construction work on property owned by tax-exempt organizations (religious, charitable and governmental) may be purchased tax free. However, the purchaser must have an Exemption Certificate. To obtain the certificate, the contractor must submit an "Application for Exemption Certificate" this form is issued by the [Department of Revenue](#).

The sales and use tax exemption applies to materials that become part of the structure, highway, road, street or other public works owned and used by the tax-exempt organization. Also, electricity and most fuels consumed in the construction of exempt constructions projects are exempt. The purchase or rental of equipment, supplies and other materials by the contractor is taxable.

THE ABOVE INFORMATION IS A SUMMARY IN LAYMAN'S TERMS OF THE RELEVANT LOVELAND TAX LAW FOR THIS INDUSTRY OR BUSINESS SEGMENT. IT IS NOT INTENDED FOR LEGAL PURPOSES TO BE SUBSTITUTED FOR THE FULL TEXT OF THE LMTC (LOVELAND MUNICIPAL TAX CODE) AND APPLICABLE RULES AND REGULATIONS.