



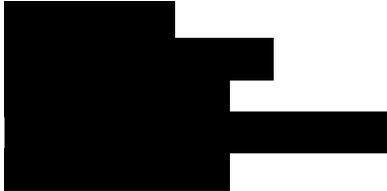
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July 21, 2016



RE: Gross Receipts Tax – Installation of Theater Seating
Opinion Number 20160404

Dear [REDACTED]:

This letter is in response to your request for a Revenue Legal Counsel Opinion by letter dated March 22, 2016. Specifically, your letter requested a sales/use tax determination on an installation project of your employer, [REDACTED] (“Taxpayer” or “contractor”). The facts that you provided in your original opinion request are, in pertinent part, as follows:

Taxpayer is an installation company mostly performing installations of theater seating. The customer contracted with taxpayer for a full supply and install contract for the theater seating. Taxpayer is supplying the seating in the contract, purchasing them from the customer’s selected [REDACTED] company and reselling them to the customer. Taxpayer is a [REDACTED] corporation, registered in the state of Arkansas. The subject project is an old theater which has been torn down, leaving the façade, and newly constructing everything inside. The theater seating gets fixed to this entirely newly constructed portion of the building. Taxpayer provided this information in case it makes a difference for the sale/use tax determination. Taxpayer had the customer clearly present product, freight, installation, and performance bond costs separate in the order.

Based on this information you asked six questions:

1. Confirm that the theater seating installation would be tax exempt in this contract as a “new construction/substantially modified building”?
2. With the freight cost shipping direct from a factory outside of the country to the jobsite, can you confirm if only the product would be taxed, or product and freight?
3. Confirm if the tax is sales or use tax?
4. If use tax, is the cost basis our cost or the price resold and paid by the final customer?
5. If use tax, are there any maximums for city, county, or state?
6. Confirm whether the performance bond (a surety insurance policy) is taxed or not?

In our subsequent email correspondence in May and June 2016, you provided some additional information. As to the types of theater seats, you stated that they would be standard model, but that each project is customized for their specific fit. The large majority of the theater seats will be fixed (anchored) to the cement floor. You also stated that there would be removable fixed seating that have a base, but the seats are thumb screwed and can be removed. Additionally, the contract includes loose seats. You also clarified that Taxpayer does not manufacture the seats. The seating manufacturer drop ships the products to the location where Taxpayer does the installation. As to the shipping, the costs are separately billed by a third-party carrier. Taxpayer will pay the separate billing costs and add that amount the contract with the customer.

RESPONSE

Question 1: Confirm that the theater seating installation would be tax exempt in this contract as a “new construction/substantially modified building”?

This question actually involves multiple issues, so I will separate the answer accordingly.

A. Taxability of the fixed seat installation.

The Arkansas Gross Receipts tax, commonly referred to as "sales tax", generally applies to all sales of tangible personal property and certain enumerated services unless otherwise exempted. *See* Ark. Code Ann. §§ 26-52-301 et seq. (Repl. 2014); *see also* 2008-3 Arkansas Gross Receipts Tax Rules¹. The provisions of Ark. Code Ann. § 26-52-301(3)(B)(viii)(a) (Repl. 2014) provide that the service of initial installation, alteration, addition, refinishing, replacement or repair of non-mechanical, passive, or manually operated components or fixtures affixed to real estate are considered nontaxable contractor services.

The answer to the question on the taxability of the installation service will depend on whether the theater seats are considered affixed to the real estate. The test for determining whether an item is a fixture of the real estate is: 1) whether the tangible personal property is attached to the real estate; 2) whether the property is custom-made for the use or purpose of the part of the real estate to which it is connected; and 3) whether the party intends to make the attachment permanent. *Dobbins v. Lacefield*, 35 Ark. App. 24, 811 S.W.2d 334 (1991). Additionally, the Arkansas Supreme Court has used a fourth test to determine if tangible personal property is a fixture. This test is whether the property is attached in such a manner that it cannot be removed without serious injury to the real estate. *Id*; *see also Sanders v. Putnam*, 315 Ark. 251, 866 S.W.2d 827 (1993).

Based on your description, it appears that the fixed seats are attached to real property, are customized for this specific theater, are intended to be permanent seating, and cannot be removed without materially altering the real estate. The installation of the theater seating would be considered a nontaxable service as an installation of passive non-mechanical fixtures of the real estate.

¹ The Arkansas Gross Receipts Tax Rules are available online at http://www.dfa.arkansas.gov/offices/policyAndLegal/Documents/et2008_3.pdf.

In addition, special provisions exist for contractors in Arkansas. *See* Ark. Code Ann. §§ 26-52-103(5) and 26-52-307 (Repl. 2014); *see also* GR-21. A “contractor” is defined as follows:

(5) “Contractor” means any person who contracts or undertakes to construct, manage, or supervise the construction, erection, alteration, or repair of any building or other improvement or structure affixed to real estate, including any of their component parts[.] Ark. Code Ann. § 26-52-103(5) (Repl. 2014); *see also* GR-3(D) and GR-21(A)(3).

Here, Taxpayer acts as a contractor when it installs the theater seating. Contractors are deemed to be the end consumers of all materials they use in the performance of a contract and must pay sales/use tax on the materials used by them in providing the nontaxable services. Ark. Code Ann. § 26-52-301(3)(B)(viii)(b) (Repl. 2014) and GR-21(A)(1). When a contractor holds a sales tax permit, the contractor may purchase materials tax-exempt on a sale for resale basis. *See* Ark. Code Ann. § 26-52-301(3)(B)(viii)(b) (Repl. 2014) and GR-21(D)(1). Further, you provided that the product will be drop shipped by the seating manufacturer from outside of Arkansas. In the case of an out-of-state company that sells tangible personal property and drop ships the property directly to the installation site in Arkansas, the sale is considered an exempt sale for resale. *See* GR-5(D). Then the contractor will pay Arkansas use tax on the purchase price of the materials at the time the contractor withdraws those items from stock for use in fulfilling a contract. *See* GR-21(D)(1). Withdrawal from stock occurs when a contractor withdraws merchandise from stock for its own use in performing the service or when a taxpayer withdraws merchandise to give to the customer or a third party. *See* GR-18.

Contractors do not collect tax from their customers unless they perform a taxable service. *See* GR-21(D)(1). It has already been determined that the installation of the theater seating is a non-taxable service. Accordingly, when Taxpayer installs the theater seating, Taxpayer is acting as a contractor and neither the purchase of the seating, nor the service of installing them, will be taxable to the customer. I have confirmed that Taxpayer does hold a valid Arkansas Sales and Use Tax Permit. So, as a contractor holding a sales and use tax permit and having purchased and received the product by drop shipment, Taxpayer may purchase the seating tax free as a sale for resale and then must pay tax on the seats as they are withdrawn from stock to be used to fulfill the contract or complete the job.

B. Taxability of the loose seats.

In our email correspondence, you mentioned that loose seats are included in this contract. It is important to distinguish between the loose seats and the fixed seats. The installation of the fixed seats is a service performed on non-mechanical components or fixtures affixed to real estate and exempt as a non-taxable contractor service. *See* Ark. Code Ann. § 26-52-301(3)(B)(viii)(a) (Repl. 2014). Taxpayer, as the contractor, is considered the consumer of all materials used in fulfilling the contract and thus is responsible for the purchase and applicable taxes on the fixed seats. However, if Taxpayer only sells loose seats at retail to the customer and is not hired to install or perform some other contractor type service, the price of the product and any installation charges would be taxable to the customer as a retail sale. Taxpayer must then collect, report, and remit Arkansas sales tax on the sales price of the seats just like any

other retail seller of tangible personal property. Ark. Code Ann. § 26-52-301(1) (Repl. 2014); *see also* Arkansas Gross Receipts Tax Rule GR-4(A) and GR-5(A).

C. Installation in a new construction/substantially modified building.

The service of initial installation, alteration, addition, refinishing, replacement or repair of non-mechanical, passive, or manually operated components or fixtures affixed to real estate are considered nontaxable contractor services. Ark. Code Ann. § 26-52-301(3)(B)(viii)(a) (Repl. 2014). The exemption does not change whether it is a new construction, substantially modified building, or not. However, if the installation involved machinery, electrical devices, or flooring the taxability would depend on whether the building was a new construction or substantial modification. *See* Ark. Code Ann. § 26-52-301(3)(B)(i) (Repl. 2014).

Question 2: Confirm if only the product would be taxed, or product and freight, with freight cost shipping direct from a factory outside of the country to the jobsite?

Separate freight or transportation costs are not subject to tax based upon the facts as you have provided.

You stated that the product would be drop shipped from the manufacturer. Specifically, in addressing drop shipments, Arkansas Gross Receipts Tax Rule GR-5 exempts transactions of this nature stating:

DROP SHIPMENTS. A drop shipment is a sales transaction involving three parties – two sellers and one consumer. The first seller sells property to the second seller, who sells to the consumer; however, the first seller delivers the property directly to the consumer. The taxability of drop shipments depends on the location of the second seller and the consumer. The location of the first seller is irrelevant because the sale from the first seller to the second seller is an exempt sale for resale. GR-5(D).

Thus, the initial sale by the manufacturer to Taxpayer is exempt as a sale for resale. Taxpayer as the contractor providing installation services is considered the consumer of the product and is responsible for self-assessing and remitting tax at the time the item is withdrawn from stock. *See* GR-18.

Generally, delivery charges will be taxable if the item being delivered is taxable, but, if the item sold is exempt, then delivery charges are not taxable. *See* GR-18. Arkansas Gross Receipts Tax Regulation GR-18A specifically states that all freight or transportation charges are part of the gross receipts or gross proceeds on which the tax must be collected and remitted unless the freight charges are billed directly to the purchaser by a carrier other than the seller. In our email correspondence, you stated that shipping is separately stated from the product price and that you pay the shipping to a third-party carrier. Therefore, the exemption applies and the separate freight cost will not be subject to tax.

Question 3: Confirm if the tax is sales or use tax?

The tax is use tax when it is an exempt purchase and the contractor pays the tax. The customer pays sales tax on non-exempt retail sales made by the contractor to the customer.

Arkansas Compensating Use Tax Rule UT-10² provides special rules for contractors. First, UT-10(A) defines contractors to be the consumers of the materials they use in the performance of a contract in this state. All tangible personal property that is procured from outside Arkansas and consumed by a contractor in the performance of a contract in Arkansas is subject to compensating use tax on the purchase price or its market or book value (whichever is greater). See Ark. Code Ann. § 26-53-203(a)(1) (Repl. 2014) and UT-10(B). In addition, an out-of-state contractor that withdraws materials from stock for use in a construction contract in Arkansas is responsible for applicable Arkansas state and local use tax based on the location of the job site. See UT-10(F). However, when [REDACTED] only sells the loose chairs and is not performing a contractor service, sales tax must be collected from the consumer based on the selling price just like any other retail seller of tangible personal property. See Ark. Code Ann. § 26-52-301(1) (Repl. 2014); see also GR-4(A) and GR-5(A).

Question 4: If use tax, is the cost basis our cost or the price resold and paid by the final customer?

The cost basis for use tax will be either your purchase price or the market or book value of the product, whichever value is greater.

All tangible personal property that is procured from outside Arkansas and consumed by a contractor in the performance of a contract in Arkansas is subject to compensating use tax on the purchase price or its market or book value (whichever is greater). See Ark. Code Ann. § 26-53-203(a)(1) (Repl. 2014) and UT-10(B). Therefore, contractors must pay tax on the materials they use in construction projects either at the time they are purchased from the supplier or, if the contractor has a retail permit and has purchased the materials as sales for resale, the contractor must self-assess and pay tax on the materials as they are withdrawn from inventory. When materials are withdrawn from inventory to be used in a construction contract, the contractor should self-assess and pay use tax based upon his purchase price, including the applicable local use tax based on the location of the job site. See UT-10(F). When materials are withdrawn from inventory and sold at retail, the customer should be charged sales tax based on the selling price of the product, including the applicable local sales tax based on the location of the job site. See GR-18.

Question 5: If use tax, are there any maximums for city, county, or state?

As of January 1, 2008, the \$2,500.00 local sales tax cap no longer applies to most purchases. See Ark. Code Ann. § 26-73-301 (Repl. 2008). The tax cap now only applies to the purchase of a motor vehicle, aircraft, watercraft, modular home, manufactured or mobile home. See Ark.

² The Arkansas Compensating Use Tax Rules are available online at http://www.dfa.arkansas.gov/offices/policyAndLegal/Documents/et2008_3.pdf.

Code Ann. §§ 26-73-301, 26-74-220, 26-74-320, 26-74-412, 26-74-612, 26-75-222, and 26-75-319 (Repl. 2008).

However, a rebate of local tax is available to purchasers that pay any municipal or county tax in excess of the tax due on the first \$2,500.00 of gross receipts from a qualifying purchase in a single transaction. *See* Ark. Code Ann. § 26-52-523 (Repl. 2014). A qualifying purchase is a purchase of tangible personal property or taxable service for which a business may claim a business expense deduction or depreciation deduction for federal income tax purposes. Ark. Code Ann. § 26-52-523(a)(1) (Repl. 2014). A purchase will be eligible even though the business purchaser may not be required to file an income tax return. Purchasers may claim the rebate by filing a Claim for Local Cap Rebate Form (ET-179A)³ with the Department or through the self-rebate process (claiming the rebate on a tax return).

Pursuant to Ark. Code Ann. § 26-52-523(a)(2) (Repl. 2014), a single transaction is defined as any sale of tangible personal property or a taxable service reflected on a single invoice, receipt, or statement for which an aggregate sales or use tax amount has been reported and remitted to the state for a single local taxing jurisdiction. If your purchases meet the business expense or depreciation deduction requirements, you are entitled to request a rebate or to self rebate. The amount of the rebate or self rebate will depend upon how the seller invoices the transaction. If the seller invoices you separately for each payment, then you can request a rebate of (or self rebate) the local tax due on the amount in excess of \$2,500 for each payment. If the seller invoices the entire transaction on one invoice, you may request a rebate of (or self rebate) the local tax due on the amount in excess of \$2,500 for the entire transaction.

Effective July 1, 2013, the State Use Tax rate is the same as the Sales Tax rate, 6.500%. In addition, you are required to remit the local use tax based on the location of the job site. *See* UT-10(F). The current city and county tax rates can be found on the Arkansas DFA website: <http://www.dfa.arkansas.gov/offices/exciseTax/salesanduse/Documents/cityCountyTaxTable.pdf>. It is important to note that city and county tax rates are subject to change.

Question 6: Confirm whether the performance bond (a surety insurance policy) is taxed or not?

Ark. Code Ann. § 26-52-301(1) (Repl. 2014) levies gross receipts tax on the gross proceeds or gross receipts derived from all sales of tangible personal property. Additionally, Ark. Code Ann. § 26-52-103(13)(A) (Repl. 2014) defines “gross receipts”, “gross proceeds”, or “sales price” as the total amount of consideration for which tangible personal property or services are sold, leased, or rented. As such, all charges related to the sale are subject to state gross receipts tax, unless the charges fit within one of the excluded categories identified in Ark. Code Ann. § 26-52-103(13)(B) (Repl. 2014). Since the installation of the seats are exempt from tax, the performance bond would also be nontaxable if included as part of the sale of the installation service.

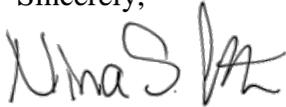
³ Form ET-179A and other applicable Sales and Use Tax Forms are available online at <http://www.dfa.arkansas.gov/offices/exciseTax/salesanduse/Pages/Forms.aspx>.

CONCLUSION

This opinion is based upon my understanding of the facts as set out in your inquiry and as current Arkansas laws and rules govern those facts. Any change in the facts or law could result in a different opinion. Please be advised that this opinion may only be binding upon DFA for three (3) years from the date of issuance. *See* GR-75.

The Arkansas Tax Rules cited in this opinion may be viewed on DFA's website at http://www.dfa.arkansas.gov/offices/policyAndLegal/Documents/et2008_3.pdf

Sincerely,

A handwritten signature in black ink, appearing to read "Nina S Carter". The signature is written in a cursive, somewhat stylized font.

Nina Samuel Carter
Office of Revenue Legal Counsel