**Opinion Letter**

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| **Letter Number:** | **O-2010-002** |

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| **Tax Type:** | **Kansas Retailers' Sales Tax** |
| **Brief Description:** | **Rental charges for temporary scaffolding at a refinery.** |
| **Keywords:** |  |
| **Approval Date:** | **04/20/2010** |

**Body:**

Office of Policy & Research

April 20, 2010

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RE: Your letter dated March 29, 2010

Dear XXXX:

Thank you for your recent letter. You seek clarification of my earlier letter that discussed the taxability of charges for temporary scaffolding. Your company is a refinery that uses the temporary scaffolding during turnarounds, capital project work, catalyst change outs, ongoing operations, the expansion of operations, and for other similar needs. You ask if rental charges for the scaffolding, and any separately-stated charges to erect and dismantle the rented scaffolding, are taxable.

Many labor services that third-party contractors perform at a refinery are exempt under K.S.A. 2009 Supp. 79-3606(kk). It exempts, in parts relevant here:

(kk)(1)(A) all sales of machinery and equipment which are used in this state as an integral or essential part of an integrated production operation by a manufacturing or processing plant or facility;
(B) all sales of installation, repair and maintenance services performed on such machinery and equipment; and
(C) all sales of repair and replacement parts and accessories purchased for such machinery and equipment.

K.S.A. 2009 Supp. 79-3606(kk)(5) identifies property that does not qualify for exemption as manufacturing machinery and equipment:

(5) "Machinery and equipment used as an integral or essential part of an integrated production operation" shall not include:
(A) Machinery and equipment used for nonproduction purposes, including, but not limited to, machinery and equipment used for plant security, fire prevention, first aid, accounting, administration, record keeping, advertising, marketing, sales or other related activities, plant cleaning, plant communications, and employee work scheduling;
(B) machinery, equipment and tools used primarily in maintaining and repairing any type of machinery and equipment or the building and plant;

K.S.A. 2009 Supp. 79-3606(kk)(5) means that maintenance equipment and tools that a manufacturer buys or leases to maintain and repair its production machinery and equipment are subject to Kansas sales tax. This is consistent with the legislative intent for (kk), which was to exempt equipment that is used as an "integral or essential part of an integrated production operation," but not other equipment purchased by a manufacturer. Thus, (kk) exempts only machinery and equipment used in: "an integrated series of operations engaged in at a manufacturing or processing plant or facility to process, transform or convert tangible personal property by physical, chemical or other means into a different form, composition or character from that in which it originally existed." *K.S.A. 2009 Supp. 79-3606(kk)(2)(A); K.S.A. 2009 Supp. 79-3606(kk)(3).*

Machinery and equipment located at a refinery that qualifies for exemption under this provision are atmospheric distillation units, vacuum distillation units, fluid catalytic cracker units, coking units, coking units, isomerization units, and similar equipment that touches and transforms raw oil or gas into different products. Equipment and tools purchased and used to maintain and repair this production machinery and equipment are not exempt because they are not used as part of "an integrated series of operations engaged in at a manufacturing . . . facility to process, transform or convert tangible personal property by physical, chemical or other means into a different form. . . ."

K.A.R. 92-19-66c explains how tools, equipment, and machinery that a contractor or repairman purchases or leases are taxed in Kansas:

(a) Each contractor, subcontractor and repairman shall be considered the final user or consumer of all tools, equipment and machinery purchased to perform construction services. Sales of tools, equipment and machinery to contractors, subcontractors and repairmen to perform construction services shall be subject to sales tax. With the exception of leases of equipment and machinery by a contractor under a project exemption certificate, leases of tools, machinery and equipment by a contractor to perform construction services shall be subject to sales tax.
(b) Leases of tools, equipment and machinery by a contractor are not exempt from sales tax as an ingredient or component part of the services performed by the contractor, whether the services are taxable or exempt from the sales tax.
(c) Leases of tools, equipment and machinery by a contractor are not exempt from sales tax as consumed in the production of the service performed by the contractor, whether the services are taxable or exempt from the sales tax.

K.A.R. 92-19-66c means that a contractor's or repairman's rental of temporary scaffolding for use in performing construction services or servicing production machinery at a refinery is subject to Kansas sales tax. This treatment is consistent with the treatment that K.S.A. 2009 Supp. 79-3606(kk)(5) provides to manufacturers who rent temporary scaffolding to work on their production machinery or equipment or to do other work at a refinery. That treatment is to tax rental charges for temporary scaffolding that are billed to a manufacturer.

Charges for temporary scaffolding are taxed as charges for the rental of tangible personal property by nearly all, if not all, of the states that impose sales tax.*See e.g. Louisiana Department of Revenue, Revenue Ruling No. 07-005 (Sept. 19, 2007); Combs v. Chevron USA. Inc. Texas Court of Appeals, Third District at Austin, No. 03-07-00127-CV (Feb. 5, 2010); Giorgi Interior Systems, Inc. v. Limbach, Ohio Board of Tax Appeal, No. 87-G-276 (Nov. 8, 1991); New Jersey Sales and Use Tax Reg. 18:24-5.5(b)(2); West Virginia State Tax Department Administrative Decision No. 01-381 U, 01-382 C (March 24, 2002); Vermont Sales Tax Regulation 226-7.VI; Utah State Tax Commission Advisory Opinion 96119, (Aug. 12, 1996); Massachusetts Department of Revenue, Letter Ruling 1981-44 (June 4, 1981); Missouri Department of Revenue Letter Ruling No. LR6105, (February 5, 2010).*As an employee of the Texas Comptroller of Public Accounts explained in Letter No. 200112688L, which was sent to a scaffolding company in 2001:

Your total charge to [the refinery] for the rental or lease of scaffolding, including charges for erection and dismantling, are subject to tax. The fact that repair or maintenance services are done during a plant turnaround does not affect the tax treatment of the scaffolding.

The Texas Court of Appeals agreed that scaffolding should be treated as a rental of property rather than as the providing of a service:

We think it indisputable that the essence of Chevron’s scaffolding contracts was the rental of the scaffolding itself, not the attendant services. Chevron’s underlying goal in executing the contracts was to facilitate maintenance work at its refinery. It was scaffolding, not the services incidental to use of scaffolding, that Chevron primarily wanted. To put it another way, Chevron would (if possible) have gladly used the scaffolding without purchasing the attendant services. On the other hand, the attendant services would have been useless to Chevron without the ability to use the scaffolding to perform maintenance work. *Combs v. Chevron USA. Inc. Texas Court of Appeals, Third District at Austin, No. 03-07-00127-CV (Feb. 5, 2010)*

While states uniformly treat charges for temporary scaffolding that is erected and left for use at a job site as rental charges, there is no uniformity about how sales tax applies to separately-stated charges for delivering, erecting, and dismantling the scaffolding. For example, some states do not tax separately-stated charges for the delivery and set up of rented scaffolding. Others tax both delivery and set up charges, as well as any other charges that are recovered by the scaffolding company under the rental contract. These can include charges to reimburse the rental company for per diem travel expenses, meals, motel rooms, and mileage, among other things. If the rental charge is subject to sales tax in these states, these charges are taxed even if the charges are separately stated on the invoice given to the customer.

The different sales tax treatment that states accord to rental charges comes about because state sales tax laws differ on whether the tax is imposed on an amount that includes delivery charges, installation charges, and set up charges. The amount that sales tax is imposed on is the "tax base," which for Kansas and many other states is the "sales or selling price." This is the amount that is multiplied by the tax rate to determines amount of sales tax owed by the customer.

In states that do not include delivery, installation, or set up charges in the sales tax base, the charges are not taxed if the charges are separately listed on the customer's invoice. In these states, the charges are taxed when they are lumped together with the rental charge. In states that include deliver, installation, and set up charges in the tax base, the charges are taxable even when they are separately listed on the customer's invoice.

The tax base for Kansas sales tax is found in K.S.A. 2009 Supp. 79-3602(ll)(1):

"Sales or selling price" applies to the measure subject to sales tax and means the total amount of consideration, including cash, credit, property and services, for which personal property or services are sold, leased or rented, valued in money, whether received in money or otherwise, without any deduction for the following:
(A) The seller's cost of the property sold;
(B) the cost of materials used, labor or service cost, interest, losses, all costs of transportation to the seller, all taxes imposed on the seller and any other expense of the seller;
(C) charges by the seller for any services necessary to complete the sale, other than delivery and installation charges;
(D) delivery charges; and
(E) installation charges.

This definition shows that the Kansas tax base for rental of temporary scaffolding includes any separately-stated charges to deliver, set up, or dismantle the scaffolding. The tax base also includes any separately stated charges that are billed by the scaffold rental company to recover per diem travel expenses, meal costs, motel costs, mileage costs and other costs that the scaffold company recovers to pay for the expenses involved in renting the scaffolding. *See e.g. Missouri Dept. of Revenue Letter Ruling No. LR6105 (Feb. 5, 2010).* These are expenses of the seller, and are taxable under K.S.A. 2009 Supp. 79-3602(ll)(1)(B) even if the expense is re-billed to the customer at cost.

The "service" charges for delivering, erecting, and disassembling the temporary scaffolding are part of the taxable rental charge, and are taxed or exempted based on whether the scaffolding rental is taxed or exempted. Examples of scaffolding rentals that are not subject to sales tax are direct rentals to schools, hospitals, and Kansas governmental subdivisions. As used here, a "direct rental" means that the rental charge is billed to and paid by the schools, hospitals, and Kansas governmental subdivisions, rather than by a contractor hired by one of the exempt entities.

In Kansas, charges to deliver, erect, and disassemble temporary scaffolding are part of the rental charge for the scaffolding. These charges are taxable whether they are separately stated or lumped together as part of a single charge for the rental. The taxation of these services is not affected by the fact that the temporary scaffolding being rented is used on a project that qualifies for the original construction exception for labor services extended in K.S.A. 79-3603(p), or on a project that involves installation or repair services done to manufacturing machinery or equipment that are exempt under K.S.A. 79-3606(kk).

Sincerely,

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Attorney/Policy & Research

**Date Composed: 04/26/2010 Date Modified: 04/26/2010**