



## **TAX BULLETIN 24-3**

### ***Virginia Department of Taxation***

**June 27, 2024**

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## **NEW LAW ALLOWS A ONE-TIME SAFE HARBOR FOR OMITTED AND ERRONEOUSLY REMITTED RETAIL SALES AND USE TAXES TO CONTRACTORS**

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Effective July 1, 2024, House Bill 1508 and Senate Bill 709 (2024 *Acts of Assembly*, [Chapters 113](#) and [128](#)) permit the Department of Taxation (“the Department”) to apply erroneously collected retail sales tax payments by a contractor from its customer to a use tax assessment made to the contractor regarding the transaction.

### **Background**

For purposes of the Retail Sales and Use Tax, *Va. Code* § 58.1-610 provides that businesses that contract to perform construction, reconstruction, installation, repair, or any other service with respect to real estate or fixtures thereon (“contractors”) are not required to collect sales tax from the customers for whom they install tangible personal property. Instead, such contractors are deemed to have purchased all tangible personal property used or consumed in the performance of such contract.

Because contractors are considered to be the end consumers of all tangible personal property that they install for their customers, they are not required to and should not collect sales tax on these transactions. Instead, contractors are subject to the Retail Sales and Use Tax on all purchases of property, items, tools, materials, and supplies used in the performance of their work. If the sales tax on such purchases is not collected by their supplier or vendor at the time of purchase, use tax must be accrued by the contractor and remitted to the Department.

In addition, some businesses operate in a dual capacity as both a dealer (retailer or wholesaler) and a contractor. If the business is not certain at the time of purchase whether the item would be sold to a customer or used in the installation service and does not pay the sales tax, it is liable for the use tax on such items at the time of installation. The contractor should accrue and remit use tax to the Department on these items and should not pass their use tax liability on to a customer by charging the sales tax.

When a contractor erroneously imposes sales tax on its customers, it does not eliminate the contractor's responsibility to remit use tax on the property being installed. Under audit, if it was determined that use tax should have been paid rather than the erroneously remitted sales tax, the contractor would receive an assessment for the unpaid use tax. Because the transaction on which the sales tax was collected is a separate transaction, credit has not generally been granted against the use tax assessment. The contractor is entitled to a refund of the sales tax only if he can show that the tax erroneously collected was paid by him and not passed on to the customer or that the tax was collected from the customer as tax and subsequently refunded to the customer. See 23 Virginia Administrative Code ("VAC") 10-210-410 for additional information concerning the application of the Retail Sales and Use Tax to contractors.

### **Change in Law Effective July 1, 2024**

Effective July 1, 2024, if the Department determines that a contractor has erroneously charged, collected, and remitted sales tax on transactions in which tangible personal property was installed and annexed into real property, as provided under *Va. Code* § 58.1-610, and a use tax assessment has been made with regard to the same tangible personal property, the Department will apply the erroneously collected sales tax to the use tax assessment for eligible contractors for the first instance in which a taxpayer incorrectly collects sales tax from its customers rather than paying the use tax.

To be eligible, the contractor must clearly show that the property included in transactions for which sales tax was erroneously collected and remitted was the same specific property that was incorporated into realty and subject to the use tax assessment.

#### **Example 1**

A fencing business purchased materials, supplies, and tools without paying sales tax, but charged and erroneously collected sales tax on the entire price of an installed fence. The business purchased wood, screws, nails, gate hardware, and other supplies based on the scope of work required by a contract.

Under audit, the purchases are correctly identified as subject to use tax. In order to receive a credit, the business will need to match the purchase invoices to the specific fencing contract on which sales tax was collected and remitted. The credit would be limited to materials and supplies that physically become part of the fence. Supplies consumed and tools used by the business in the performance of the contract would still be subject to sales or use tax and would not be eligible for the credit. Going forward, the business must correctly pay the tax, as the credit is only allowed if the taxpayer has not yet received such relief previously.

## Example 2

A cabinet installer buys cabinets, shims, nails, and screws in bulk for use in kitchen remodeling jobs without paying sales tax. When the installer contracted for a job, it removed materials from inventory to complete work and erroneously collected sales tax on the entire contract price.

Under audit, the purchases are correctly identified as subject to use tax. In order to receive a credit, the installer will need to provide records that match the specific items removed from inventory to the specific cabinet installation contract on which sales tax was collected and remitted. The credit would be limited to materials and supplies that physically become part of the kitchen. Credit would not be granted for materials for which the installer is unable to match to a specific job or items remaining in inventory. Going forward, the installer must correctly pay the tax, as the credit is only allowed if the taxpayer has not yet received such relief previously.

The contractor may not apply for and receive such relief if it has previously applied for and received the relief described by this legislation, or in the case of a false or fraudulent action by the taxpayer with the intention of evading the tax. The relief herein is limited to a single instance, as the intention is to provide contractors with a one-time safe harbor due to confusion within the industry. In addition, such relief only allows qualifying contractors to receive credit for erroneously collected sales tax to the use tax assessment and does not entitle any contractor to a refund of any retail sales tax payments erroneously remitted unless the contractor can affirmatively show that tax was refunded to the purchaser or credited to the purchaser's account.

If a contractor is eligible for the relief described by this legislation, the Department may consider the availability of such relief in determining the amount of the taxpayer's use tax assessment for any pending audits occurring on and after July 1, 2024. The contractor must comply with all requests for evidence to substantiate its eligibility.

If a contractor has already received from the Department a use tax assessment, including use tax assessments made before July 1, 2024, and such contractor believes that it is eligible for the relief described by this legislation, it must complete and submit an offer in compromise ("OIC") request on Form OIC B-2 documenting its eligibility. As noted above, contractors cannot receive a refund of any retail sales tax payments remitted unless they can affirmatively show that the tax has been refunded to the purchaser or credited to the purchaser's account. For information on the OIC process and the forms on which to submit such a request, please visit <https://www.tax.virginia.gov/offer-compromise>.

After a contractor has received this relief, the contractors must pay sales tax to its vendors or accrue and remit the use tax directly to the Department on its purchases of tangible personal property consumed in its real property contracts. Such relief will not

be available for future instances where the taxpayer erroneously treats transactions as retail sales and incorrectly charges the sales tax to its customers.

#### **Additional Information**

This Tax Bulletin is available online in the [Laws, Rules & Decisions](#) section of the Department's website. If you have additional questions, please visit the Department's website at [www.tax.virginia.gov](http://www.tax.virginia.gov) or contact the Department at (804) 367-8037.