

SUMMARY

QUESTION:

Does the Direct Purchase Agreement for the purchase of materials set out in the contract for the construction of the facility meet the legal requirements for the Exempt Organization to purchase the materials tax exempt?

ANSWER:

The procedures meet the legal requirement for the Exempt Organization to purchase the materials tax exempt.

The Direct Purchase Agreement is incorporated into the construction contract. The terms of the construction contract are controlling in determining the taxability of the materials.

The Direct Purchase Agreement meets the requirements that Exempt Organization issue the payment directly to the vendors, that Exempt Organization assume risk of loss of the materials prior to their incorporation into the project as an additional named party on the Contractor's builders risk insurance policy, that the Exempt Organization issue the purchase orders, and that vendors issue their invoices directly to the Exempt Organization.

July 8, 2008

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Re: Technical Assistance Advisement 08A-019
Sales and Use Tax – Construction Contract/Exempt Organization
Section: 212.08, F.S.
Petitioner: XXX (herein "Organization N"); XXX (herein "Organization S")
FEI: XXX, XXX

Dear XXX:

This letter is a response to your petition dated May 21, 2008, for the Department's issuance of a Technical Assistance Advisement ("TAA") concerning the above referenced parties and matter. This petition is a follow up to TAA XXX, which was issued earlier this year. Your petition has been carefully examined and the Department finds it to be in compliance with the requisite criteria set forth in Chapter 12-11, Florida Administrative Code. This response to your request constitutes a TAA and is issued to you under

the authority of s. 213.22, Florida Statutes.

ISSUE

Whether the Direct Purchase Agreement is sufficient to allow a tax-exempt organization to take advantage of its tax-exempt status on the purchase of materials for use in a real property construction contract.

PRESENTED FACTS

The petition sets forth the following information:

[Organization S] is America's leading orchestral academy. [Organization S's] three-year fellowship program is an in-depth course of instruction and performance that prepares outstanding graduates of conservatories and universities for musical leadership in orchestras and ensembles around the world. [Organization S] is developing and constructing a state-of-the-art educational, performance and Internet2 facility. [Organization S's] new facility will be located on land owned by [City], a Florida municipal corporation, subject to a XXX-year ground lease pursuant to which the City has leased to [Organization S], for nominal rent, land upon which [Organization S] will build its new facility. The lease has XXX XXX-year automatic extensions.

[Organization N] was formed by [Organization S] to participate in the development of the new facility described above, on behalf of [Organization S]. [Organization S] is the sole member of [Organization N]. [Organization N] and [Organization S] have entered into an operating agreement that sets forth their understanding concerning the operations of [Organization N]. [Organization N] has contracted with [Contractor], a XXX limited liability company, to develop the new facility. [Project Manager] has been hired by [Organization N] as project manager. [Organization N] and the "Contractor" have established procedures (the "Procedures") under which [Organization N] will purchase materials and equipment included in any subcontractor's scope of work directly from the supplier of the materials or equipment in order to achieve sales tax savings. A copy of the procedures is enclosed in the form of a "Direct Purchase Agreement" [which is an amendment to the original contract.]

The terms of the amendment are as follows:

Owner represents to Contractor that Owner is a "tax exempt entity" entitled to make purchases which are exempt from Sales Tax and Use Tax levied by the State of Florida and its political subdivisions. The Owner elects to implement a Direct Purchase Program for the Project to purchase materials and equipment included in certain subcontractors' scope of work directly from the supplier of such materials or equipment in order to achieve sales and use tax savings. Such materials and equipment are referred to as "Direct Purchase Materials". When Owner and Contractor execute this Direct Purchase Agreement, the contract between the parties dated XXX will be amended accordingly and the following terms and conditions will apply to such purchase and be incorporated in and made a part of the contract:

Contractor shall require its subcontractors to itemize materials and equipment included in their subcontracts and to provide the purchase price of such materials and equipment that equals the sales tax deduction already subtracted from such subcontractor's subcontract amount in the Construction Contract and to identify the supplier, manufacturer, brand, model, specification number, and quantity of such materials and equipment to be purchased.

The Owner shall promptly issue a purchase order directly to the supplier of such Direct Purchase Materials for the applicable materials and equipment and [supplier] shall issue its invoice directly to Owner. The purchase order shall require that the supplier provide the required shipping and handling insurance and provide for delivery F.O.B. Project site. A corresponding Change Order to the Construction Contract shall be executed by Owner and Contractor.

Upon delivery of Direct Purchase Materials to the Project site, the Owner, through its agent, shall inspect the equipment and materials and accompanying invoices to determine that they conform to the Owner's purchase order. Assuming that the Direct Purchase Materials conform to Owner's purchase order, Owner will then accept and take title to the Direct Purchase Materials through its agent. Owner will process invoices and issue payment directly to the applicable supplier after receipt from its agent of approved invoices and associated back-up documentation for accepted Direct Purchase Materials. Owner's agent as referred to in this paragraph is Contractor. Owner shall obtain a Final Waiver and Release of Lien and Right to Claim against Contractor's Payment Bond in exchange for every direct payment Owner makes to a supplier hereunder.

Upon acceptance of the Direct Purchase Materials, Owner shall assume risk of loss of such materials until their incorporation into the Project. Contractor, as Owner's agent, and the applicable subcontractor shall be responsible for safeguarding all Direct Purchase Materials, and for obtaining and managing all warranties and guarantees for all materials and products as required by the Contract Documents. Prior to installation, Contractor and the applicable subcontractor shall determine that Direct Purchase Materials conform to the requirements of the Contract Documents. Owner shall maintain builder's risk insurance on the Direct Purchase Materials.

Owner assumes all risk that any attempted tax exempt purchase hereunder may be disallowed, in whole or in part, or that any tax saving contemplated hereunder is not realized. In the event any sales or use tax is ultimately determined to be due on an attempted tax exempt purchase, the Construction Contract and applicable subcontract(s) shall be adjusted by Change Order to increase the Construction Contract and subcontract sums by the amount of such tax assessed on the attempted tax exempt transaction.

In addition, you have provided a copy of Organization N's Consumer's Certificate of Exemption.

LAW AND DISCUSSION

Nonprofit institutions that qualify under section 501(c)(3) of the Internal Revenue Code may structure

construction contracts in order to take advantage of tax exemptions available to them. If the organization elects to take advantage of tax exemptions in a construction contract, certain elements are required in order to legally effect the exemption. These elements must be followed for the exempt organization to receive its exemption.

Pursuant to section 212.08(7)(p), Florida Statutes, sales tax does not apply to the purchase, by an organization exempt from income tax under I.R.C. Section 501(c)(3), of tangible personal property, including building materials, where payment is made directly to the vendor by the exempt organization and such purchases will be used to carry out the exempt organization's customary nonprofit activities. Further, the exempt organization is required to present the vendor with a properly completed exemption certificate at the time of purchase in order to establish the tax-exempt status of the transaction.

In those instances where the tax-exempt entity makes purchases of tangible personal property in the tax-exempt entity's own name, using its own purchase orders, and making direct payment to the vendor of the materials, and provided that the tax exempt entity is invoiced directly for the purchases, no sales tax is due on such purchases.

Notwithstanding the previous paragraph, even if the tax exempt entity has structured a contract as described above, the tax-exempt entity must assume all risk of damage or loss for the building materials from the time of purchase and prior to their installation or incorporation into the project in order for the sale of building materials to be deemed a sale to the tax-exempt entity and, thus, to be tax exempt. Further, the Department will also give special consideration to several factors (bidding, indemnification, inspection, acceptance, delivery, payment, and storage) that govern the status of tangible personal property prior to its affixation to real property when determining whether the sale of such property is to the tax-exempt entity or instead to a contractor. However, the assumption of risk of damage or loss is the paramount consideration. The assumption of risk would include the period of time that the building materials are physically stored at the job site prior to their installation or incorporation into the project. The tax-exempt entity will be deemed to have assumed the risk of damage or loss if the tax-exempt entity either bears the economic burden of posting a bond or obtaining insurance covering damage or loss, or enjoys the economic benefit of the proceeds of such bond or insurance. If the tax-exempt entity does not assume the risk of damage or loss, the contractor will be construed to be the ultimate or final consumer of the building materials it uses and will be liable for the applicable tax.

In order to make a determination that the exempt entity is the final consumer of the building materials, the construction contract must include the following provisions:

- 1) The Exempt Organization must issue the purchase orders in its own name along with a copy of its Consumer's Certificate of Exemption.
- 2) Materials must be delivered to Exempt Organization at the job site, and title of materials must be transferred to Exempt Organization.
- 3) The Exempt Organization must be billed directly by the selling vendor.

- 4) Payment for the materials must be made directly by the Exempt Organization.
- 5) The Exempt Organization must bear all risk of loss or damage to materials from the time of purchase and prior to their installation into the project.

CONCLUSION

Organization N's procedures are sufficient for it to take advantage of its tax-exempt status for the purchase of building materials for Contractor's use in the construction project. The terms of the construction contract are controlling in determining the taxability of the materials, and the procedures set forth in the amendment to the contract quoted above do allow for the purchase of materials tax-exempt.

The amendment clearly states that Organization N shall be the party issuing the purchase orders. The

amendment requires that vendors issue their invoices directly to Organization N. The amendment provides that Organization N shall issue the payment directly to the vendors who will deliver the materials to the jobsite. The amendment further provides that Organization N will take ownership of the items upon their arrival at the jobsite, and that Organization N will assume risk of loss of the materials prior to their incorporation into the project and shall maintain builder's risk insurance on the Direct Purchase Materials.

Thus, materials purchased under the amended contract, and which comply with the terms listed in said amendment, may be purchased exempt from Florida sales tax.

This response constitutes a Technical Assistance Advisement under Section 213.22, Florida Statutes, which is binding on the department only under the facts and circumstances described in the request for this advice, as specified in Section 213.22, Florida Statutes. Our response is predicated upon those facts and the specific situation summarized above. You are advised that subsequent statutory or administrative rule changes or judicial interpretations of the statutes or rules upon which this advice is based may subject similar future transactions to a different treatment from that which is expressed in this response.

You are further advised that this response, your request and related backup documents are public records under Chapter 119, Florida Statutes, and are subject to disclosure to the public under the conditions of s. 213.22, Florida Statutes. Confidential information must be deleted before public disclosure. In an effort to protect confidentiality, we request you provide the undersigned with an edited copy of your request for

Technical Assistance Advisement

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Technical Assistance Advisement, the backup material and this response, deleting names, addresses and any other details which might lead to identification of the taxpayer. Your response should be received by the Department within 10 days of the date of this letter.

Sincerely,

Kama D. S. Monroe
Senior Attorney
Technical Assistance and Dispute Resolution

Control # 46068