



FLORIDA

Executive
Director

Leon Biegalski

QUESTION: ARE TAXPAYER’S CONTRACTS FOR REAL PROPERTY IMPROVEMENTS?

ANSWER: THE CONTRACTS VARY AND MUST BE DECIDED ON A CASE BY CASE BASIS.

September 9, 2016

Subject: Technical Assistance Advisement (“TAA”) 16A-015
Sales and Use Tax
Real property improvements; Cathodic protection

Section(s) 212.02, 212.05, 212.06, 212.08(17), Florida Statutes (“F.S.”)
Rule(s) 12A-1.051, Florida Administrative Code (“F.A.C.”)

XXXX (“Taxpayer”)(“Petitioner”)

FEIN: XXXX

BPN: XXXX

Dear XXXX:

This letter is a response to your petition dated May 6, 2016, for the Department’s issuance of a Technical Assistance Advisement (“TAA”) to Petitioner, regarding whether Taxpayer is a real property improvement contractor. Your petition has been carefully examined, and the Department finds it to be in compliance with the requisite criteria set forth in Rule Chapter 12-11, F.A.C. This response to your request constitutes a TAA and is issued to you under the authority of section 213.22, F.S.

Issue

Whether sales made by Taxpayer are for real property improvements or sales of tangible personal property?

Facts

Taxpayer provides cathodic protection systems and related services, including design engineering services. These systems are designed to provide corrosion protection to certain metal and concrete structures, including pipelines, refineries, water and storage tanks, platform rigs, and other industrial property. Taxpayer’s cathodic protection systems are designed to prevent corrosion in new structures and mitigate corrosion in existing structures. Taxpayer uses

Child Support – *Ann Coffin, Director* • General Tax Administration – *Maria Johnson, Director*
Property Tax Oversight – *Dr. Maurice Gogarty, Director* • Information Services – *Damu Kuttikrishnan, Director*

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different types of equipment, products, and services to protect various types of structures. The systems may include different types of anodes and rectifiers, including those made of different metals, impressed current anodes, and galvanic anodes. Taxpayer may also provide coating protection, installation, testing, and monitoring.

XXXX. The cathodic protection devices or items are placed in the ground. Taxpayer may place them encased in concrete approximately 100 feet deep. In some instances, no concrete encasement is used. In other cases, the items are placed closer to the ground. The items will not be replaced. When needed, another similar system will be installed in a similar manner.

Taxpayer provides cathodic protection systems for storage tanks used to store hazardous liquids and other industrial materials. On existing tanks, the anodes are installed less than 20 feet in the ground surrounding the existing tank. For new tanks, the anode is placed under the concrete slab on which the tank is built. The anodes and other items cannot be removed. Taxpayer provides coating of the tank. Taxpayer also monitors and inspects the systems.

Taxpayer provides cathodic services to water and storage tanks. In some instances, the systems are permanently installed within the tank. In other instances, the system is suspended or hung with or without being bolted while submerged in the water contained in the tank. Taxpayer may remove the current system when installing a new system. In some instances, the system is easily removed. In some instances, a municipality or other local government unit may be the customer.

Taxpayer furnishes engineering support to the XXXX. The support services include protection system design, system inspection for corrosion control, cathode installation and augmentations, protective coating, and cathode protection management. Taxpayer also manages cathodic protection systems.

Taxpayer also surveys and repairs projects as a primary contractor. XXXX. Taxpayer's engineering design services and monitoring services are contracted and billed on time and materials used. Taxpayer also sells parts direct to customers and contractors.

Taxpayer provided several contracts and/or billings with the request. This documentation relates only to the pipelines and above ground tanks.

Taxpayer Position

Taxpayer maintains that the sales related to pipelines and non-water storage tanks are real property contracts. In these contracts, Taxpayer maintains that the tax is based on the manufactured costs of the anodes and materials used. In regard to water tanks system sales, Taxpayer maintains the sales are for repairs and installations of tangible personal property. Taxpayer maintains that cities are exempt on these types of contracts. Taxpayer maintains that all defense contracts are exempt from the tax, as provided by s. 212.08(17), Florida Statutes ("F.S."). Taxpayer maintains that engineering and monitoring services are not subject to sales tax.

Applicable Law and Discussion

Section 212.05(1)(a)1.a., F.S., provides, in part, the following:

It is hereby declared to be the legislative intent that every person is exercising a taxable privilege who engages in the business of selling tangible personal property at retail in this state

(1) For the exercise of such privilege, a tax is levied on each taxable transaction or incident, which tax is due and payable as follows:

(a)1.a. At the rate of 6 percent of the sales price of each item or article of tangible personal property when sold at retail in this state, computed on each taxable sale for the purpose of remitting the amount of tax due the state, and including each and every retail sale.

Section 212.02(10)(h) and (14)(a), F.S., provide, in part, the following:

(10)(h) “Real property” means the surface land, improvements thereto, and fixtures, and is synonymous with “realty” and “real estate.”

(14)(a) “Retail sale” or a “sale at retail” means a sale to a consumer or to any person for any purpose other than for resale in the form of tangible personal property A sale for resale includes a sale of qualifying property. As used in this paragraph, the term “qualifying property” means tangible personal property, other than electricity, which is used or consumed by a government contractor in the performance of a qualifying contract as defined in s. 212.08(17)(c), to the extent that the cost of the property is allocated or charged as a direct item of cost to such contract, title to which property vests in or passes to the government under the contract. The term “government contractor” includes prime contractors and subcontractors. As used in this paragraph, a cost is a “direct item of cost” if it is a “direct cost” as defined in 48 C.F.R. s. 9904.418-30(a)(2), or similar successor provisions, including costs identified specifically with a particular contract.

Section 212.06(14), F.S., provides, in part, the following:

(14) For the purpose of determining whether a person is improving real property, the term:

(a) “Real property” means the land and improvements thereto and fixtures and is synonymous with the terms “realty” and “real estate.”

(b) “Fixtures” means items that are an accessory to a building, other structure, or land and that do not lose their identity as accessories when installed but that do become permanently attached to realty....

(c) “Improvements to real property” includes the activities of building, erecting, constructing, altering, improving, repairing, or maintaining real property.

Section 212.08(17), F.S., provides, in part, the following:

(17) (a) Subject to paragraph (d), the tax imposed by this chapter does not apply to the sale to or use by a government contractor of overhead materials. The term “government contractor” includes prime contractors and subcontractors.

(b) As used in this subsection, the term “overhead materials” means all tangible personal property, other than qualifying property as defined in s. 212.02(14)(a) and electricity, which is used or consumed in the performance of a qualifying contract, title to which property vests in or passes to the government under the contract.

(c) As used in this subsection and in s. 212.02(14)(a), the term “qualifying contract” means a contract with the United States Department of Defense or the National Aeronautics and Space Administration, or a subcontract thereunder, but does not include a contract or subcontract for the repair, alteration, improvement, or construction of real property, except to the extent that purchases under such a contract would otherwise be exempt from the tax imposed by this chapter. (Emphasis added)

(d) The exemption provided in this subsection applies as follows:

4. Beginning July 1, 2003, the entire sales price or cost price of such overhead materials is exempt from the tax imposed by this chapter.

The exemption provided in this subsection does not apply to any part of the cost of overhead materials allocated to a contract that is not a qualifying contract.

Rule 12A-1.051, Florida Administrative Code (“F.A.C.”), provides, in part, the following:

(1) Scope of the rule. This rule governs the taxability of the purchase, sale, or use of tangible personal property by contractors and subcontractors who purchase, acquire, or manufacture materials and supplies for use in the performance of real property contracts other than public works contracts performed for governmental entities, which are governed by the provisions of Rule 12A-1.094, F.A.C....

(2) Definitions. For purposes of this rule, the following terms have the following meanings:

(a) "Fabricated cost" means the cost to a real property contractor of fabricated items, as defined in the following paragraph. The elements of cost included in fabricated cost are set forth in Rule 12A-1.043, F.A.C....

(c)1. "Fixture" means an item that is an accessory to a building, other structure, or to land, that retains its separate identity upon installation, but that is permanently attached to the realty. Fixtures include such items as wired lighting, kitchen or bathroom sinks, furnaces, central air conditioning units, elevators or escalators, or built-in cabinets, counters, or lockers.

2. In order for an item to be considered a fixture, it is not necessary that the owner of the item also own the real property to which the item is attached. A retained title provision in a sales contract or in an agreement that is designated as a lease but is in substance a conditional sales contract is not determinative of whether the item involved is or is not a fixture. Similarly, the fact that a lessee or licensee of real property rather than the lessor/owner enters into a contract for an item to be permanently attached to the real property does not prevent that item from being classified as a fixture.

3. The determination whether an item is a fixture depends upon review of all the facts and circumstances of each situation. Among the relevant factors that determine whether a particular item is a fixture are the following:

a. The method of attachment. Items that are screwed or bolted in place, buried underground, installed behind walls, or joined directly to a structure's plumbing or wiring systems are likely to be classified as fixtures. Attachment in such a manner that removal is impossible without causing substantial damage to the underlying realty indicates that an item is a fixture.

b. Intent of the property holder in having the item attached. If the property holder who causes an item to be attached to realty intends that the item will remain in place for an extended or indefinite period of time, that item is more likely to be a fixture. That intent may be determined by reviewing all of the property holder's actions in regard to the item, including how the item is treated for purposes of ad valorem and income tax purposes. For example, if a property owner reports the value of the item for purposes of ad valorem taxation of the realty and depreciates the item for tax and financial accounting purposes as real property, that indicates an intent that the property is permanently attached as a fixture.

c. Real property law. If an interest in an item arises upon acquiring title to the land or building, the item is more likely to be considered a fixture. For example, if the seller of real property would be expected to leave an item behind when vacating the premises for a new owner without the contract specifically requiring that it be left, that item is likely to be classified as a fixture.

d. Customization. If items are custom designed or custom assembled to be attached in a particular space, they are more likely to be classified as fixtures. Customization indicates intent that the items are to remain in place following installation.

e. Permits and licensing. If installation of an item requires a construction permit or licensing of the contractor under statutes or regulations governing the building trades, that item is more likely to be regarded as a fixture.

f. Legal agreements. The terms of any purchase agreement, deed, lease, or other legal document pertaining specifically to an item may be relevant in determining whether that item is a fixture of real property.

The foregoing list of factors relevant to determining whether an item is a fixture is intended to be illustrative only. Additional factors may exist in any particular case, and the weight to be given to the factors will also vary in each case.

(h)1. "Real property contract" means an agreement, oral or written, whether on a lump sum, time and materials, cost plus, guaranteed price, or any other basis, to:

- a. Erect, construct, alter, repair, or maintain any building, other structure, road, project, development, or other real property improvement;
- b. Excavate, grade, or perform site preparation for a building, other structure, road, project, development, or other real property improvement; or
- c. Furnish and install tangible personal property that becomes a part of or is directly wired or plumbed into the central heating system, central air conditioning system, electrical system, plumbing system, or other structural system that requires installation of wires, ducts, conduits, pipes, vents, or similar components that are embedded in or securely affixed to the land or a structure thereon.

Real property is defined by s. 212.02(10)(h), F.S., to include surface land, improvements, and fixtures. Section 212.06(14)(c), F.S., provides that improvements include activities of building, erecting, constructing, altering, improving, repairing, and maintaining real property. Section 212.06(14)(b), F.S., provides that fixtures include an accessory to the building and land that does not lose its identity as an accessory when installed. Industrial machinery or equipment is not considered to be a fixture. To the extent that the systems put in place by Taxpayer include primarily equipment, then Rule 12A-1.051, F.A.C., does not apply.

Rule 12A-1.051(4), F.A.C., provides that generally real property improvement contractors are the ultimate consumers of materials and supplies they use to perform real property contracts and must pay tax on their costs of those materials and supplies. Also see Rule 12A-1.051(10), F.A.C., regarding the calculation of use tax on fabrication costs. If Taxpayer's cathodic system projects involve a combination of real property improvements and the sale of tangible personal property, then Taxpayer's agreements with its customers may be mixed contracts. See Rule 12A-1.051(8), F.A.C.

The primary issue identified by the request is whether Taxpayer is improving real property or selling tangible personal property for different types of transactions. Section 212.05, F.S., provides that the sale of tangible personal property is subject to sales tax. Sales tax also applies on the sales price for the sale, installation, and repair of tangible personal property. It also applies to engineering or monitoring services that are part of the sale of tangible personal property. For example, design engineering and installation labor are part of the sale of tangible personal property when the contract is in regard to the sale, repair, or fabrication of tangible personal property. When Taxpayer's sales are performed on vessels, platform rigs, or other items clearly involving tangible personal property, then Taxpayer must collect sales tax on the full sales price, including monitoring and engineering services that are part of the sale of the system. However, if the installation or repair is done so the property sold is permanently affixed to real property, then the charge may qualify as a real property improvement of which the charge for the improvement is not subject to sales tax, as provided by Rule 12A-1.051, F.A.C.

To the extent that the system installed is predominantly equipment or machinery, then the charges are for installation of tangible personal property. Also, services, such as coating performed on pipeline or other tangible personal property prior to installation with a real property improvement, are considered as fabrication to tangible personal property that is subject

to sales tax. In addition, you should note that cathodic protection systems used in relation to electricity production were considered to be related to tangible personal property. See Jacksonville Electric Authority v. Department of Revenue, 486 So.2d 1350 (Fla. App. 1st DCA 1986).

Specific activities classified as real property contracts typically involving an improvement to real property include drilling, steel and concrete installation, foundational work, cement and concrete work, and coating such as painting and waterproofing. Also included are electrical system installation and repairs, including structural wiring and cabling, meter boxes, switches, receptacles, wall plates, and similar items. Other examples are included in Rule 12A-1.051(17), F.A.C. To the extent that Taxpayer's activities are those identified by this Rule, then the activity is related to a real property improvement.

Although Rule 12A-1.051, F.A.C., does not identify the characterization of water tanks, pipelines, and storage tanks, this type of property could be construed as real property, since these items are typically considered to be fixtures. The installation of a cathodic protection system could be construed as a real property improvement for sales tax purposes if the systems do not predominantly include a device, equipment, or machinery.

Response

Section 212.05, F.S., provides that the sales tax must be imposed on the sale of tangible personal property. Section 212.21(2), F.S., provides, in part, the following:

(2) It is hereby declared to be the specific legislative intent to tax each and every sale, admission, use, storage, consumption, or rental levied and set forth in this chapter, except as to such sale, admission, use, storage, consumption, or rental as shall be specifically exempted therefrom by this chapter subject to the conditions appertaining to such exemption....

All sales of tangible personal property are taxable unless the items are specifically exempt from the tax. Wanda Marine Corporation v. Department of Revenue, 305 So.2d 65 (Fla. 1st DCA 1974).

Rule 12A-1.051(17), F.A.C., provides, in part, that the determination whether any particular job involves a contract for an improvement to real property will be based on criteria set forth in paragraphs (c), (d), (e), (g), (h), (i), and (j) of subsection (2). In this instance, the criteria established in paragraph (c), F.A.C., should be determined for each type of contract by Taxpayer. Although the request did not provide all facts related to each criterion for each contract provided with the request, the response is being made limited to the facts provided.

Taxpayer must maintain documentation to support exempt transactions for a minimum of three (3) years. See ss. 212.13(2), 213.35, and 95.091, F.S. Consequently, under Florida law, the burden is on Taxpayer, as the party claiming the exemption, to establish from its books and

records that it is clearly entitled to a particular exemption when making a sale. This includes exemption certificates used to support an exempt sale. It also includes documentation regarding the criteria established for Rule 12A-1.051(2)(c), (d), (e), (g), (h), and (i), F.A.C. Therefore, a review of documentation, including proposals, purchase orders, billings, agreements, characterization of the property for federal and local tax purposes, and other relevant information, should be reviewed for each type of contract.

Although the documents provided regarding specific pipeline and non-water storage tanks do not provide clarification of the circumstances, the request provides general information regarding these two types of projects. The request provides that Taxpayer will install the cathodic system into the ground, and/or sometimes, within or beneath the concrete foundations. The request provides that in some instances, the system is placed in the ground at substantial depths below the surface or below items that are protected by the cathodic system. The request provides that for all projects, the intent is to never remove the cathodic system put in place. Even when a new system is required, the old system is not removed. These circumstances tend to demonstrate that the criteria identified by Rule 12A-1.051(2)(c)3.a. and b., F.A.C., are satisfied to establish that Taxpayer is acting as a real property improvement contractor for these projects.

In regard to the above ground water storage tanks projects, Taxpayer did not provide any documentation regarding the criteria provided for by Rule 12A-1.051(2)(c), F.A.C. The request provides that Taxpayer will install the cathodic system in one of two manners. Taxpayer may simply hang the system submersed in the water contained in the tank. Taxpayer may attach the cathodic system to the tank.

In both instances, the intent will be to replace the old system with a new system, which will result in the removal of the old system. Removal in either instance will be easily done without damage to the tank. When the cathodic system is installed by hanging in suspension with the intent to remove it at a later date, then these circumstances tend to demonstrate that the criteria identified by Rule 12A-1.051(2)(c)3.a. and b., F.A.C., are satisfied to establish that Taxpayer is acting as a seller of tangible personal property.

When Taxpayer bolts the system in place, this tends to demonstrate that Taxpayer is acting as real property improvement contractor. However, since removal will not cause damage to the tank, as indicated in the request, this will also tend to demonstrate that Taxpayer is selling tangible personal property. When Taxpayer's customer is a local governmental entity, then Taxpayer may accept the exemption certificate provided by the customer, including the ones included within the request. Taxpayer is required to provide proof of the method of affixation and removal.

In regard to Taxpayer's defense contracts, no information or documentation regarding a particular project was provided. Therefore, a specific response cannot be made. To the extent the Taxpayer can establish that the criteria provided by s. 212.08(17), F.S., can be confirmed, then Taxpayer sales may qualify for the exemption. You should note that real property improvements contracts are not qualifying contracts for purposes of the exemption. See s. 212.08(17)(c), F.S.

This response constitutes a Technical Assistance Advisement under section 213.22, F.S., 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, F.S. Our response is predicated on 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 than expressed in this response.

You are further advised that this response, your request and related backup documents are public records under Chapter 119, F.S., and are subject to disclosure to the public under the conditions of section 213.22, F.S. 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, 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.

Respectfully,

Charles Wallace
Technical Assistance & Dispute Resolution
850-717-7541

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