

Sales Tax Interpretation 20-03

Application of Taxable Transaction Limits to Long-term Service Contracts

The Finance Director has made a sales tax interpretation that the taxable transaction limit, as it applies to long-term service contracts and arrangements, is \$12,000 per invoice for each single interrelated service, or prorated selling price per each 30-day period if invoiced less frequently than monthly.

Facts:

1. SGC 4.09.100 (N) states that "*That portion of a selling price for a single piece of equipment or tangible personal property or sale unit in excess of twelve thousand dollars is exempt. A single sale unit is (2) Any sale of services sold by an individual unit price*".
2. The application of SGC 4.09.100 (N) to long-term service contracts and long-term construction contracts has led to confusion and misunderstanding on the part of citizens, merchants, and Municipal employees.
3. Merchants providing services often enter into contracts or agreements wherein performance of the service takes many months to complete. Performance of the service and subsequent invoicing to the customer may be sporadic.
4. Contractors frequently enter into long-term construction contracts spanning several months, either on a fixed price basis or a time and materials basis. Such contracts usually, but not always, provide for progress billings to customers.

Discussion:

1. A frequent point of confusion encountered by Municipal sales tax employees is how to apply the taxable transaction limit exemption in SGC 4.09.100 (N) to long-term service contracts and long-term construction contracts. The existing verbiage in the Sitka General Code is confusing, and, both merchants and Municipal employees have requested clarification.
2. Long-term service and construction contracts are complicated for several reasons. First of all, unrelated services performed over a lengthy period of time are sometimes bundled together into a single contract. Secondly, invoicing to customers occurs irregularly; sometimes it is billed all at once in once large invoice, other times progress invoices termed "draws" are generated. Thirdly, especially with construction contracts, change orders are often generated which change the scope of the construction project.
3. By their nature and how their billings work, the two common types of construction contracts – fixed price and time and materials – lead to different concepts of what, exactly, "*any sale of services sold by an individual unit price*" means. In a time and materials contract, materials purchased and used are marked up by an agreed-upon percentage and labor performed is charged at an agreed-upon hourly price. Under a fixed price contract, the contractor quotes a fixed price at the outset of the job and is bound to it unless the scope of the work is changed through change orders. As a fixed price is quoted to the customer ahead of time by a contractor in a fixed price contract, an argument could be made that a fixed price contract is a sale of services by an individual unit price. It is difficult to make this same argument, however, for a time and materials contract as there is no fixed price quoted and what constitutes an individual unit price is open for interpretation. This difference in how contracts work could lead to differences in how sales taxes are levied. For time and materials jobs, sales tax is frequently levied on each invoice which could lead to differences in taxation between fixed price and time and materials jobs.
4. In long-term construction contracts, and, with some long-term service contracts, the contractor bills the customer for "draws" in order to generate cash flow and afford the contractor to pay payroll, purchase materials, etc. Such draws frequently resemble invoices in form and substance. An interpretative question has arisen as to whether or not a "draw" is "*any sale of services sold by an individual unit price*". Should each separate draw billed to the customer be subject to the taxable transaction limit?

5. On rare occasions, situations have been discovered in the past wherein services performed over multiple months have been bundled together into a single invoice for sales tax purposes in order to combine the totals and make the amount of the invoice exceed \$12,000, but the customer has been afforded the ability to make partial payments against the once invoice. An example would be as follows: a firm provides comprehensive professional services at the monthly price of \$1,500. An entire year is invoiced to the customer for \$18,000, with sales tax of \$600 levied on the first \$12,000. The customer is afforded the ability to make twelve monthly payments of \$1,550 against the invoice. Although instances like this are rare and have significantly declined with the increase of the taxable transaction limit to \$12,000, they still occur.
6. Other Municipalities in Southeast Alaska have struggled with this same interpretative question. The administrative guidelines from the City and Borough of Juneau for single service exemptions is attached. In those administrative guidelines, Juneau has stated that the single service transaction limit exemption applies to the amount owed for a single month, or if invoiced more frequently than once a month, the amount of each invoice (see attached).
7. An illustrative example, as follows, shows the difference in sales taxes levied under different interpretations of individual unit price.

Situation: A time and materials contract to remodel a home for \$100,000. Five equivalent monthly draws of \$20,000 are invoiced to the customer. Job lasts 5 months.

If entire contract is considered to be one individual price, sales tax is \$600. Amount of exempted sales - \$88,000.

If each draw is considered to be a separate unit price, sales tax is \$3,000 (5 x \$600). Amount of exempted sales - \$40,000 (5 x \$8,000).

8. The approach followed by the City and Borough of Juneau is logical, straight-forward to interpret and administer, and serves as a reasonable model guideline for Sitka to adopt.

Interpretation

For the purpose of implementing SGC 4.09.100 (N) (commonly referred to as the taxable transaction limit sales tax exemption), as it applies to the sale of services and long-term service and construction contracts, a single sale unit sold by an individual unit price is interpreted to mean the amount owed on a 30-day basis, or if invoiced more than once in a 30-day period, the amount owed per invoice. If a service or construction contract exceeds a 30-day period, the exemption only applies to the amount owed for each consecutive 30-day period. If a service or construction contract exceeds a 30-day period, and, is billed either at the end of the project or on an irregular basis, contractors are required to allocate the billings on a pro rata basis over the full term of the contract. Draws in conjunction with long-term construction contracts are to be deemed invoices for purposes of implementing this interpretation.

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To be submitted to the Assembly for ratification