

March 5, 2007

<name>  
<address 1>  
<address 2>  
<city, state zip>

Formal Ruling 2007-02

Dear <name>:

You have requested a formal ruling on behalf of <company>, as to the sales and use tax implications from the sale and installation of warehouse racking systems. <Company>, a <State> limited liability company, intends to expand its business into Vermont.

Facts:

<Company>, a business located in the state of <State>, contracts with its customers for the sale and installation of warehouse racks. Customers provide warehouse dimensions to <company>, which with the aid of a professional engineering firm that provides certain calculations and technical assistance, develops a computer-aided design (CAD) of the warehouse racking. Blueprints of the project are sent to the customer for approval. Once approved, <company> delivers a final quotation to the customer separately detailing the sales price of the material, installation, estimated freight, engineering fees (the fees paid to the outside engineering firm), building permit fees and any applicable taxes.

Upon entering a contract with the customer, <company> contracts with a third party manufacturer located in a separate state to manufacture the customized warehouse racks according to specification.\* The manufactured racking is shipped in pieces by common carrier FOB manufacturer directly to the customer's location in Vermont. <Company> then invoices the customer by specifically detailing the sales price of the material. The freight appears as a separate line item on the invoice and typically represents the actual cost paid by <company> to the common carrier.

When the materials arrive at the customer's warehouse, the racks are installed by <company> employees who are dispatched to Vermont. The employees may remain onsite for weeks if not months

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\* For the purpose of this ruling, it is presumed that the out-of-state manufacturer has no nexus with Vermont and no filing requirement.

to complete the installation. The installation price is based upon the entire job and is not a function of time.

Each rack consists of two upright beams and two base plates that are anchored to a concrete warehouse floor with  $\frac{1}{2}$  to  $\frac{3}{4}$  inch concrete wedge and epoxy anchors. The racks are made of structural steel. The racking is ordinarily used to store inventory, but may hold raw materials used in a production or manufacturing process. The typical rack is 42 inches deep and capable of supporting hundreds, and perhaps thousands of pounds of inventory, goods, materials or products. In the aggregate, the racks themselves may weigh hundreds of thousands of pounds.

The installation process primarily consists of bolting the various components of each rack together and securing the rack to the floor. Typically, no welding or cutting is required. Concrete wedges are usually installed every eight feet. Anchors are installed  $3\frac{3}{4}$  to  $5\frac{1}{2}$  inches deep on average, and are inserted into a hole drilled into the concrete floor. The concrete wedge anchor is then expanded, wedging itself securely into the concrete. Once installed, a concrete anchor may only be removed by cutting it from the floor.

As certain milestones are completed, <company> invoices the customer based on the agreed fixed installation price. The charges for installation are separately stated on the invoice and in the master contract. The same invoice may also contain line items separately detailing the sales price of materials, freight, building permit fees, engineering fees, and sales tax. Once the installation is complete, the customer makes the final payment and signs off on the project. The sales price of projects may surpass \$1,000,000.

Though it is theoretically possible to remove the warehouse racking, removal requires significant effort including, but not limited to, cutting the concrete wedge flush with the floor. When the racking is removed, two holes approximately one inch in diameter will appear in the concrete floor where each rack was once anchored. The building owner generally requires the holes to be refilled with concrete to repair the damage and to mitigate a potential safety hazard. Due to the high cost and customization of the warehouse racking systems, these units generally have a long useful life.

#### Sales and Use Tax Issues and Liability:

<Company> has asked the following questions concerning its sales and use tax obligation to Vermont:

1. Should <company> charge sales tax to its Vermont customer or pay use tax as the consumer of the goods?

Given the nature of warehouse racking, including the high cost and difficulty of removing the racking once attached to the real property, <company>, the installer of the racking, is considered a contractor performing improvements to real property. Under Vermont law, sales to contractors of materials and supplies for use in erecting, improving or repairing real property are considered retail sales of tangible personal property, *see* Reg. §1.9701(5)-1, and tangible personal property sold at retail in this state is subject to the sales tax. 32 V.S.A. § 9771(a). When tangible personal property on which no sales tax was paid is used within the state, it becomes subject to the compensating use tax. 32 V.S.A. § 9773. “Use” is broadly defined as “the exercise of any right or power over

tangible personal property by the purchaser thereof and includes, but is not limited to, the receiving, storage or any keeping or retention for any length of time, withdrawal from storage, any installation, any affixation to real or personal property, or any consumption of that property.” 32 V.S.A. § 9701 (13).

Here, <company> takes possession of and uses tangible personal property in this state that has not been subject to the sales tax; accordingly, the compensating use tax is due on the cost of the property to <company> – an amount equal to that which <company> would have paid had the purchase been subject to Vermont sales tax. *See Morton Buildings, Inc. v. Dept. of Taxes*, 167 Vt. 371 (1997) (building components assembled out-of-state and brought into Vermont for construction subject to use tax); 32 V.S.A. § 9773 (use tax imposed at same rate as sales tax).

2. Should the tax appear separately on the itemized invoice?

Section 9778 of Title 32 requires that sellers separately state the sales tax on invoices provided to customers, from whom the sellers collect the tax. There is no such requirement for the use tax. If <company> chooses to itemize the tax, it should clearly indicate to its customer that the tax was paid by <company>, and is not due from the customer.

3. Which of the following itemized components are taxable?

- a. Material
- b. Freight
- c. Engineering Fees
- d. Permit Fees

<company> should pay use tax on the price it pays for the materials and supplies it purchases that become part of the warehouse racks. The materials are tangible personal property, ordinarily subject to the sales tax, as discussed above. In addition, <company> would be liable for use tax on any materials, equipment and machinery used in the installation process for which tax has not been legally due and paid to another jurisdiction. 32 V.S.A. § 9744 (3).

As of January 1, 2007, the charge for freight is subject to the tax because delivery charges are included in the definition of “sales price”. 32 V.S.A. § 9701(4)(A). Delivery charges include the costs for transportation, shipping, postage, handling, crating, and packing. Reg. § 1.9701 (4) –1. <company>, as user of the property within the state taking delivery within the state, is responsible for the tax.

Neither the engineering fees or the permit fees are subject to the tax.

4. Should the tax be computed based upon <company>’s sales price to the customer or on the purchase price or cost?

The use tax should be computed based on the price paid by <company> to the seller of the materials. *See #1, above.*

5. Do any exemptions apply, for example, would the product be exempt as it relates to a manufacturing process?

Section 9741 of Title 32 outlines the exemptions to the sales and use tax, including the manufacturing exemption. Under that exemption, tangible personal property may be exempted from the tax when it becomes an ingredient or component part of manufactured tangible personal property that will be sold by a manufacturer in the regular course of its business. 32 V.S.A. § 9741(14); Reg. §1.9741(14)-3. Here, <company> is not the manufacturer of the property and the exemption does not apply. The exemption may also apply when the materials and supplies used in the manufacture of tangible personal property are consumed or destroyed in the manufacturing process. *Id.* Again, <company> is not eligible for the exemption. The materials and supplies used to construct the warehouse racking are not consumed or destroyed during a manufacturing process; the provision applies only to those materials with a normal life expectancy of less than one year. *Id.* Neither the manufacturing or any other exemption applies to materials and supplies purchased by <company>.

6. If <company> is responsible for the use tax on the cost of materials consumed, can <company> pay the tax to the manufacturer to minimize its filing burden?

The use tax is imposed on the privilege of using, keeping or consuming the purchased goods within the taxing state. 32 V.S.A. §§ 9701(13), 9773. Even though <company> purchases the materials from a third party out-of-state seller, <company> takes possession of the property in Vermont and thereafter uses the property within the state. In this scenario, no reciprocal credit for taxes paid to another state would be available to <company> because no tax is lawfully due to another jurisdiction. *See* 32 V.S.A. § 9744(3) (property is not subject to use tax to “extent that a retail sales or use tax was *legally due* and paid thereon” to another jurisdiction) (emphasis provided); *see generally Frank W. Whitcomb Const. Corp. v. Comm’r Of Taxes*, 144 Vt. 466, 472 (1984) (Vermont’s tax scheme providing credit for taxes paid in reciprocal jurisdictions satisfies constitutional requirement that tax be fairly apportioned). While <company> may understandably wish to relieve itself of the filing requirement in Vermont, it is <company> – not the manufacturer – that is liable to Vermont for the tax. Accordingly, <company> should file returns and remit the tax directly to the state.

This ruling will be made public after deletion of the parties’ names and any information which may identify the parties. A copy of this ruling showing the proposed deletion is attached, and you may request that within thirty (30) days the Commissioner delete any further information that might identify the interested parties. The final discretion as to deletions rests with the Commissioner.

This ruling is issued solely to your business and is limited to the facts presented as affected by current statutes and regulations. Other taxpayers may refer to this ruling to determine the Department’s general approach, but the Department will not be bound by this ruling in the case of any other taxpayer or in the case of any change in the relevant statute or regulations.

Section 808 of Title 3 provides that this ruling will have the same status as an agency decision or an order in a contested case. You have the right to appeal this ruling within thirty days.

Sincerely,

Judith Henkin  
Attorney for the Department

Approved this \_\_\_\_ day of \_\_\_\_\_, 2007.

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Tom Pelham  
Commissioner of Taxes