

# **UNDERSTANDING SALES & USE TAX FOR CONTRACTORS**

*Article by:*

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## Understanding Sales and Use Tax for Contractors

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*By Cheryl Ganim, CPA, and Agnes Spoelker, CPA, Tax Managers*

In today's challenging economic climate, many struggling state tax departments are focusing their attention on self-assessed use tax to identify and capture revenue. Businesses are encouraged to proactively manage their sales and use tax compliance and liability, which in turn will reduce their audit exposure. It can be particularly challenging for local contractors, because Ohio Sales and Use Tax rules for construction contracts are becoming increasingly complex.

Ohio levies Sales and Use Tax on transfers of tangible personal property and certain taxable services, unless an exemption or exclusion applies. The Ohio sales/use tax treatment of personal property purchased by a construction contractor depends on whether the property is transferred to the owner of the contract and whether it is incorporated into realty, or whether it remains personal property after installation or is deemed consumed by the contractor but not incorporated into real property.

Under Ohio sales and use tax rules, if tangible personal property is incorporated into real property through a construction contract, it is not considered a sale of such tangible personal property. The construction contractor is the consumer of the tangible personal property and must pay sales or use tax when items are incorporated into realty. The contractor pays tax on materials and charges no sales tax to the contractee (owner) on either labor or materials used in fulfilling the construction contract.

For example, a business that fabricates and installs countertops is (for Ohio sales tax purposes) a construction contractor and thus is the consumer of the materials that it purchases to make the countertops. In this situation, the contractor pays the sales and/or use tax. If the contractor is installing an underground storage tank or data lines, for example, the materials remain tangible personal property.

That rule does not apply to the installation of items that do not become part of the real estate, such as free-standing wood stoves, draperies, light bulbs, processing machinery and equipment. When tangible personal property is permanently affixed to real property but primarily benefits the business conducted on the premises rather than the realty, it is considered a "business fixture" and retains its status as personal property. In these cases, the contractor must charge the contractee (owner) sales tax on the materials and labor.

Items purchased by a contractor for incorporation into realty owned by a tax-exempt entity are exempt from sales and use tax, if the necessary exemption certificates are used. The same is likely true for items that remain tangible personal property after conveyance to the exempt organization. Not all conveyances to income-tax-exempt organizations are exempt from sales/use tax, however. The contractor must rely on the certifications provided by the contractee in such a situation.

Construction contractors must pay sales or use tax to the state in which the materials ultimately are affixed to real property. For example, a contractor who fabricates steel beams in Kentucky and installs them into realty in Ohio is a construction contractor and pays sales and/or use tax to



Ohio, the location of the realty. An out-of-state contractor who sells “business fixtures” or other tangible personal property in Ohio should charge Ohio sales tax to the contractee.

In general, all warranties under which a vendor agrees to repair or maintain the property of a consumer are taxable unless the warranty is sold in conjunction with a unit to be installed in real property (for example, a furnace). Parts purchased and used in fulfilling a warranty are exempt as purchases for resale.

There are important considerations in the tax treatment of mixed transactions involving both transfers of tangible personal property and services. Tax authorities look to the primary object of the purchaser and if there is separate pricing to determine if a mixed transaction is subject to sales and use tax.

Most businesses are familiar with sales tax but may be unaware that they owe use tax on purchases for which no sales tax was charged by the vendor. Taxpayers have several opportunities and tools available to drive efficiencies and manage use tax audit risk:

- Reverse Sales and Use Tax Audit.
- Exemption and Resale Certificates.
- Direct Pay Permit arrangements for manufacturers, contractors, and other consumers.
- Invoices clearly delineating transactions involving a bundling of goods and services.
- Understand the provisions that govern where to source use tax, such as transactions where businesses use tangible personal property in more than one location, (for example, “canned software” used by multi-state operations).
- In situations when the vendor is not required to collect sales tax (for example, certain online sales), understanding when use tax is payable by the taxpayer/purchaser.
- Voluntary Disclosure Agreements to limit audit look-back periods and move into compliance.

*For more information on sales and use tax and how it impacts your company, please contact us at [cganim@barnesdennig.com](mailto:cganim@barnesdennig.com) or [aspaelker@barnesdennig.com](mailto:aspaelker@barnesdennig.com) or call 513.241.8313.*



## ABOUT THE AUTHORS

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**Cheryl Ganim, CPA**  
**Tax Manager**

Cheryl's expertise in tax research and analysis complement the skills of Barnes Dennig's tax team and make her a decided asset for clients in numerous industries. She has more than 10 years of experience working for local and international accounting firms and a large, regional bank, with a particular focus on state tax compliance and analysis.

**Industry Focus:**

Construction  
Real Estate  
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**Affiliations:**

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**Education:**

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Prior to joining Barnes Dennig, Cheryl was a senior tax analyst for the bank, where she researched technical tax issues and provided recommendations to management. During her time at an international accounting firm, she worked closely with clients to prepare and review complex consolidated corporate federal and state tax returns. She also was responsible for training and developing staff accountants.

Cheryl is a graduate of the University of Cincinnati. She is a member of the American Institute of Certified Public Accountants (AICPA) and the Ohio Society of Certified Public Accountants (OSCPA).



**Agnes Spoelker, CPA**  
**Manager / Tax Specialist**

As a tax specialist and assistant team leader, Agnes provides tax advisory services to the firm's construction and real estate clients, while providing counsel to numerous high net worth individuals. She is driven to help clients structure their tax decisions based on sound business practices.

Agnes has worked on engagements with large, multi-national corporations, middle-market companies, family businesses and small businesses in her 10-year public accounting career. She understands the client's need for expert tax advice and she dedicates herself to providing exceptional client service.

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Agnes graduated from the University of Cincinnati with a Bachelor of Business Administration in Accounting. She is a member of the American Institute of Certified Public Accountants (AICPA) and the Ohio Society of CPAs (OSCPA). She has been a guest on local public radio, discussing tax issues facing individuals.