

**REPORT OF THE
VIRGINIA DEPARTMENT OF TAXATION**

**SALES AND USE TAXATION
OF MODULAR HOUSING**

**TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA**



HOUSE DOCUMENT NO. 47

**COMMONWEALTH OF VIRGINIA
RICHMOND
2000**



COMMONWEALTH of VIRGINIA

Department of Taxation

December 10, 1999

TO: The Honorable James S. Gilmore, III
And
Members of the General Assembly of Virginia

House Joint Resolution No. 742, sponsored by Delegate Allen W. Dudley and passed by the 1999 session of the General Assembly, requests the Department of Taxation to study all issues relating to the application of the Virginia retail sales and use tax to modular housing, i.e., factory-built housing subject to similar construction standards as site-built homes, and to report our findings and recommendations to the Governor and the 2000 session of the General Assembly.

In addition, this study is to determine the fiscal impact from any proposed changes to the current law and whether the proposed changes are declarative of existing law or substantive in nature. This study is also to determine the suitability of suspending all audits, assessments, accrual of interest, and collection actions related to sales of modular housing during the period of the study.

On behalf of everyone who contributed to this study, I am pleased to present this report to you.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Danny M. Payne".

Danny M. Payne
Tax Commissioner

PREFACE

Authority for this study. House Joint Resolution (HJR) 742, sponsored by Delegate Allen W. Dudley and passed by the 1999 Session of the Virginia General Assembly, requests the Department of Taxation to conduct a study of all issues relating to the Virginia retail sales and use taxation of modular housing and to complete its work in time to submit its findings to the Governor and the 2000 Session of the General Assembly.

Industry group. As requested by HJR 742, the study group included representatives from the Virginia Manufactured Housing Association (Ronald W. Dunlap and J. Steven Erie), the Industrialized Housing Association of Virginia, Inc. (Dale H. Powell and Bret A. Berneche), the Mid-Atlantic Building Systems Council (Steve Snyder) located in Harrisburg, Pennsylvania, and other interested parties. We wish to thank all who contributed their time and effort to this study.

Staff assigned. Staff of the Department of Taxation involved in the conduct of this study: Office of Fiscal Research: Maxim Shvedov, Economist; Judy Waldron, Senior Economist. Office of Tax Policy: Howard T. Macrae, Jr., Assistant Tax Commissioner; Mike Melson, Executive Assistant; Steven Schwartz, Senior Tax Policy Analyst; Timothy J. Harris, Tax Policy Analyst; George H. Parsons, Senior Management Analyst; Ashley Beuttel, Law Student Intern.

Exclusions from the report. Manufactured homes (formerly, mobile homes) as defined in Code of Virginia § 36-85.3 and mobile offices as defined in Code of Virginia § 58.1-2401, both of which are subject to the motor vehicle sales and use tax imposed by Code of Virginia § 58.1-2402, are not considered “modular housing” or “modular buildings” for purposes of this report.

Broad findings of the study. If the modular housing industry is to achieve tax parity with the conventional home construction industry, legislation with substantive changes in law will need to be enacted.

Endorsements. The Virginia Manufactured Housing Association endorses the enclosed report, and it strongly supports the proposed legislation set forth in Part VIII, therein.

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I. EXECUTIVE SUMMARY

The 1999 General Assembly approved House Joint Resolution 742 (“HJR 742”) requesting the Department of Taxation (“TAX”) to: (i) examine the sales tax laws and policies as they apply to modular housing sales and service transactions and (ii) recommend whether administrative or legislative changes are needed for the modular housing industry to achieve tax parity with the conventional or site-built housing industry.

In response to this request, TAX invited several industry associations and other interested parties to meet and discuss the issues relating to the current sales and use taxation of modular housing. Industry participants of this study expressed a range of views. Some in the modular housing industry declared that the current taxing structure has worked well for the past 28 years. For others in the modular housing industry, however, the current taxing structure poses significant inequities.

Current Policy

Generally, modular housing is taxed in one of two ways: (1) on the cost price of raw materials which make up the modular home when sold *with* installation, or (2) on the retail sales price of the modular home when sold *without* installation. Special rules apply when a manufacturer sells in both manners.

Accordingly, the proper tax treatment on modular housing transactions depends largely on whether installation services are included as a part of the sale. For example, if the seller contracts to furnish and install a modular home on a permanent foundation, the transaction is treated as a real property services transaction. In such instances, the seller is generally liable for the tax on the cost of materials. However, if a modular home is sold *without* installation services to a consumer, the transaction is treated as a retail sale of tangible personal property, and the tax applies to the retail sales price of the modular home.

Issues

Although modular homes are *generally* taxed the same as conventionally built homes (e.g., when a modular housing manufacturer acts as contractor by selling and installing its homes), there are instances in which modular homes are taxed more than conventionally built homes. In the latter instance, however, the statute does not allow any deviation from the sales price concept set out in the *Virginia Retail Sales and Use Tax Act*. Unfortunately, a disparity of taxation can be created when modular housing is sold at retail.

For instance, modular homes are potentially subject to higher sales and use taxation than conventionally built homes when the modular home is sold at retail (i.e., without installation) to the final consumer. The tax applies not only to the materials costs but also to the fabrication labor, overhead, and other costs associated with assembling the sections in a factory setting (i.e.,

tax applies to the total sales price). This contrasts with conventionally built homes in which the tax application is limited to the cost of raw materials and other material components of the home.

Study Group's Findings

The study group, consisting of industry representatives and TAX, explored several ways to correct the perceived tax inequities under the existing laws. Thorough consideration was given to whether modular housing manufacturers should be treated as final consumers in all transactions. However, such treatment would create constitutional and jurisdictional concerns with out-of-state manufacturers who have no substantial nexus with Virginia as to require them to register with TAX for sale or use tax purposes.

The study group also considered whether the statute should be amended to define "modular housing" as "real property." It was found that this would be problematic as it would conflict with the "sales price" concept set out in the *Virginia Retail Sales and Use Tax Act* (i.e., sales tax is a tax on retail sales of tangible personal property and therefore is not a tax on real property) and could potentially create a substantial tax loophole.

The modular housing industry has also indicated that a consistent tax treatment is desired for the sale of its products that are subject to the retail sales and use tax. To provide for a consistent tax treatment, the study group decided that any new proposed legislation should include not only modular housing, but non-dwelling modular structures, such as modular restaurants, branch banks, churches, and the like. However, mobile offices and mobile homes would be excluded as such structures are subject the motor vehicle sales and use tax administered by the Department of Motor Vehicles.

The study group further determined that taxing only the actual value of building materials, even if delineated on the manufacturer's invoice under a retail sales transaction, would be problematic as it would be in direct conflict with the "sales price" concept established in the *Virginia Retail Sales and Use Tax Act*. Furthermore, such taxing method would be difficult or impossible to implement unless absolutely accurate cost accounting records are maintained to determine the actual cost of each modular housing section produced.

Recommendation

After careful consideration of the above issues and findings, TAX and industry came to a consensus on a legislative proposal to make a substantive change in the current taxing structure for the purpose of:

- establishing tax parity between the modular housing industry and conventional home builders,
- ceasing multiple taxation of modular housing,
- establishing a tax environment in which competition between in-state and out-of-state

- modular housing manufacturers is placed on a more equal footing, and creating a fair tax environment in Virginia to encourage existing modular housing businesses to continue and expand operations in Virginia.

The legislation proposed in this report (see Part VIII and Appendix J of this report) would achieve the objectives sought by the modular housing industry as it would establish a new taxable base of 60% of the sales price when a modular building, as defined in the legislative proposal, is sold at retail (i.e., without installation) to the final consumer. If this legislative proposal is enacted, TAX estimates that state and local revenues will be negatively affected.

Based on data received from the Virginia Manufactured Housing Association, TAX estimates that the proposed legislation will result in a negative fiscal impact on state and local revenues in the amounts of \$495,900 for the fiscal year 2001 and \$568,000 for the fiscal year 2002. However, some in the modular housing industry assert that the net fiscal impact of the proposed legislation will not be negative because of industry practices and the belief that the proposal will generate additional tax revenues from increased business performance of the modular housing industry.

II. INTRODUCTION

House Joint Resolution 742 (Appendix A) passed by the 1999 Session of the General Assembly raises the concern as to whether the retail sales and use taxation of modular housing is equitable under current law and taxing policies. This report examines (i) the current retail sales and use taxation of modular housing (Parts IV and V of this report), (ii) several issues relating to such taxation of modular housing (Parts VI and VII of this report), and (iii) proposed changes to the current taxing structure (Part VIII and Appendix J of this report).

Part VIII of this report also addresses (i) the fiscal impact of the proposed amendments to the law, and (ii) whether the proposed law changes are declarative of existing laws or substantive in nature. Part IX of this report examines whether the Department of Taxation (hereinafter, "TAX") should suspend, during the course of the study, all audits, assessments, accrual of interest, and collection actions as they pertain to the applicability of the retail sales and use tax to sales of modular housing sections. In addition, several documents supplement this report and are exhibited in the Appendices. For example, Appendix L of this report provides a general overview of the tax consequences of transactions between states. Appendix M of this report discusses how other states tax modular housing.

As requested by House Joint Resolution 742, TAX included the Virginia Manufactured Housing Association, the Industrialized Housing Association of Virginia, Inc., out-of-state associations representing manufacturers who do business in the Commonwealth of Virginia, and other interested parties in its conduct of the study.

III. SCOPE OF STUDY

Modular housing is known by an assortment of names: factory-built housing, industrialized housing, ready-made housing, sectional homes, and manufactured housing. What these names generally imply is housing made in a factory setting. However, more clarification is needed to avoid confusion, especially where the retail sales and use tax is concerned. Consequently, House Joint Resolution 742 defines "modular housing," for purposes of this study, as limited to:

"single and multi-family housing, apartment units, and commercial structures comprised of two or more sections without a permanent chassis, built to a state or model code other than the National Manufactured Housing Construction Safety Standards Act of 1974, which is primarily constructed at a location other than the site at which it is to be finally assembled, and is shipped to the site of final assembly with most permanent components in place."

Based on the above definition of modular housing, the study deliberately excludes any "manufactured home" as defined in *Code of Virginia* § 36-85.3, which are homes subject to the motor vehicle sales and use tax (i.e., § 58.1-2402) administered by the Virginia Department of

Motor Vehicles. Such manufactured homes, formerly known as “mobile homes,” are built on a permanent chassis and are subject to the National Manufactured Housing Construction Safety Standards Act of 1974 under regulation by the U. S. Department of Housing and Urban Development (HUD). Housing built to HUD construction standards are not the subject of this study.

This study also excludes mobile offices¹ as defined in *Code of Virginia* § 58.1-2401. Mobile offices are subject to the motor vehicle sales and use tax.

Rather, the focus of this study is on homes which are substantially built at a factory into transportable sections without a chassis, are built to the same construction standards as applicable to conventional site-built homes (*i.e.*, the *Virginia Uniform Statewide Building Code*), are intended for installation on permanent foundations, are intended as improvements to realty, and are not subject to and certified under the HUD design and construction standards.

IV. BACKGROUND

House Joint Resolution 742 states that “questions continue to arise regarding the method to which sales and use tax should be computed” on modular housing transactions.

Regulations

Since 1969, TAX has made known its policy on the application of the sales and use tax to modular housing through various public regulations and documents. Section 1-84.1 of the *Virginia Retail Sales and Use Tax Rules and Regulations* (issued July 1, 1969) was the first public regulation on these matters and set out the following:

Sales of prefabricated house sections or units by manufacturers and other vendors are sales of tangible personal property, and the tax applies to the sales price. If the seller installs the units and the charges for installation are separately stated on the invoice, such charges are not subject to the tax, otherwise the tax applies to the total charge.

Thus, the 1969 regulation treated the sale of modular housing sections as a sale of tangible personal property regardless of whether sold with or without installation. As the 1969 regulation treated all modular housing manufacturers as sellers of tangible personal property only, they were all entitled to the industrial manufacturing exemptions.

¹ *Code of Virginia* § 58.1-2401 defines the term “mobile office” as “an industrialized building unit not subject to the federal regulation, which may be constructed on a chassis for the purpose of towing to the point of use and designed to be used with or without a permanent foundation, for commercial use and not for residential use; or two or more such units separately towable, but designed to be joined together at the point of use to form a single commercial structure, and which may be designed for removal to, and installation or erection on other sites.”

On September 22, 1971, TAX met with the modular housing industry in regard to the sales tax treatment of the 1969 regulation on sales of modular housing units. Based on the available information, it appears that modular housing manufacturers had sought to change their seller or retailer status when a transaction calls for them to act in the capacity of a real property services contractor, *i.e.*, when they contract to furnish and install modular housing sections on a permanent foundation at the building site. Subsequent to the 1971 meeting, several modular housing manufacturers furnished information to TAX which showed that they were performing a variety of transactions, including acting as real property contractors under many instances.

On December 31, 1971, TAX issued Circular No. 4 in response to the modular housing industry's request for changing the sales tax rules and regulations applicable to that industry. In effect, this circular superseded Section 1-27(c), (d), and (e) of the 1969 *Virginia Retail Sales and Use Tax Rules and Regulations* and allowed modular housing manufacturers who actually affix their products to realty to be treated as real property service contractors, *i.e.*, taxed on the cost price of materials (if solely or principally fabricating for its use or consumption) or on the fabricated cost price² of materials withdrawn (if principally fabricating for sale or resale). The 1971 method of tax application for the modular housing industry remains in existence today.

On January 1, 1979, the *Virginia Retail Sales and Use Tax Rules and Regulations* were revised and renamed the *Virginia Retail Sales and Use Tax Regulations*. As part of the revisions made, Section 1-84.1 of the *Regulations* was revised and replaced with the following:

Sales of prefabricated house sections or units by manufacturers and other vendors are sales of tangible personal property, and the tax applies to the sales price. For manufacturers or other vendors who contract to furnish and install such units, see Section 1-27 for tax application. (Emphasis added.)

Section 1-27 of the 1979 *Virginia Retail Sales and Use Tax Regulations* addresses transactions made by contractors respecting real estate. Clearly, Section 1-84.1 of the 1979 *Regulations* as cited above was revised in accordance with the policy change requested and agreed to by the modular housing industry in 1971.

Effective January 1, 1985, section 1-27 of the 1979 *Virginia Retail Sales and Use Tax Regulations* was renumbered as § 630-10-84.1 without substantive changes. Effective January 1, 1996, § 630-10-84.1 of the 1985 *Virginia Retail Sales and Use Tax Regulations* was renumbered as 23 VAC 10-210-2080 without substantive change and incorporated into the Virginia Administrative Code of Regulations.

² Fabricated cost price consists of the cost of materials, labor, and overhead charged to work in process.

Other Public Documents

In response to concerns about the application of the retail sales and use tax to modular housing or modular building construction, TAX has issued several rulings and determinations which have been available as public documents (P.D.). A listing of these public documents is shown below and a sampling of public documents setting out TAX's policy can be found at Appendices C through G.

Modular homes are addressed by P.D. 85-73 (4/3/85), 86-8 (1/3/86), 89-349 (12/20/89), 93-24 (2/10/93), 94-104 (4/7/94), 97-297 (6/30/97), and 98-161 (10/20/98).

Modular buildings are addressed by P.D. 87-210 (9/15/87) and 96-24 (3/29/96).

Precast concrete structures are addressed by P.D. 88-196 (7/6/88), canopies by 87-131 (4/21/87), and spiral staircases by P.D. 92-228 (11/9/92) and 94-144 (5/9/94).

V. OVERVIEW OF CURRENT POLICY

Generally

The key taxable distinction between modular housing manufacturers and conventional housing contractors is the "taxable base" upon which they pay the tax. For example, conventional housing contractors pay tax only on their cost of materials and thus do not incur any tax on overhead, profit or labor costs to construct a home. Modular housing manufacturers receive comparable tax treatment when they contract to perform real property construction services, such as to furnish and install a modular home. However, when a manufacturer sells modular housing sections³ *without installation* to a consumer (*i.e.*, a sale at retail to a dealer or contractor), the taxable base becomes the gross sales price. Thus, a modular home sold at retail is subject to tax based on the total charge for the modular home *without deduction* for materials, labor, overhead, profit or other costs. As such, prefabricated modular housing construction is potentially subject to a higher tax cost than materials used in conventional construction.

Although modular housing and conventional homes are built in different settings, the resulting product is essentially the same, *i.e.*, a home that is built to normal residential construction standards. Once affixed to the site, a modular home has the appearance of a conventionally built home. For these reasons, the modular housing industry feels that its product, when sold at retail without installation, is taxed unfairly under present law and seeks changes to allow it to compete on a more equal footing with the conventional housing industry.

³ A modular housing section generally consists of a compartment with finished walls, flooring, ceiling and/or roofing which is constructed away from the home site in a factory setting.

Current rules applicable to the sales and use taxation of modular housing

A manufacturer which fabricates modular housing sections or units in a factory setting and contracts to install such property on a foundation is considered performing real property construction and installation services, regardless of whether its employees perform the installation or set-up of the property, or it hires a subcontractor to perform the installation work on its behalf. See P.D. 93-24 (2/10/93) in Appendix E which addresses this issue. At any time that a modular housing manufacturer engages in the sale and installation of modular housing sections or units on permanent foundations, it is subject to the provisions of Code of Virginia § 58.1-610 on contractors and the regulations applicable to contractors respecting real estate, *i.e.*, Title 23 of the Virginia Administrative Code (VAC) 10-210-410.⁴

Under current tax law, subsections C, D and E of 23 VAC 10-210-410 (see Appendix H) provide the appropriate sales and use tax guidance for modular housing manufacturers. The application of the tax will depend upon whether the modular housing manufacturer sells only on an uninstalled basis (subsection C, operates as seller only), fabricates exclusively to furnish and install such property (subsection D, operates as contractor only), or fabricates in a dual capacity of selling fabricated property with and without installation (subsection E, operates in dual role of retailer and contractor).

Retailer Only (Subsection C fabricator). When a modular housing manufacturer only engages in the business of fabricating tangible personal property for retail sale or exempt resale, it is considered a subsection C fabricator under 23 VAC 10-210-410. Based on the *Virginia Retail Sales and Use Tax Act* (*i.e.*, Chapter 6 of Title 58.1), the sale of modular housing sections or units without installation clearly constitutes the sale of tangible personal property⁵. When a sale is to the final purchaser who uses or consumes such personal property, the sale constitutes a *retail sale or a sale at retail* as defined by Code of Virginia § 58.1-602 and is taxable based on the *gross sales price*⁶ of the modular sections or units. The gross sales price is the total amount

⁴ This treatment is clearly noted in Title 23 of the Virginia Administrative Code (VAC) 10-210-2080 which is the regulation on prefabricated house sections.

⁵ Code of Virginia § 58.1-602 defines “tangible personal property” to mean “personal property which may be seen, weighed, measured, felt, or touched, or is in any manner perceptible to the senses. The term *tangible personal property* shall not include stocks, bonds, notes, insurance or other obligations or securities.”

⁶ Code of Virginia § 58.1-603 imposes the retail sales tax upon “the gross sales price of each item or article of tangible personal property when sold at retail or distributed in this Commonwealth.” (Emphasis added). Code of Virginia § 58.1-602 defines the term *sales price* to mean “the total amount for which tangible personal property or services are sold, including any services that are a part of the sale, valued in money, whether paid in money or otherwise, and includes any amount for which credit is given to the purchaser, consumer, or lessee by the dealer, without deduction therefrom on account of the cost of the property sold, the cost of materials used, labor or service costs, losses or any other expenses

charged, including all costs for fabrication labor used in the construction of modular building sections; engineering, architectural and design expenses; administrative expenses; freight-in to the plant; transfer fees; factory overhead; and profit. When modular building sections are sold at retail (*i.e.*, to the final consumer without installation), no sales or use tax applies to separately stated charges for transportation from the manufacturer directly to the final purchaser.⁷

Pursuant to Code of Virginia § 58.1-612, any person who sells tangible personal property at retail in Virginia is required to register to: (i) collect the sales tax based on the retail sales price of tangible personal property sold⁸, and (ii) transmit a return and remit such collected tax to TAX.⁹ Thus, a modular housing manufacturer subject to dealer registration and tax collection requirements of this Commonwealth and making retail sales of modular housing sections is required by law to charge sales tax, collect sales tax from the purchaser on every retail sale, and remit the sales tax to TAX.

When modular housing sections are sold for *resale* purposes only, no sales or use tax applies to the sale, provided the seller receives a properly signed and completed resale exemption certificate¹⁰ from the purchaser. A sale for resale does not constitute the retail sale of tangible personal property.

Contractor Only (Subsection D fabricator). When engaged exclusively in selling and installing modular building sections on permanent foundations, a modular housing manufacturer is deemed a contractor only (for sales and use tax purposes) and therefore treated as a subsection D fabricator under 23 VAC 10-210-410. As a contractor, a modular housing manufacturer is subject to the retail sales and use tax based on the cost price of raw materials which it uses in constructing modular building sections.

Differences between Subsection C and D fabricators. The sales and use tax consequences for subsection D fabricators clearly differs from the tax treatment for subsection C fabricators. As a contractor, a subsection D fabricator is liable for the tax only on the cost price of materials purchased from suppliers and thus does not owe tax on its labor or service costs incurred to produce the product, *i.e.*, its costs for fabrication labor, mark-up, profit, and design costs, etc. Also, a subsection D fabricator does not collect sales tax from the final consumer as a

whatsoever.”

⁷ Pursuant to the statutory exemption of Code of Virginia § 58.1-609.5(3).

⁸ Except for separately stated transportation charges from the retailer to the purchaser.

⁹ Per Code of Virginia §§ 58.1-615 and 58.1-616.

¹⁰ Form ST-10 issued by the Virginia Department of Taxation. Pursuant to Code of Virginia § 58.1-623, all sales of tangible personal property are subject to sales and use taxation unless the dealer takes a certificate to the effect that the property is exempt from the Virginia retail sales and use tax.

separately stated charge. Rather, the tax is built into the bid price (contract price) as a cost of doing business.

On the other hand, a subsection C fabricator is required by law to charge and collect the sales tax on the gross sales price when it sells at retail. When selling at retail, the subsection C fabricator must apply the sales tax to the gross sales price which includes all costs for labor or service costs incurred to produce the product, such as fabrication labor, design costs, mark-up, profit, etc.

Dual Operation as Retailer and Contractor (Subsection E fabricator) The application of the tax for Subsection E fabricators operating in a dual capacity will depend on whether they fabricate *principally*¹¹ as a contractor (*i.e.*, primarily furnishing and installing), or *principally* as a retailer (*i.e.*, primarily selling without installation).

Subsection E fabricators which *principally* engage as contractors are ultimately and directly liable for the tax based on the cost price of the materials which make up the modular housing sections or units which they install, but are also responsible for collecting and remitting the sales tax on any modular housing sections which they sell at retail, *i.e.*, without installation.

However, Subsection E fabricators which *principally* engage as retailers must apply the tax in the same manner as Subsection C fabricators when selling without installation, but are ultimately and directly liable for the tax based on the fabricated cost price (*i.e.*, the cost of materials, labor and overhead charged to work in process) of the units which they affix to the realty.

Installation role established by records of the transaction. When a modular housing manufacturer contracts to furnish and install prefabricated house sections or units, the contract or sales invoice serving as the record of the transaction should easily establish the installation role of the manufacturer. However, without clear and satisfactory evidence of the manufacturer's installation role, a question arises on audits by TAX as to whether the manufacturer's laborers (whether manufacturer's employees or subcontractor hired and paid by the manufacturer) had an immediate and controlling role in actually affixing the modular housing sections to a permanent foundation at the home or building site. When there is a lack of suitable evidence¹² to establish that the manufacturer is the one who affixed the modular housing sections to the realty, TAX has no valid basis or assurance that the manufacturer performed any real property installation or set-up services. In such instances, the transaction would be deemed to be a retail sale of tangible personal property in which the tax applies to the total sales price, rather than the cost of materials

¹¹ The term *principally* as used herein means more than 50% of the time.

¹² Modular housing manufacturers and other dealers are required by Code of Virginia § 58.1-633 and 23 VAC 10-210-470 to keep and preserve for three years adequate records to substantiate their tax liabilities.

which make up the fabricated sections.

However, a modular housing manufacturer disagrees with the above policy statement to require sufficient documentation to substantiate one's installation role. Rather, it maintains that a written commitment for installation services on a sales invoice or contract is not needed, provided an oral promise or arrangement is made with its customer that it will furnish and install a modular home on a permanent foundation.

VI. INDUSTRY'S POSITION

Tax Parity with Conventional Site Builders

House Joint Resolution 742 declares that "every modular home is intended to be real estate from the time the home is designed and manufacturing begins."

On this basis, the modular housing industry advocates that all sales of modular housing sections or units should be subject to the sales and use tax based on the manufacturer's cost of materials¹³, regardless of whether sold with or without installation by the manufacturer. Such tax treatment would provide the modular housing industry with tax parity equal to the conventional housing industry, which consists of contractors building conventional homes entirely at the home-site¹⁴ and paying tax only on the cost price of construction materials¹⁵ which make up the finished home.

Taxable base. The modular housing industry maintains that many states currently tax modular housing on a lesser taxable base than Virginia. In its survey of other states (see Appendix M), TAX found this to be true in the states of West Virginia, Maryland, South Carolina, Connecticut, Maine, California, Arizona, Colorado, Wyoming, and Idaho. However, the majority of states which impose a sales and use tax, including Virginia and Ohio, currently tax the retail sale of modular housing based on 100% of the sales price.

The modular housing industry seeks to lower the taxable base for modular housing and

¹³ i.e., the cost price of materials which make up the fabricated sections or units, exclusive of fabrication labor, other labor costs in connection with the design, engineering and construction of such modular housing sections or units, overhead costs, and profit.

¹⁴ This differs from modular housing construction in which homes are substantially completed at a factory and transported in sections to the home site for erection on a prepared foundation.

¹⁵ Generally includes framing lumber, roofing materials, siding, bricks, mortar, and other materials incorporated in the home. Please note, however, that prefabricated components are used in both modular and site built construction. For example, both construction methods typically use prefabricated components, such as windows, exterior and interior doors, staircases, kitchen and bathroom cabinets, appliances, carpet and other floor coverings, etc.

modular buildings. As mentioned above, the industry is pursuing tax parity with conventional builders. Tax parity would mean paying the tax on the cost of materials used in producing modular housing sections or on a set percentage of the sales price which is representative of the cost of materials. Tax parity can only be achieved through a lowering of the taxable base.

Generally, the cost of materials for a modular home may range between 40% and 60% of the sales price.¹⁶ When modular housing is sold at retail (*i.e.*, without installation), the Virginia retail sales and use tax currently applies to 100% of the sales price. However, the industry seeks to change the taxable base from 100% of sales price to 60% of sales price. If this change is enacted, the tax on a retail sale of modular housing sections would approximate a tax on the cost of materials.

Using a 60% rule as the taxable base for retail sales of modular housing and modular buildings would provide a significant reduction in the taxation of such products. This reduced taxable base would especially help modular dealers and contractors to compete on a more level playing field with conventional builders.

For example, a modular dealer buys a custom-designed modular house at retail for \$200,000.00 and sets it on a permanent foundation. In this instance, the dealer acts as a real property services contractor and must pay tax on the cost of materials it purchases. Currently, the Virginia retail sales and use tax owed is \$9,000.00 ($\$200,000 \times 4.5\%$) based on the cost of the modular home the dealer purchases and installs. However, if a 60% rule is applied, the tax would be \$5,400.00 ($\$200,000 \times 60\% \times 4.5\%$). Using a 60% taxable base would result in a tax savings of \$3,600.00.

Clearly, lowering the taxable base would help promote the sale of modular housing. In addition, modular home owners as the end customers may benefit if dealers pass on the tax savings in the form of lower prices.¹⁷

Elimination of Double Taxation for Multistate Transactions. The Virginia modular housing industry is concerned about the potential for double taxation in sales transactions occurring between states, *i.e.*, paying sales and use tax to Virginia on homes fabricated in Virginia as well as to another state where the product is sold and installed. In other words, they wish to avoid paying tax twice on the same transaction. However, for the reasons set out below

¹⁶ One Virginia manufacturer cites the material cost range as 41% to 47% of sales price. Another cites the material cost range as 45% to 52% of sales price. From public filings, TAX learned that the raw material costs of one out-of-state manufacturer ranged between 63% and 65% of gross sales price.

¹⁷ The final transaction of modular housing is the one with the home owner who buys the home already situated on the property and all improvements completed. This final transaction is the sale of real estate, *i.e.*, the sale of land with improvements. Industry, however, generally does not sell modular housing at retail to the ultimate homeowner. Rather, a retail sale would generally be made by (i) a manufacturer to a dealer acting as a contractor or (ii) a dealer to a contractor.

and in Appendix L of this report, there are mechanisms currently in place to avoid the double taxation of modular housing sales (i.e., sales without installation).

Sales in Interstate Commerce. The interstate commerce clause of the United States Constitution prohibits the originating state from imposing its sales and use tax on goods for which title or possession passes in another state. In essence, double taxation by the states is prohibited when tangible personal property is sold in interstate commerce. This federal prohibition is set out in *Code of Virginia* § 58.1-609.10(4) which provides an exemption from the retail sales and use tax for the “delivery of tangible personal property outside the Commonwealth for use or consumption outside the Commonwealth.”

Title 23 of the Virginia Administrative Code (VAC) 10-210-780, which interprets the above statute, establishes that the retail sales and use tax does not apply to sales of tangible personal property made in interstate or foreign commerce. For example, modular housing sold to a consumer *without installation* constitutes a retail sale of tangible personal property.¹⁸ If such modular housing is delivered outside Virginia by the seller or its agents, the retail sale is not taxed by Virginia, provided the purchaser takes title or possession of the modular housing outside Virginia and makes no use of it in Virginia. In such instances, the destination state would be the only state to impose its sales and use tax.

However, if the purchaser takes title or possession of the modular housing in Virginia, the Virginia retail sales and use tax would apply as the sale does not constitute a sale in interstate commerce. In such instances, TAX found that most states would allow a tax credit against their state’s sales tax for sales or use taxes paid in another taxing jurisdiction. Although the same transaction may become subject to taxation by two states, there is no double taxation in the sense that each state fully taxes the product. Rather, the total tax on the product would generally not exceed the highest tax rate charged by the states.

For example, a Pennsylvania consumer buys modular housing sections from a Virginia manufacturer for \$40,000.00 and sends its trucks into Virginia to transport them to a Pennsylvania site. As possession passes to the purchaser in Virginia, the sale is taxable by Virginia. The Pennsylvania consumer would owe Virginia retail sales and use tax of \$1,800.00 ($\$40,000 \times 4.5\%$). When the modular housing sections are transported into Pennsylvania, the sections would then become subject to the Pennsylvania sales and use tax. As Pennsylvania allows a credit against its tax for taxes paid to other jurisdictions, the Pennsylvania consumer would only owe Pennsylvania sales and use tax of \$600.00 ($\$40,000 \times 6\% = \$2,400; \$2,400 - \$1,800$). Thus, the combined tax paid between the two states is no more than \$2,400.

Sales for resale. Sales for resale do not constitute the retail sale of tangible personal

¹⁸ Conversely, a transaction requiring the seller to *furnish and install* a modular home on a permanent foundation constitutes a real property service contract and therefore does not constitute a transaction for the sale or retail sale of tangible personal property.

property. As the Virginia retail sales and use tax applies only to the retail sale of tangible personal property or certain taxable services, a sale for resale is not taxable, provided the purchaser provides the seller with a properly completed and signed resale certificate of exemption, Form ST-10 or Form ST-14.

For example, an out-of-state dealer properly registered in another state may purchase modular housing sections for resale purposes only, if it furnishes the Virginia modular housing manufacturer with a completed resale exemption certificate. In a resale transaction, it does not matter whether the out-of-state dealer sends its own trucks into Virginia to immediately transport the housing sections out-of-state or allows the Virginia manufacturer to ship them to the dealer outside Virginia. Since the transaction is exempt on the basis of the resale exclusion, it is not affected by the mode or place of delivery of the product to the purchaser.

Elimination of Multiple Taxation. The modular housing industry seeks the elimination of certain multiple tax consequences incurred in Virginia so as to compete more effectively with those out-of-state manufacturers who do not suffer from multiple taxation in their own states.

Under Virginia's contractor rules affecting modular housing manufacturers¹⁹, a fabricator who is primarily operating as a retailer may purchase all materials exempt of the tax. However, a fabricator who is primarily operating as a contractor and who cannot identify a resale purchase of materials, is required to pay the tax on the cost price of all materials. When such fabricator/contractor sells at retail, it is also required to collect the sales tax based on the sales price but is not allowed a credit for taxes paid on the cost of materials. The reason is that the purchase of raw construction materials and the sale of fabricated modular housing sections are clearly separate and distinct transactions and products. As there is currently no statute allowing a credit under these circumstances, the multiple taxing method is necessary in those cases when a contractor is unable to identify a resale purchase of materials at the time of purchase.

The Virginia retail sales and use tax is a moment of transaction tax. Under Virginia law, the retail sales and use tax applies to every sale unless an exemption can be established. Thus, at the moment of purchase, the tax applies unless the purchaser definitely knows and certifies to the seller using a valid exemption certificate that it will use such property for an exempt purpose or will resale it only. Although the multiple taxation rule increases the cost of selling modular homes, it is an unavoidable cost of doing business when no procedures are in place to identify and track resale purchases. Fabricators who operate primarily as contractors have the option of implementing their own procedures and are thus not without a means to avoid multiple taxation.

Notwithstanding the foregoing, some modular housing manufacturers maintain that it is impractical and burdensome to identify materials purchased for resale purposes. They also maintain that out-of-state manufacturers enjoy a competitive advantage as such manufacturers generally pay tax only once on their products. If Virginia modular building manufacturers were

¹⁹ See "Overview of Tax Policy" section of this report.

similarly treated, they would avoid multiple tax consequences and enjoy tax parity with out-of-state manufacturers.

Modular Home Retailers

“The Virginia Manufactured Housing Association (‘VAMHA’) is a statewide nonprofit trade association in existence since 1965 and dedicated to promoting the common business interests of its members in the manufactured home and modular home industries in the Commonwealth of Virginia. Its principal office is located at 8413 Patterson Avenue, Richmond, Virginia 23229, and its president is Ronald W. Dunlap.

More than 180 manufactured home and modular home retailers are members of VAMHA. An increasing percentage of those retailers are now engaged in modular home sales, often in what are termed ‘land/home’ or ‘land in lieu’ transactions, throughout Virginia and especially in those areas of Virginia adjacent to surrounding states. Over the coming decade, VAMHA anticipates that many, if not most, of its retailer members will become increasingly involved in modular home sales in an effort to capture a growing market share.

Virtually all modular home retailers that sell modular homes both sell and install modular homes for their customers.

VAMHA endorses the enclosed Modular Housing Report and it strongly supports the proposed legislation set forth in Article VIII, therein.

To that end, it is VAMHA’s firm conviction that reducing the taxable base on which the sales or use tax is assessed to 60 percent of retail sales price - an amount approximately equivalent to a modular home’s actual cost of materials - will place VAMHA’s modular home retailers in a more competitive position as to conventional home builders, and particularly as to other retailers in surrounding states. It also is VAMHA’s belief that enacting such a tax reduction will significantly stimulate economic activity in Virginia’s modular housing industry, to the benefit of all Virginians, at the same time that it generates additional tax revenues from increased business performance thereby minimizing if not eliminating any tax loss to the Commonwealth.”²⁰

VII. MEETINGS

In the conduct of this study, three meetings and two conference calls were conducted with representatives of the modular housing industry and other interested parties. See Appendix I for a list of associations invited to the initial meeting. All meetings and conference calls were attended by representatives of the Virginia Manufactured Housing Association, the Industrialized Housing Association of Virginia, Inc., and the Mid-Atlantic Building Systems Council.

²⁰ Contributed by J. Steven Erie, Attorney at Law, on behalf of VAMHA.

August 11th meeting. The initial meeting was held at TAX on August 11, 1999. TAX reported on the sales and use tax laws and policies currently in existence for the modular housing industry, such as the taxing policies noted in the *Overview of Current Policy* section of this report. The modular housing industry commented on its positions, as generally covered in Part VI of this report. As a result of this meeting, the modular housing industry agreed to draft a specific legislative proposal to correct the perceived sales tax disadvantage with conventional home builders for discussion at the next meeting.

September 10th Meeting. The second meeting was held at TAX on September 10, 1999. The meeting focused on the draft legislation proposed by the modular housing industry. As there were constitutional and jurisdictional concerns with the initial proposed legislation, the modular housing industry agreed to redraft their legislative proposal to resolve several concerns raised by the initial proposal.

October 1st Meeting. The third meeting was held at TAX on October 1, 1999. Industry's second legislative draft was reviewed and discussed. In particular, the group discussed the proposed "modular building" definition as it classified modular buildings as real property.

TAX commented that such real property classification was potentially problematic. In that the Virginia retail sales and use tax is a tax only on retail sales of tangible personal property, it is not a tax on real property. Furthermore, modular building sections do not become part of the realty until affixed to a permanent foundation. To prevent potential legal conflicts, TAX recommended that the term "modular building" for purposes of the retail sales and use tax should not be defined as real property as it is considered tangible personal property up until the time it is affixed to realty. The industry group subsequently agreed to this change.

TAX suggested other changes to industry's proposed legislation. Industry agreed to revise it and forward the revision to TAX. TAX agreed to send a tentative draft of its report to industry representatives following agreement on the final draft legislation.

October 25th Conference Call. On October 25, 1999, the Tax Policy staff of TAX held a conference call with three association representatives of the modular housing industry to discuss the legislative proposal. It was determined that further changes were needed and that another conference call would be set up to discuss the changes.

November 1st Conference Call. On November 1, 1999, the Tax Policy staff of TAX held a conference call to discuss the draft of the legislative proposal with three association representatives of the modular housing industry. The group agreed that the legislative proposal was acceptable with only some minor modifications.

VIII. PROPOSED LEGISLATION

The Final Legislative Proposal

After several meetings and conference calls with industry, TAX and the modular housing industry came to a consensus on the final legislative proposal. The draft of the final legislative proposal is outlined below and is also shown at Appendix J.

1. The Final Legislative Proposal would amend *Code of Virginia* § 58.1-609.1 (Government and commodities exemptions) by adding a new partial exclusion in combination with a new credit provision, as follows:

16. Beginning July 1, 2000, the retail sale of a modular building as defined by § 58.1-602, by a modular building manufacturer or modular building retailer as defined by § 58.1-602, shall be subject to tax upon sixty percent (60%) of the retail sales price. If the modular building manufacturer has paid the Virginia retail sales and use tax on the cost price of materials incorporated in a modular building which has been constructed for sale without installation, it may credit, against the tax shown to be due on the return, the amount of sales or use tax paid on the cost of materials used in fabricating a modular building sold without installation.

2. To clarify the intent and scope of industry's Final Legislative Proposal, an amendment to *Code of Virginia* § 58.1-602 would be needed to add three new definitions, as follows:

"Modular building" shall include, but not be limited to, single and multi-family houses, apartment units, commercial buildings and permanent additions thereof, comprised of one or more sections which are intended to become real property, primarily constructed at a location other than the permanent site, built to comply with the Virginia Industrialized Building Safety Law (§ 36-70 et seq.) as regulated by the Virginia Department of Housing and Community Development, and shipped with most permanent components in place to the site of final assembly. For purposes of this chapter, a modular building shall not include a mobile office as defined in § 58.1-2401 or any manufactured building subject to and certified under the provisions of the National Manufactured Housing Construction and Safety Standards Act of 1974 (42 U.S.C. § 5401 et seq.).

"Modular building manufacturer" means a person or corporation who owns or operates a manufacturing facility and is engaged in the fabrication, construction and assembling of building supplies and materials into modular buildings as defined in § 58.1-602 at a location other than at the site where the modular building will be assembled on the permanent foundation and may or may not be engaged in the process of affixing the modules to the foundation at the permanent site.

“Modular building retailer” means any person who purchases or acquires a modular building from a modular building manufacturer, or from another person, for subsequent sale to a customer residing within or outside of the Commonwealth of Virginia, with or without installation of the modular building to the foundation at the permanent site.

3. The Final Legislative Proposal also addresses situations in which a person furnishes a modular building to an installation contractor. In such instances, the current contractor statute of *Code of Virginia* § 58.1-610 requires the contractor to pay tax based on the fair market value of tangible personal property, e.g., the full cost price of modular housing or modular building sections purchased by persons who have contracted with a contractor for installation. To avoid placing contractors at a tax disadvantage, an amendment to subsection E of *Code of Virginia* § 58.1-610 to add a new provision (which is underscored) would be needed as follows:

“E. Nothing in this section shall be construed to (i) to affect or limit the resale exclusion provided for in this chapter, or the industrial materials and other industrial exclusions set out in § 58.1-609.3, or the exclusion for baptistries set in subdivision 2 of § 58.1-609.8, or the partial exclusion for the sale of modular buildings as set out in subdivision 16 of § 58.1-609.1, or (ii) impose any sale or use tax with respect to the use in the performance of contracts with the United States, this Commonwealth, or any political subdivision thereof, of tangible personal property owned by a governmental body which actually is not used or consumed in the performance thereof.”

Effect of the Final Legislative Proposal

The Final Legislative Proposal has the effect of taxing all retail sales of modular buildings (as defined) based on 60% of the retail sales price. This would result in tax parity with conventional buildings.

The Final Legislative Proposal would affect those modular housing manufacturers who operate *primarily* as contractors and sell at retail some of the time. Although such manufacturers would still be required to pay the tax on the cost price of all materials, this proposal would allow them to take a tax credit on their sales and use tax return for taxes paid on the cost of materials used to fabricate modular buildings, e.g., when they make a retail sale, an exempt sale for resale, or exempt sale in interstate commerce (i.e., any sale without installation) of modular buildings. As such, this proposal removes the consequences of multiple taxation inherent in the present policy.

However, the Final Legislative Proposal does not change the rules for those modular housing manufacturers who fabricate modular housing and building structures *exclusively* for use or consumption in real property construction contracts. Such manufacturers who operate *exclusively* as contractors would continue to pay the sales and use tax only on the cost price of materials.

Direct payment permit holders who fabricate “manufactured homes” for sale and fabricate “modular buildings” primarily for their use or consumption. In certain instances, TAX has issued direct pay permits²¹ to manufacturers who fabricate manufactured homes (mobile homes) for sale and fabricate modular buildings primarily for their use or consumption in real property construction contracts. Such manufacturers would continue to pay the retail sales and use tax on the cost of materials incorporated into modular housing sections when they contract to furnish and install modular housing or modular building sections on permanent foundations, i.e., when the transaction is for real property construction services.

However, when such direct payment permit holders sell modular housing sections at retail (i.e., sell without installation to the final consuming purchaser), the Final Legislative Proposal would require them to collect the sales tax based on sixty percent of the retail sales price. If such direct payment permit holders sell modular housing sections without installation to a purchaser who buys for resale purposes only, the transaction would not be subject to the Virginia retail sales and use tax, provided the purchaser provides such manufacturer with a valid resale exemption certificate.²² If such direct payment permit holders sell modular housing sections without installation in a transaction which qualifies as an exempt sale in interstate commerce, no Virginia retail sales and use tax would apply. Rather, the modular housing sections would be subject only to the destination state’s sales and use tax, if imposed by such other state.

Estimated Fiscal Impact of Final Legislative Proposal

Based on data received from the Virginia Manufactured Housing Association (“VAMHA”), TAX estimates that the proposed legislation will have a negative fiscal impact on state and local revenues. This estimate is based on the nature of the proposed change, i.e., the fact that the taxable base on a retail sale of a modular building would be changed from 100% to 60% of the sales price. Several modular housing retailers are most likely to be affected by the proposed legislation as they at times purchase modular homes at retail or for resale purposes. A negative fiscal impact is also presumed under the proposed legislation for manufacturers when they sell a modular building without installation services and take the new proposed credit for taxes paid on the cost of materials.

At the request of TAX, VAMHA conducted a survey of its 185 dealers asking them for

²¹ A direct payment allows a manufacturer to buy materials exempt of the tax, when purchases are made under circumstances which make it impossible at the time of sale to determine the manner in which such property will be used. See Title 23 of the Virginia Administrative Code 10-210-510 and 10-210-410(E) and *Code of Virginia* § 58.1-624. Certain modular housing manufacturers who also fabricate and sell manufactured homes (i.e., mobile homes subject to the *motor vehicle sales and use tax* administered by the Department of Motor Vehicles) have been issued direct payment permits by TAX.

²² Purchasers who buy tangible personal property for resale purposes only are required to furnish the seller with a properly completed and signed resale certificate of exemption, Form ST-10. The exemption certificate rules set out in 23 VAC 10-210-280 apply.

(1) the dollar amount and number of modular homes which they purchased and installed (i.e., the manufacturer provides no installation), and (2) the dollar amount and number of modular homes which they sold at retail (i.e., the dealer sells without installation to final consumer). The requested data needed to exclude "mobile homes" and "mobile offices." As of November 30, 1999, 25 dealer members of VAMHA had reported sales information.

The 25 reporting dealers indicated that they had purchased and installed 28 modular homes and sold two at retail over the latest twelve month period. It is TAX's understanding that the data excluded "mobile homes" and "mobile offices." Extrapolating the sample data received from the 25 reporting dealers and assuming a 5% growth rate, TAX estimates the potential fiscal impact of the Final Legislative Proposal in the following table:

Fiscal Year	Total Impact	State Revenue Impact				Local Revenue Impact
		General Revenue Fund	Unrestricted	Restricted - Educ.	Transportation Trust Fund	
FY 2001	\$495,914	\$383,716	\$218,411	\$109,206	\$56,099	\$112,198
FY 2002	\$568,047	\$439,529	\$250,180	\$125,090	\$64,259	\$128,517

Contrary Opinion. A modular housing manufacturer and the Mid-Atlantic Building Systems Council disagree with TAX's estimated negative revenue impact associated with this legislative proposal. They contend that the proposal will not impact state revenues negatively. Rather, the manufacturer and the Council assert that any negative revenue impact due to the reduced tax base will be offset by tax revenues generated by increased business activity.

Prospective versus Retroactive Application

The Final Legislative Proposal, if enacted as drafted, would take effect beginning on and after July 1, 2000, without any retroactive effect. If any type of retroactive application is subsequently contemplated, it must be recognized that there will be an additional negative fiscal impact to the Commonwealth.

A retroactive application would benefit the modular building industry, such as modular housing manufacturers, dealers, and contractors alike. However, it would likely have no direct benefit to their past customers, such as home owners. For businesses who have complied with existing laws and regulations, a retroactive application would require the State to refund sales tax based on the difference between the current taxable base (i.e., 100% of sales price) and the new taxable base (i.e., 60% of sales price). In addition, a retroactive application would require further refunds based on the new proposed tax credit provision of the Final Legislative Proposal.

Clearly, a retroactive application would pose a significant negative fiscal impact. TAX

has found no justification for supporting any type of retroactive application in this matter. Therefore, if the Final Legislative Proposal is enacted, TAX recommends prospective application, beginning no earlier than July 1, 2000.

In response, the Virginia Manufactured Housing Association (“VAMHA”) has stated a “concern for those dealer members adversely impacted by the Department’s interpretation of existing law, particularly for those dealers which had relied in good faith on other interpretations of existing law.” Accordingly, VAMHA has reservation about prospective application of the proposed legislation and requests “that appropriate relief be made available to them, either legislatively or administratively....”²³

Declarative v. Substantive

The regulations set out in Title 23 of the Virginia Administrative Code (VAC) 10-210-2080 and 10-210-410 are valid interpretations of the existing law and were developed with input from the modular housing industry to reflect how they were doing business in 1971. These regulations are declarative of the existing law. The Final Legislative Proposal, except for the three new definitions included in such proposal, represents a substantive change in existing law as it provides (i) a new taxable base of 60% for modular buildings, and (ii) a new tax credit applicable only to modular housing sold without installation. Accordingly, the Final Legislative Proposal is not declarative of existing law.

IX. SUSPENSIONS EXAMINED

House Joint Resolution 742 requires this study to address “whether the Department should suspend, during the period of this study, all audits, assessments, accrual of interest, and collection actions as they pertain to the applicability of the retail sales and use tax to sales of modular homes.”

Legal Authority to Postpone Audits and Assessments

For retail sales and use tax purposes, *Code of Virginia* § 58.1-634 states, in part, “taxes imposed by this chapter shall be assessed within three years from the date on which such taxes became due and payable.” In the event that additional time is needed by TAX to complete an audit and to issue an assessment for omitted or additional taxes, *Code of Virginia* § 58.1-220 allows the Tax Commissioner and the taxpayer to agree to extend the time limitation imposed under *Code of Virginia* § 58.1-634. TAX and the taxpayer need only sign a Form DT-36 (“Waiver of Time Limitations on Assessment of Taxes”).

This waiver has also been used in instances when taxpayers request postponement in scheduling or completing an audit due to certain extenuating circumstances. Acting under the

²³ Quoted response provided by J. Steven Erie, Attorney at Law, on behalf of VAMHA.

authority of *Code of Virginia* § 58.1-220 and provided the taxpayer has consented to such authority, TAX has the authority to postpone conducting an audit and thus postpone making an assessment.

Accrual of Interest

Pursuant to *Code of Virginia* §§ 58.1-635(C) and 58.1-1812(A), the accrual of interest on omitted retail sales and use taxes is mandatory until the tax deficiency is paid in full.

Collection Actions

For the period of the study, collection actions were suspended by TAX on those unpaid sales and use tax assessments issued as a result of an audit by TAX of modular housing manufacturers and dealers selling modular housing as defined by House Joint Resolution 742.

X. APPENDICES

GENERAL ASSEMBLY OF VIRGINIA -- 1999 SESSION

HOUSE JOINT RESOLUTION NO. 742

Requesting the Department of Taxation to study the sales and use taxation of modular housing.

Agreed to by the House of Delegates, February 23, 1999

Agreed to by the Senate, February 18, 1999

WHEREAS, modular housing consists of single and multi-family housing, apartment units, and commercial structures comprised of two or more sections without a permanent chassis, built to a state or model code other than the National Manufactured Housing Construction Safety Standards Act of 1974, which is primarily constructed at a location other than the site at which it is to be finally assembled, and is shipped to the site of final assembly with most permanent components in place; and

WHEREAS, it is customary for each modular home to be manufactured to a specific home buyer's custom order, delivered to a permanent location and installed on a permanent foundation; and

WHEREAS, it is customary that modular housing is sold utilizing builders and dealers who work with the home buyers in determining their specific needs and prepare the permanent site for the installation of the housing modules; and

WHEREAS, every modular home is intended to be real estate from the time the home is designed and manufacturing begins; and

WHEREAS, Virginia modular housing is subject to the retail sales and use tax administered by the Department of Taxation; and

WHEREAS, questions continue to arise regarding the method to which sales and use tax should be computed; and

WHEREAS, some modular manufacturers pay sales tax in the Commonwealth of Virginia at the time building supplies and materials are purchased and other manufacturers purchase materials tax-exempt and remit use tax to the Department after the home is sold; and

WHEREAS, modular manufacturers and builders/dealers had an understanding that the sales and use tax should be computed at the Virginia sales and use tax rate of four and one-half percent of only the actual cost of building supplies and materials used in the manufacture and installation of the home or on a percentage of the manufacturer's invoice price that reflects the value of materials as a percentage of the total invoice price of the modular home; and

WHEREAS, in instances where a builder/dealer buys modular housing or sections of a modular home and assumes any responsibility for installing the unit, connecting the sections at the home site, or arranging for someone else to perform such installation, the Department has ruled that the builder/dealer is deemed to be the final consumer and the housing modules are considered tangible personal property and not real estate; and

WHEREAS, in such instances the builder/dealer is deemed a real property installation contractor and thus the person liable for the retail sales and use tax; and

WHEREAS, the practice of assessing builder/dealers retail sales and use tax based on 100 percent of the price charged by the manufacturer for the unit or individual sections is inequitable; and

WHEREAS, it may be appropriate to amend the Code of Virginia to define modular housing as real property regardless of who assumes responsibility for the installation of the housing modules and to ensure that the sales and use tax is payable only on the actual value of the building supplies and materials used in the manufacture and installation of a modular home, as delineated on the manufacturer's invoice, and on the preparation of the site and permanent installation of the home; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That the Department of Taxation be requested to study the sales and use taxation of modular housing. The study shall address all issues relating to the application of the retail sales and use tax to modular housing, including, but not limited to: (i) the fiscal impact of any recommended amendments to the current law; (ii) whether any proposed changes to the wording of applicable provisions of the Code of Virginia are intended to be declarative of existing law rather than

substantive in nature; and (iii) whether the Department should suspend, during the period of this study, all audits, assessments, accrual of interest, and collection actions as they pertain to the applicability of the retail sales and use tax to sales of modular homes. The Department shall include the Virginia Manufactured Housing Association, the Industrialized Housing Association of Virginia, Inc., out-of-state associations representing manufacturers who do business in the Commonwealth of Virginia, and all other interested parties in its conduct of the study.

All agencies of the Commonwealth shall provide assistance to the Department in its conduct of this study, upon request.

The Department shall complete its work in time to submit its findings and recommendations to the Governor and the 2000 Session of the General Assembly as provided in the procedures of the Division of Legislative Automated Systems for the processing of legislative documents.

Statutory Definitions***Code of Virginia*****§ 58.1-602. Definitions (Partial Listing).**

As used in this chapter, unless the context clearly shows otherwise, the term or phrase:

"Business" includes any activity engaged in by any person, or caused to be engaged in by him, with the object of gain, benefit or advantage, either directly or indirectly.

"Cost price" means the actual cost of an item or article of tangible personal property computed in the same manner as the sales price as defined in this section without any deductions therefrom on account of the cost of materials used, labor, or service costs, transportation charges, or any expenses whatsoever.

"Distribution" means the transfer or delivery of tangible personal property for use, consumption, or storage by the distributee, and the use, consumption, or storage of tangible personal property by a person who has processed, manufactured, refined, or converted such property, but does not include the transfer or delivery of tangible personal property for resale or any use, consumption, or storage otherwise exempt under this chapter.

"Gross proceeds" means the charges made or voluntary contributions received for the lease or rental of tangible personal property or for furnishing services, computed with the same deductions, where applicable, as for sales price as defined in this section over the term of the lease, rental, service, or use, but not less frequently than monthly.

"Gross sales" means the sum total of all retail sales of tangible personal property or services as defined in this chapter, without any deduction, except as provided in this chapter. "Gross sales" shall not include the federal retailers' excise tax or the federal diesel fuel excise tax imposed in § 4091 of the Internal Revenue Code if the excise tax is billed to the purchaser separately from the selling price of the article, or the Virginia retail sales or use tax, or any sales or use tax imposed by any county or city under § 58.1-605 or § 58.1-606.

"Import" and *"imported"* are words applicable to tangible personal property imported into this Commonwealth from other states as well as from foreign countries, and *"export"* and *"exported"* are words applicable to tangible personal property exported from this Commonwealth to other states as well as to foreign countries.

"In this Commonwealth" or *"in the Commonwealth"* means within the limits of the Commonwealth of Virginia and includes all territory within these limits owned by or ceded to the United States of America.

"Lease or rental" means the leasing or renting of tangible personal property and the possession or

use thereof by the lessee or renter for a consideration, without transfer of the title to such property.

"Motor vehicle" means a "motor vehicle" as defined in § 58.1-2401, taxable under the provisions of the Virginia Motor Vehicles Sales and Use Tax Act (§ 58.1-2400 et seq.) and upon the sale of which all applicable motor vehicle sales and use taxes have been paid.

"Occasional sale" means a sale of tangible personal property not held or used by a seller in the course of an activity for which he is required to hold a certificate of registration, including the sale or exchange of all or substantially all the assets of any business and the reorganization or liquidation of any business, provided such sale or exchange is not one of a series of sales and exchanges sufficient in number, scope and character to constitute an activity requiring the holding of a certificate of registration.

"Person" includes any individual, firm, copartnership, cooperative, nonprofit membership corporation, joint venture, association, corporation, estate, trust, business trust, trustee in bankruptcy, receiver, auctioneer, syndicate, assignee, club, society, or other group or combination acting as a unit, body politic or political subdivision, whether public or private, or quasi-public, and the plural of such term shall mean the same as the singular.

"Retail sale" or a *"sale at retail"* means a sale to any person for any purpose other than for resale in the form of tangible personal property or services taxable under this chapter, and shall include any such transaction as the Tax Commissioner upon investigation finds to be in lieu of a sale. All sales for resale must be made in strict compliance with regulations applicable to this chapter. Any dealer making a sale for resale which is not in strict compliance with such regulations shall be personally liable for payment of the tax.

The terms "retail sale" and a "sale at retail" shall specifically include the following: (i) the sale or charges for any room or rooms, lodgings, or accommodations furnished to transients for less than ninety continuous days by any hotel, motel, inn, tourist camp, tourist cabin, camping grounds, club, or any other place in which rooms, lodging, space, or accommodations are regularly furnished to transients for a consideration; and (ii) sales of tangible personal property to persons for resale when because of the operation of the business, or its very nature, or the lack of a place of business in which to display a certificate of registration, or the lack of a place of business in which to keep records, or the lack of adequate records, or because such persons are minors or transients, or because such persons are engaged in essentially service businesses, or for any other reason there is likelihood that the Commonwealth will lose tax funds due to the difficulty of policing such business operations. The Tax Commissioner is authorized to promulgate regulations requiring vendors of or sellers to such persons to collect the tax imposed by this chapter on the cost price of such tangible personal property to such persons and may refuse to issue certificates of registration to such persons.

The term *"transient"* shall not include a purchaser of camping memberships, time-shares, condominiums, or other similar contracts or interests that permit the use of, or constitute an interest in, real estate, however created or sold and whether registered with this Commonwealth or not. Further, a purchaser of a right or license which entitles the purchaser to use the amenities and facilities of a specific real estate project on an ongoing basis throughout its term shall not be deemed

a transient; provided, however, that the term or time period involved is for seven years or more.

"Retailer" means every person engaged in the business of making sales at retail, or for distribution, use, consumption, or storage to be used or consumed in this Commonwealth.

"Sale" means any transfer of title or possession, or both, exchange, barter, lease or rental, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property and any rendition of a taxable service for a consideration, and includes the fabrication of tangible personal property for consumers who furnish, either directly or indirectly, the materials used in fabrication, and the furnishing, preparing, or serving for a consideration of any tangible personal property consumed on the premises of the person furnishing, preparing, or serving such tangible personal property. A transaction whereby the possession of property is transferred but the seller retains title as security for the payment of the price shall be deemed a sale.

"Sales price" means the total amount for which tangible personal property or services are sold, including any services that are a part of the sale, valued in money, whether paid in money or otherwise, and includes any amount for which credit is given to the purchaser, consumer, or lessee by the dealer, without any deduction therefrom on account of the cost of the property sold, the cost of materials used, labor or service costs, losses or any other expenses whatsoever. "Sales price" shall not include (i) any cash discount allowed and taken or (ii) finance charges, carrying charges, service charges or interest from credit extended on sales of tangible personal property under conditional sale contracts or other conditional contracts providing for deferred payments of the purchase price. Where used articles are taken in trade, or in a series of trades as a credit or part payment on the sale of new or used articles, the tax levied by this chapter shall be paid on the net difference between the sales price of the new or used articles and the credit for the used articles.

"Storage" means any keeping or retention of tangible personal property for use, consumption or distribution in this Commonwealth, or for any purpose other than sale at retail in the regular course of business.

"Tangible personal property" means personal property which may be seen, weighed, measured, felt, or touched, or is in any other manner perceptible to the senses. The term "tangible personal property" shall not include stocks, bonds, notes, insurance or other obligations or securities.

"Use" means the exercise of any right or power over tangible personal property incident to the ownership thereof, except that it does not include the sale at retail of that property in the regular course of business. The term does not include the exercise of any right or power, including use, distribution, or storage, over any tangible personal property sold to a nonresident donor for delivery outside of the Commonwealth to a nonresident recipient pursuant to an order placed by the donor from outside the Commonwealth via mail or telephone.

"Use tax" refers to the tax imposed upon the use, consumption, distribution, and storage as herein defined.

PD 85-73

April 3, 1985

Re: Request for Ruling/Sales and Use Tax

Dear

This will reply to your letter of November 19, 1984, in which you request a clarification as to the application of the sales and use tax to builders of modular homes.

Section 58.1-610A of the Code of Virginia provides:

Any person who contracts orally, in writing, or by purchase order, to perform construction, reconstruction, installation, repair, or any other service with respect to real estate or fixtures thereon, and in conjunction therewith to furnish tangible personal property, shall be deemed to have purchased such tangible personal property for use or consumption. Any sale, distribution, or lease to or storage for such person shall be deemed a sales distribution, or lease to or storage for the ultimate consumer and not for resale...

Under the foregoing statute, a modular builder is considered to be a contractor only when he performs construction; installation, or some other service in connection with the affixation of a modular home to real estate. Without the provision of such services, a modular builder is deemed to be a retailer and must collect the sales tax from his customers based upon the sales price of the modular home.

As the provision of services with respect to real estate is the key to determining whether a modular home builder is a contractor or retailer, the point at which title to a home passes from the builder is of no consequence. As to the examples provided in your March 30, 1984 letter, I would consider a modular home builder to be a contractor when he assists in actually affixing a modular home to real estate; however, I do not consider a builder to be a contractor solely by virtue of his responsibility for the correction of construction defects after the affixation of a modular home to real estate.

Sincerely,

W. H. Forst
Tax Commissioner

P.D. 89-349
December 20, 1989

Re: Ruling Request/ Virginia Sales and Use Tax

Dear

This will reply to your letter dated November 1, 1989 in which you request a ruling for Virginia Sales and Use Tax.

FACTS

You represent a New Jersey corporation (taxpayer) which is engaged in manufacturing of modular homes. The homes are assembled in a warehouse into two or more units and then placed on a truck for delivery to a builder or consumer in Virginia to be affixed to real estate.

The taxpayer requests clarification of the Virginia sales and use tax regulations on the following points:

1. Whether the modular units are considered to be tangible personal property prior to the installation of the units on a lot.
2. Whether the corporation is considered a manufacturer for the purpose of purchasing materials on a tax exempt basis.
3. Collection and payment of the sales and use tax when the units are sold to a builder for resale to the ultimate user.
4. Collection and payment of the sales and use tax if the corporation sells the modular homes directly to the ultimate user.

PD 89-349

Page 2

December 20, 1989

5. Application of the Use tax to the aforementioned situations.

RULING

In accordance with Virginia Regulation 630-10-84.1, sales of prefabricated modular house sections or units by manufacturers without installation are sales of tangible personal property that are subject to the Virginia sales and use tax. If the taxpayer is not authorized to collect the tax or fails to collect the tax, the purchaser (the builder) must remit the tax directly to the Department of Taxation on Form ST-7, Consumer's Use Tax Return.

A builder who purchases and installs the modular unit for a customer will not be entitled to the resale exemption. Inasmuch as the unit loses its identity as tangible personal property and becomes real property upon installation the builder is deemed to be the consumer of the material under Virginia Regulation 630-10-27 (enclosed) for purposes of applying the tax.

The taxpayer itself will be deemed the taxable user or consumer of any modular home which it erects or contracts to erect in Virginia. In such an event, the tax is computed based on the primary purpose rule set out in Virginia Regulation 630-10-27(E).

The taxpayer is entitled to purchase raw materials, component parts, and other tangible personal property to be fabricated for sale under the industrial manufacturing exemption provided that more than one half its production consists of units to be sold to builders or other consumers.

I hope the foregoing information has answered your questions. However, please contact the department if you need additional information.

Sincerely,

W. H. Forst
Tax Commissioner

Enclosure

PD 93-24
February 10, 1993

Re: Ruling Request: Retail Sales and Use Tax

Dear

This is in reply to your letter of February 12, 1992 in which you request guidance as to the proper application of Virginia sales and use tax to the operations of the "Taxpayer").

FACTS

The Taxpayer is a dual role contractor which manufactures modular homes from an operation located in Virginia. These homes are primarily produced for suburban residential markets located both within Virginia and surrounding states. Following its manufacture, each modular home is delivered to its permanent site and affixed to the foundation by the Taxpayer's set crew or by an independent contractor hired by the Taxpayer.

In addition to the modular homes, the Taxpayer also produces housing panels. These panels are produced in the same facility as the modular homes and are sold as tangible personal property to construction contractors for their use in construction projects both inside and outside of Virginia.

The Taxpayer does not purchase its materials in a "job-specific" manner. That is, at the time of purchase, the Taxpayer is not able to determine whether materials will be incorporated in a home remaining in Virginia, a home destined for out-of-state delivery, or housing panels. The Taxpayer has requested a response to questions relative to its operations.

RULING

In that there is a series of questions in your letter, I will address them below in the sequence written.

1. In circumstances where the Taxpayer delivers a completed modular home to a site in Virginia and affixes the unit to the foundation with a set crew consisting of its own employees or independent contractors, is the Taxpayer acting as a construction contractor subject to the provisions of Virginia Regulation (VR) 630-10-27?

In that the Taxpayer is manufacturing modular homes which it will incorporate in real property, it would be considered a contractor with respect to real estate. As such, in accordance with VR 630-10-27, it would be considered a construction contractor subject to the tax as the ultimate consumer of tangible personal property used and consumed in the installation of the modular homes.

2. Assuming the answer to question (1) is affirmative, what is the specific Virginia use tax base applicable to the completed modular home? Has Virginia adopted any separate provisions applicable to the modular home industry as opposed to traditional construction?

Any person who is principally a fabricator of tangible personal property for its own use will generally use material and supply cost as the base to compute the applicable tax when manufacturing a modular home. However, when a person is principally fabricating tangible personal property for sale or resale, Virginia Regulation (VR) 630-10-27(E) provides that:

Any person who withdraws tangible personal property from inventory for use and consumption in the performance of real property construction contracts is liable for the tax based on the fabricated cost price of the tangible personal property withdrawn. Fabricated cost price is computable by totaling the cost of materials, labor, and overhead charged to work in process. Freight inward at the plant is treated as an element of the cost of the materials. (Emphasis added.)

For example, the Taxpayer manufactures housing panels and places the completed panels in a finished goods inventory for resale to their contracting customers. At a later date, some of these panels are withdrawn from inventory by the Taxpayer and used in the manufacturing of a modular home which the Taxpayer either installs by his own set crew or by an independent

contractor hired by the Taxpayer. In this instance, the base to use in computing the tax on the housing panels is the total fabricated cost of the housing panels including the cost of the materials, labor, overhead and freight-in charged to work in process.

The department has not adopted separate provisions applicable to the modular home industry in that present regulations adequately addresses industry concerns.

3. Again assuming that the response to question (1) is generally affirmative, if the set crew utilized by the Taxpayer consists of independent contractors rather than its own employees, must any particular relationship or contractual provisions exist between the Taxpayer, the set crew, and the developer-purchaser in order for the Taxpayer to retain status as a construction contractor rather than a vendor of tangible personal property?

If the Taxpayer has entered into a real estate contract with a developer-purchaser to install a modular home, the Taxpayer is considered a construction contractor and is the ultimate consumer of tangible personal property used in manufacturing and affixing the home to realty regardless of whether it uses its own employees or a subcontractor to physically install the home.

4. With respect to modular homes manufactured in Virginia but delivered to an out-of-state location and subsequently affixed to the foundation, are there any Virginia sales or use tax implications with either the materials incorporated or the sale of the homes? Does the method or terms of delivery affect the response to this question?

VR 630-10-51(B) provides that:

The tax applies to the first use in Virginia of tangible personal property purchased elsewhere in a transaction which would have been taxed had the transaction occurred in Virginia, regardless of the fact that such property may have been, or may be used in interstate commerce. (Emphasis added.)

In addition, Va. Code §58.1-602 defines "use" as the "exercise of any right or power over tangible personal property incident to the ownership thereof."

Therefore, if modular homes are manufactured by the Taxpayer for installation by its employees or subcontractors, the Taxpayer, as a construction contractor, is subject to the tax on materials

used and consumed in the manufacturing of the modular home since first use of the material occurred in Virginia. In this instance, the terms for delivery of the home out-of-state do not exempt the tax on materials used in manufacturing the home.

However, if the Taxpayer sold at retail and delivered the modular home to an out-of-state developer for installation by the developer, the Taxpayer may purchase exempt of the tax materials used to manufacture the mobile home. Furthermore, the sales price of the modular home would be exempt from the tax in that an interstate commerce transaction has occurred.

5. If no Virginia sales and use tax is due on modular homes delivered out-of-state, what documentation must the Taxpayer maintain for audit purposes?

If a modular home is sold at retail and delivered out-of-state for installation by the customer, no sales tax would be charged. In such cases, proper documentation would include but not be limited to the following:

- ◆ Notation on the sales invoice of the out-of-state location to which the home was shipped.
- ◆ Supporting shipping documents to verify out-of-state location to which the home was shipped.
- ◆ Sufficient customer contracts or files to verify that the transaction was a retail sale instead of a construction contract project.

6. Must the Taxpayer collect Virginia sales tax on sales of housing panels to Virginia construction contractors?

In that the Taxpayer makes retail sales of housing panels, in accordance with VR 630-10-84.1, it must collect the tax on the sale of housing panels to its customers.

7. If the answer to question (6) is affirmative, is Virginia sales and use tax due on materials purchased by the Taxpayer and incorporated into the panels?

Concerning dual role contractors who primarily fabricate tangible personal property for their own use and consumption but who also make retail sales, VR 630-10-27(E) provides in part that:

Any person who is principally fabricating tangible personal property for his own use and consumption in real property construction contracts shall apply the tax according to subsection (D) above. In addition, persons who sell tangible personal property to consumers must register, collect, and pay the tax on the selling price of the tangible personal property. Such person is entitled to purchase exempt from the tax only that tangible personal property which can be identified at the time of purchase as purchases for resale. If the person is unable to identify at the time of purchase the tangible personal property which will be resold, such person is required to pay the tax to this supplier. If at later date, the person sells the tangible personal property at retail, the tax is collected upon retail selling price. Such persons are not entitled to credit for the tax paid to the suppliers since the transactions are separate and distinct taxable transactions. (Emphasis added.)

Therefore, the Taxpayer principally fabricates housing panels for its own use and, at the time of purchase, can not identify that material will be resold at retail, the purchases of materials are subject to the tax. In such instances, where the Taxpayer subsequently makes a retail sale of those items to a customer, the Taxpayer must charge the tax on the sales price. No credit is allowed for the tax paid to suppliers on the purchase of such item.

8. Under the circumstances described, is the Taxpayer eligible for a direct pay permit under the provisions of Virginia Sales & Use Tax Regulation 630-10-34?

From the information presented it appears the Taxpayer would qualify for use of the direct payment permit. However reasonable care and judgement must be exercised in the use of this permit. If the Taxpayer misuses the permit, it will be liable for tax, penalty and interest not paid because of the misuse and may also have its permit revoked.

9. Are there any other Virginia Sales & Use Tax provisions pertinent to the Taxpayer which have not been addressed in this correspondence?

In that the Taxpayer is a manufacturer, some of its equipment used directly in the manufacturing may meet the manufacturing exemption as provided in Va. Code § 58.1-608(A)(3) and VR 630-10-63. If the Taxpayer manufactures primarily for its own use, such items would be subject

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to the tax. However, if the Taxpayer manufactures primarily for sale or resale, such items would be exempt from the tax. Lastly, if the Taxpayer has equipment which it uses in both a taxable and an exempt manner, the preponderance of use will determine its taxable status.

If you have further questions, please contact the department.

Sincerely,

W. H. Forst
Tax Commissioner

OTP/5965N

P.D. 97-297

June 30, 1997

Re: § 58.1-1821 Application: Retail Sales and Use Tax

Dear

This will reply to your letter in which you seek correction of an assessment issued to (the "Taxpayer"), for the period October 1994 through March 1996. I apologize for the delay in responding to you.

FACTS

The Taxpayer manufactures modular homes for its own use in performing real estate construction contracts. The Taxpayer also sells modular homes on an uninstalled basis to contractors for use in real estate construction jobs. The Taxpayer treats itself as a using and consuming contractor on all the modular homes it manufactures and pays use tax on the cost of the raw materials used to manufacture the modular homes. An audit of the Taxpayer revealed that it was treating retail sales of the modular homes as if the Taxpayer was the user and consumer of the tangible personal property. The Taxpayer was paying use tax on the raw materials incorporated into the modular homes that were sold at retail. The department's auditor assessed use tax on the difference between the sales price of the modular homes and the cost of the raw materials on which use tax was paid.

DETERMINATION

The Taxpayer maintains that the assessment ignores the primary purpose rule set out in Title 23 of the Virginia Administrative Code (VAC) 10-210-410(E) which states that "[a] manufacturer, processor or miner who operates in a dual capacity of fabricating tangible personal property for sale or resale and fabricating for his own use and consumption in the performance of real property construction contracts shall follow a primary purpose rule based on gross receipts in determining sales and use tax application."

The third paragraph of Title 23 VAC 10-210-410(E) states that "[a]ny person who is principally fabricating tangible personal property for his own use and consumption in real property construction contracts shall apply the tax according to subsection D above. In addition, persons who sell tangible personal property to consumers must register, collect, and pay the tax on the retail selling price of the tangible personal property. Such person is entitled to purchase exempt from the tax only that tangible personal property which can be identified at the time of purchase as purchases for resale. If the person is unable to identify at the time of purchase the tangible personal property which will be resold, such person is required to pay the tax to his supplier. If at a later date, the person sells the tangible personal property at retail, the tax is collected upon retail selling price. Such persons are not entitled to credit for the tax paid to suppliers since the transactions are separate and distinct taxable transactions." (Emphasis added).

The Taxpayer is primarily fabricating modular homes for its own use and consumption; therefore, subsection D would apply to the Taxpayer's use and consumption of property in the performance of real property construction jobs. Subsection E of the regulation clearly indicates that the Taxpayer's retail sales of modular homes to consumers are subject to the tax on the retail selling price. This distinction between property used and consumed by a fabricator and property sold by a fabricator does not invalidate the primary purpose rule. The primary purpose rule is used to determine the proper method for paying use tax on property used and consumed by manufacturers or fabricators who are also contractors.

While I am sympathetic with the Taxpayer's situation, the auditor's assessment was proper. Due to the length of time taken to respond to the Taxpayer, I will waive the accrual of additional interest on the assessment if it is paid within sixty days. The department's records indicate a current balance of . If you have any questions concerning this matter, please contact in the Office of Tax Policy at . Your payment may be mailed to at P.O. Box 1880, Richmond, Virginia 23218-1880.

Sincerely,

Danny M. Payne
Tax Commissioner

OTP/11540S

P.D. 87-210

September 15, 1987

Re: Ruling Request/ Sales and Use Tax

Dear

This will reply to your letter of July 23, 1987 seeking information on the correct application of the sales and use tax to the sale and installation by (taxpayer), of one-unit modular buildings made of concrete and steel for Virginia customers.

FACTS

According to the information enclosed with your letter, the taxpayer is engaged in the manufacture of the above mentioned modular buildings in its Florida factory for use as branch banks, fast food restaurants, professional offices, gas marts, health clinics, etc. In general, the taxpayer ships the buildings to its Virginia customers with fully tested plumbing, heating, and air conditioning systems in place. Some buildings are also shipped with floor tiles, furnishings, bathroom fixtures, and pictures for walls already in place, according to customer specifications. After shipment of the buildings to its Virginia customers, the taxpayer provides installation work at the job site.

Accordingly, the taxpayer seeks a ruling on the correct application of the tax to the sale and installation of the modular buildings for Virginia customers.

RULING

§58.1-610 of the Virginia Code provides that "[a]ny person who contracts... to perform construction, reconstruction, installation, repair, or any other service with respect to real estate or fixtures thereon, and in connection therewith to furnish tangible personal property, shall be deemed to have purchased such tangible personal property for use or consumption." In addition, the statute provides that "[a]ny sale...to...such person shall be deemed a sale...to...the ultimate consumer and not for resale." Thus, a contractor respecting real estate is deemed to be the taxable user or

consumer of all materials furnished under a contract to erect or install property that will become affixed to realty and does not collect the sales tax from his customers when performing such contracts.

Since the modular buildings sold and installed by the taxpayer become a part of realty and are assessed as real property (rather than tangible personal property) for Virginia local tax purposes, I conclude that the taxpayer acts as a contractor respecting real estate when it sells and installs such buildings, together with any fixtures permanently affixed thereto, for Virginia customers. Accordingly, the taxpayer will be subject to the tax on any materials, equipment, etc., used to construct buildings for Virginia customers, subject to a nonrefundable credit for any tax paid on such materials, equipment, etc., in the state in which they were purchased. In addition, the taxpayer will not need to collect the sales tax from its Virginia customers. For example, if the taxpayer pays Florida sales tax on its purchases of materials used in the fabrication of the modular buildings, the taxpayer may claim a credit against Virginia's use tax to the extent of such Florida sales tax previously paid, in an amount not to exceed the amount of the Virginia tax.

However, while the taxpayer is a contractor for purposes of the modular buildings, (and fixtures attached thereto), which it installs for Virginia customers, it will be considered a retailer with respect to buildings which it sells without installation. Accordingly, the taxpayer would be required to collect the tax on the total sales price of any modular building which it sells to a Virginia customer for its own installation or to a Virginia contractor for installation for a customer. In addition, the taxpayer will be considered a retailer with respect to any other items of tangible personal property which it provides to its Virginia customers in connection with its installation of the modular buildings, but which do not become permanently affixed to the buildings, such as wall pictures, furniture, and similar items.

For your further information, I have enclosed copies of two rulings issued by the department, dated April 3, 1985 and April 21, 1987, in closely related cases, together with applicable sales and use tax regulation sections. I hope that all of the foregoing has responded to your questions, but let me know if you have any further questions.

Sincerely,

W. H. Forst
Tax Commissioner

Enclosures

§ 23 VAC 10-210-410 Contractors respecting real estate.

A. Basic rules. A contractor is defined as any person who contracts to perform construction, reconstruction, installation, repair or any other service with respect to real estate or fixtures thereon, including highways, and in connection therewith to furnish tangible personal property, whether such person be a prime contractor or subcontractor. Unless otherwise noted, the law treats every contractor as the user or consumer of all tangible personal property furnished to him or by him in connection with real property construction, reconstruction, installation, repair, and similar contracts.

Tangible personal property incorporated in real property construction which loses its identity as tangible personal property and becomes real property is deemed to be tangible personal property used or consumed by the contractor. Any sale, distribution, or lease to or storage for such a contractor is deemed a sale, distribution, or lease to or storage for the ultimate consumer (the contractor), and not for resale by the contractor. The dealer (supplier) making the sale, distribution, or lease to or storage for such a contractor must collect the tax from him. No sale to a contractor is exempt on the ground that the other party to the contract is a governmental agency, a public service corporation, a nonprofit school, or nonprofit hospital, or on the ground that the contract is a cost-plus contract.

A contractor must remit the use tax on any tangible personal property purchased exclusive of the tax and furnished to him except when such property is purchased and furnished to a contractor by a governmental unit or agency. Property which is exempt from the tax when purchased by a manufacturer, processor, miner, public service corporation, commercial radio, television or cable television operation, farmer, or shipbuilding and repair business may also be furnished to a contractor without such contractor becoming subject to use tax. Contractors may also purchase machinery and tools to be used directly in industrial manufacturing or processing (see 23 VAC 10-210-920) exempt from the tax.

A contractor, whether he be a prime contractor or subcontractor, does not pass the sales or use tax on to anyone else as a tax. He will take the amount of the tax into consideration in submitting bids.

If a supplier of a contractor doing work in Virginia does not collect the Virginia tax from the contractor, the contractor will be liable for the use tax on his purchases from the supplier.

B. Person who is a using or consuming contractor and also a seller. A person who is a using or consuming contractor, as explained in subsection A, may also be engaged in the business of selling tangible personal property to customers, including contractors, for use or consumption by them. If so, the person is a dealer with respect to such sales, and is required to obtain a Certificate of Registration.

After obtaining a Certificate of Registration as a dealer because he is engaged in the business of selling tangible personal property to customers for use or consumption by them, a contractor may purchase the tangible personal property under a resale exemption certificate. He may not purchase under a resale exemption certificate any tangible personal property which he knows at the time of purchase will be furnished by him in connection with any specific contract. If such a person, as a using or consuming contractor, removes from his sales inventory for use in the performance of any contract any tangible personal property purchased under a resale certificate, he must include the cost to him of such tangible personal property on his dealer's return and pay the tax.

C. Fabricator (manufacturer, processor or miner) who fabricates tangible personal property and sells it to customers. A person who fabricates tangible personal property and sells it to customers, including contractors, for use or consumption by them, must add the sales tax to the sales price and collect it from the customer for payment to the state. Raw materials, component parts, and other tangible personal property to be fabricated for sale may be purchased under a resale certificate of exemption.

D. Fabricator (manufacturer, processor or miner) who fabricates tangible personal property exclusively for use and consumption in real property construction contracts. A fabricator who contracts to perform services with respect to real estate construction, and in connection therewith to furnish tangible personal property for incorporation in real estate construction thereby causing it to lose its identity as tangible personal property by becoming real property, is classified as a using or consuming contractor and must pay the tax on the cost price of the raw materials which make up such fabricated property. The tax must be paid at the time of purchase to all suppliers who are authorized to collect the tax. In instances where the supplier is not authorized to collect the tax or fails to collect the tax, the tax must be remitted directly to the Department of Taxation on Form ST-7, Consumer's Use Tax Return.

E. Fabricator (manufacturer, processor or miner) who operates in a dual capacity of fabricating tangible personal property for sale or resale and fabricating for its own use and consumption in the performance of real property construction contracts. A manufacturer, processor or miner who operates in a dual capacity of fabricating tangible personal property for sale or resale and fabricating for his own use and consumption in the performance of real property construction contracts shall follow a primary purpose rule based on gross receipts in determining sales and use tax application.

Any person who is principally fabricating tangible personal property for sale or resale shall apply the tax according to subsection C above. Such fabricators should collect and remit the tax based upon the total amount for which tangible personal property and services are sold, except that charges for labor and services rendered in installing, applying, remodeling or repairing property sold may be excluded from the tax when separately stated or charged. In addition, any person who withdraws tangible personal property from inventory for use and consumption in the performance of real property construction contracts is liable for the tax based on the fabricated cost price of the tangible personal property withdrawn. Fabricated cost price is computable by totaling the cost of materials, labor, and overhead charged to work in

process. Freight inward at the plant is treated as an element of the cost of the materials.

Any person who is principally fabricating tangible personal property for his own use and consumption in real property construction contracts shall apply the tax according to subsection D above. In addition, persons who sell tangible personal property to consumers must register, collect, and pay the tax on the retail selling price of the tangible personal property. Such person is entitled to purchase exempt from the tax only that tangible personal property which can be identified at the time of purchase as purchases for resale. If the person is unable to identify at the time of purchase the tangible personal property which will be resold, such person is required to pay the tax to his supplier. If at a later date, the person sells the tangible personal property at retail, the tax is collected upon retail selling price. Such persons are not entitled to credit for the tax paid to suppliers since the transactions are separate and distinct taxable transactions.

A person who fabricates tangible personal property, both for sale or resale and for use in real property construction contracts, may apply to the Tax Commission to pay any tax directly to the state and avoid the collection of tax by suppliers, if his purchases are made under circumstances which normally make it impossible at the time of sale to determine the manner in which such property will be used. (See 23 VAC 10-210-510 on direct payment permits.)

F. Fabricator's production exemptions, when allowable. Fabricators of tangible personal property may take the status of industrial manufacturers, processors or miners under 23 VAC 10-210-920 or 23 VAC 10-210-960 and when they fabricate tangible personal property for sale or resale, they may enjoy the production exemptions set out in 23 VAC 10-210-920 or the mining exemptions set out in 23 VAC 10-210-960. The production and mining exemptions are not available to a fabricator of tangible personal property who fabricates for his own use or consumption (as a contractor or otherwise) and not for sale or resale. However, a fabricator whose principal or primary business is the fabrication of tangible personal property for sale or resale, and who, as a lesser or minor part of this business, fabricates for his own use and consumption, will not be deprived of the production exemptions set out in 23 VAC 10-210-920, or the mining exemptions set out in 23 VAC 10-210-960.

G. Contractor or retailer selling and installing tangible personal property that becomes real property after installation (including fences, venetian blinds, window shades, awnings, storm windows and doors, floor coverings, cabinets, kitchen equipment, window air conditioning units, and other like or comparable items).

A person selling and installing tangible personal property that becomes real property after installation is generally considered a contractor, except that a retailer selling and installing fences, venetian blinds, window shades, awnings, storm windows and doors, floor coverings (as distinguished from floors themselves), cabinets, kitchen equipment, window air conditioning units or other like or comparable items is not classified as a using or consuming contractor with respect to them.

For purposes of this subsection only, a "retailer" shall be deemed to be any person who maintains a retail or wholesale place of business, an inventory of the aforementioned items and/or materials which enter into or become a component part of the aforementioned items, and who performs installation as part of or incidental to the sale of the aforementioned items. As so defined, a retailer is not classified as a using or consuming contractor with respect to installations of the aforementioned items. A retailer must treat such transactions as taxable sales except that installation charges when separately stated on an invoice are exempt from tax.

Persons who are not classified as retailers within the definition set forth above and who sell and install fences, venetian blinds, etc., are deemed to be contractors and must pay the sales tax on such items at the time of purchase.

"Floor coverings" (as distinguished from the floors themselves) include rugs, mats, padding, wall-to-wall carpets when installed by the tack strip or stretch-in methods, and other floor coverings which are not glued, cemented, or otherwise permanently attached to the floor below. Persons selling and installing floor coverings which become permanently attached to floors are deemed to be using or consuming contractors with respect to such items. Such floor coverings include carpet, wood block, cork, tile, linoleum, and vinyl floor coverings when glued, cemented or otherwise permanently attached to floors or plywood and concrete subflooring.

Both retailers and contractors are deemed to be the users or consumers of supplies used in installing tangible personal property that becomes real property after installation. Therefore, retailers and contractors are subject to the tax on their purchases of tacks, stripping, glue, cement, and other supplies purchased.

Subsection B is applicable to persons engaged as contractors with respect to the installation of fences, venetian blinds, etc., and also as sellers of such items at retail to customers, including contractors, on an uninstalled basis for use or consumption by them.

H. Retailer selling and installing tangible personal property. Any person who sells tangible personal property at retail and installs such property as part of or incidental to the sale is a retailer and is required to add the sales tax to the sales price. The tax does not apply to installation charges when separately stated on a sales invoice. If the installation charge is not separately stated, the tax must be computed on the total charge.

Retailers are deemed to be the users or consumers of all supplies used in installing tangible personal property. Therefore, retailers are subject to the tax on all such supplies purchased.

I. Construction materials temporarily stored in Virginia. Construction contractors may purchase exempt from tax construction materials for temporary storage in Virginia to be used in exempt construction projects in other states or foreign countries. Contractors entitled to this exemption may obtain certificates of exemption upon written request to the Department of Taxation. The request should include information to show that the construction materials

could be purchased by the contractor free from sales or use tax in the other state or foreign country.

This exemption is restricted to construction materials incorporated into exempt real property construction. The tax applies to equipment, tools, supplies, etc., used in performance of the construction contract. The tax applies to all other construction materials, temporarily stored in Virginia, that will be incorporated into real estate construction projects outside Virginia.

J. Government contracts. Generally, purchases of tangible personal property by contractors in connection with real property construction contracts with the governments of Virginia or the United States or political subdivisions thereof, are sales to such contractors for their own use or consumption and contractors are subject to the tax on such transactions. This applies regardless of whether title to such property passes directly to the governmental entity upon purchase by the contractor or if the contractor is reimbursed directly by the government entity for the cost of such property.

Only in instances where the credit of a governmental entity is bound directly and the contractor has been officially designated as the purchasing agent for such governmental entity will such purchases be deemed exempt from the tax.

Contractors are not subject to the use tax when provided with tangible personal property purchased by a governmental entity for use in real property construction contracts. For further information relating to the sales and use tax exemption for purchases by governments generally, see 23 VAC 10-210-690 on Governments.

For pollution control equipment and facilities, see 23 VAC 10-210-2070; use tax generally, see 23 VAC 10-210-6030; highway contractors specifically, see 23 VAC 10-210-410.

Statutory Authority

§§ 58.1-203, 58.1-609.3(1), 58.1-609.3(2), and 58.1-610 of the Code of Virginia.

Historical Notes

Derived from VR 630-10-27; revised June 1, 1979; January 1, 1979; August 1, 1981; amended, eff. January 1, 1985.

Cross references

As to purchase of tangible personal property from federal government subject to tax, 23 VAC 10-210-690 et seq.

Applicability of tax as to sign manufacturers and painting, 23 VAC 10-210-4070.

List of Associations Invited*
August 11, 1999 Meeting
Modular Housing Study

1. **Virginia Manufactured Housing Association**
2. **Industrialized Housing Association of Virginia**
3. **Mid-Atlantic Building Systems Council - PA**
4. **Home Builders Association of Virginia**
5. **Home Builders Association of Martinsville and Henry**
6. **Home Builders Association of Rappahanock**
7. **Home Builders Association of Richmond**
8. **Home Builders Association of Shenandoah County**
9. **Home Builders Association of Southside Virginia**
10. **Augusta Home Builders Association, Inc.**
11. **Blue Ridge Home Builders Association**
12. **Fredericksburg Area Builders Association**
13. **Tidewater Builders Association**
14. **Northern Virginia Building Industry Association**
15. **Peninsula Housing and Builders Association**
16. **Piedmont Virginia Building Industry Association**
17. **New River Valley Home Builders Association**
18. **Builders and Associates of Central Virginia**
19. **Roanoke Regional Home Builders Association**
20. **Shenandoah Valley Builders Association**
21. **The Top of Virginia Building Association**
22. **Associated Builders and Contractors of Virginia, Inc.**
23. **Virginia Building Material Association**
24. **Virginia Society of Certified Public Accountants**
25. **Associated General Contractors of Virginia**
26. **Virginia Association of Contractors**
27. **American Subcontractors Association of Virginia**
28. **West Virginia Manufactured Housing Association**
29. **North Carolina Manufactured Housing Institute**
30. **Tennessee Manufactured Housing Association**
31. **Manufactured Housing Institute of Maryland, Inc.**
32. **Manufactured Housing Institute of South Carolina**
33. **Kentucky Manufactured Housing Institute**
34. **Pennsylvania Manufactured Housing Association**
35. **Manufactured Housing Institute**
36. **National Association of Home Builders**
37. **American Hotel & Motel Association**
38. **National Multi Housing Council**
39. **American Seniors Housing Association**

“THE FINAL LEGISLATIVE PROPOSAL”

11/01/99

**Modular Housing Study
Draft of Final Legislative Proposal**

1. Amend Code of Virginia § 58.1-609.1 (Government and commodities exemptions) to add a new partial exclusion as follows:

16. Beginning July 1, 2000, the retail sale of a modular building as defined by § 58.1-602, by a modular building manufacturer or modular building retailer as defined by § 58.1-602, shall be subject to tax upon sixty percent (60%) of the retail sales price. If the modular building manufacturer has paid the Virginia retail sales and use tax on the cost price of materials incorporated in a modular building which has been constructed for sale without installation, it may credit, against the tax shown to be due on the return, the amount of sales or use tax paid on the cost of materials used in fabricating a modular building sold without installation.

2. Amend Code of Virginia § 58.1-602 to add three new definitions as follows:

“Modular building” shall include, but not be limited to, single and multi-family houses, apartment units, commercial buildings and permanent additions thereof, comprised of one or more sections which are intended to become real property, primarily constructed at a location other than the permanent site, built to comply with the Virginia Industrialized Building Safety Law (§ 36-70 et seq.) as regulated by the Virginia Department of Housing and Community Development, and shipped with most permanent components in place to the site of final assembly. For purposes of this chapter, a modular building shall not include a mobile office as defined in § 58.1-2401 or any manufactured building subject to and certified under the provisions of the National Manufactured Housing Construction and Safety Standards Act of 1974 (42 U.S.C. § 5401 et seq.).

“Modular building manufacturer” means a person or corporation who owns or operates a manufacturing facility and is engaged in the fabrication, construction and assembling of building supplies and materials into modular buildings as defined in § 58.1-602 at a location other than at the site where the modular building will be assembled on the permanent foundation and may or may not be engaged in the process of affixing the modules to the foundation at the permanent site.

“Modular building retailer” means any person who purchases or acquires a modular building from a modular building manufacturer, or from another person, for subsequent sale to a customer residing within or outside of the

Commonwealth of Virginia, with or without installation of the modular building to the foundation at the permanent site.

3. Amend subsection E of Code of Virginia § 58.1-610 to add a new provision:

“E. Nothing in this section shall be construed to (i) to affect or limit the resale exclusion provided for in this chapter, ~~or the industrial materials and other industrial exclusions set out in § 58.1-609.3, or the exclusion for baptistries set in subdivision 2 of § 58.1-609.8, or the partial exclusion for the sale of modular buildings as set out in subdivision 16 of § 58.1-609.1,~~ or (ii) impose any sale or use tax with respect to the use in the performance of contracts with the United States, this Commonwealth, or any political subdivision thereof, of tangible personal property owned by a governmental body which actually is not used or consumed in the performance thereof.”

**Survey of Allowable Credits
For Taxes Paid to Other Jurisdictions**

Resident Jurisdictions	<u>Full Tax Credit</u>	<u>Partial Tax Credit</u>
Alabama	Yes	-
Arkansas	Yes	-
Connecticut	Yes	-
District of Columbia	Yes	-
Florida	Yes	-
Georgia	No	Yes
Indiana	Yes	-
Kentucky	No	Yes
Louisiana	No	Yes
Maine	Yes	-
Maryland	Yes	-
Massachusetts	Yes	-
Mississippi	No	Yes
New Jersey	Yes	-
New York	Yes	-
North Carolina	Yes	-
Ohio	Yes	-
Pennsylvania	Yes	-
Rhode Island	Yes	-
South Carolina	Yes	-
Tennessee	Yes	-
Vermont	Yes	-
Virginia	Yes	-
West Virginia	Yes	-

Note:

Delaware and New Hampshire have no sales and use taxes.

“Full tax credit” means a credit allowance based on the state and local portions of the sales and use tax paid in other state.

“Partial tax credit” means a credit allowance only on the state portion of the sales tax paid in other jurisdictions.

X. TRANSACTIONS BETWEEN STATES (In General)

Exports (from Virginia to another state)

Retail sales. A retail sale occurs when a Virginia manufacturer or dealer sells modular housing *without* installation to an out-of-state consumer. Generally, if the transaction qualifies as a sale in interstate commerce, the transaction is not subject to the Virginia retail sales and use tax. Examples of exempt sales in interstate commerce are set out in Title 23 of the Virginia Administrative Code (VAC) 10-210-780 and include sales of tangible personal property delivered to the purchaser outside of Virginia:

- in the seller's vehicle;
- by an independent trucker or contract carrier hired by the seller; or
- to a common carrier or to the United States Post Office for delivery to the purchaser outside Virginia.

Generally, property sold in an interstate commerce transaction will be taxed by the destination state only. However, if the transaction does not constitute a sale in interstate commerce, such as when the out-of-state consumer picks up modular housing sections in Virginia, the retail sales transaction is subject to the Virginia retail sales and use tax.

Sales for resale. Sales for resale do not constitute the retail sale of tangible personal property and are exempt of the tax provided the purchaser provides a valid resale exemption certificate, such as Virginia Form ST-10 or Form ST-14.

*Real property services.*²⁴ Construction materials used by Virginia manufacturers or dealers in the performance of real property construction contracts outside Virginia are generally subject to the Virginia retail sales and use tax, when the materials are purchased in Virginia or delivered into Virginia for subsequent use out-of-state. As explained in the section entitled "Credit provisions of other states" in Appendix M of this report, most states will allow a credit against their state's sales and use tax for taxes lawfully paid to Virginia.

²⁴ A contract to furnish *and* install tangible personal property to be affixed to real estate constitutes a contract for real property construction or installation services. A real property service contract does not constitute a "sale," "resale," or "retail sale" of tangible personal property. Therefore, when a Virginia contractor contracts to furnish *and* install a modular home on a permanent foundation at an out-of-state location, the transaction constitutes a real property services contract, and therefore does not constitute the sale, resale, or retail sale of tangible personal property in interstate commerce.

Imports (from another state to Virginia)

Retail sales. If an out-of-state vendor is registered to collect the Virginia retail sales and use tax, it would collect the tax when it makes a retail sale to a Virginia consumer. If the out-of-state vendor is not registered, the Virginia consumer is ultimately liable for reporting and paying the consumer use tax due on the retail sale.

Sales for resale. Under a resale purchase, a Virginia dealer buying modular housing units from an out-of-state manufacturer would furnish a resale exemption certificate to such manufacturer. When the Virginia dealer sells the modular units at retail to a Virginia consumer, such as a contractor, it would be responsible for collecting and remitting the sales tax to TAX.

Real property services. An out-of-state manufacturer is providing real property construction services when it enters into a contract to furnish and install a modular home on a permanent foundation in Virginia. Under such transactions, the manufacturer is liable for the tax based on the cost price of materials. If the manufacturer's state requires it to pay a sales or use tax on the cost of materials, Virginia would allow a tax credit for such tax paid to another state against the Virginia retail sales and use tax owed.²⁵ As other states' sales and use tax rates are generally higher than Virginia's tax rate, the out-of-state manufacturer would probably not owe any sales or use tax to Virginia. However, many states have a temporary storage exclusion or something similar. In those states, the out-of-state manufacturer who has a real property construction contract in Virginia would not be taxed in their own state on modular housing materials. Rather, they would pay the Virginia sales and use tax in full on the cost of materials since no tax is paid elsewhere and therefore no credit would be available.

²⁵ *Code of Virginia* § 58.1-611 provides that such credit "shall not exceed the tax imposed" by the Virginia Retail Sales and Use Tax Act.

**OTHER STATES:
TAXATION OF MODULAR HOUSING**

Retail sales of modular housing - Fully Taxable

Fully taxable states. The majority of states which impose a sales or use tax, levy their tax on the total sales price of modular housing when sold at retail (*i.e.*, when sold *without installation* and the seller performs no connecting, finishing, installation, or set-up services at the permanent site). This taxing method is currently used by Virginia, Georgia, Ohio, New Jersey and many others. For more information on how other states impose their sales and use tax on modular housing, see the telephone survey which is part of this appendix.

Retail sales of modular housing - Partially Taxable

Partial exemptions on modular housing used for residential dwellings. Several states provide a partial exclusion from their sales and use tax for sales of modular housing. For example, West Virginia, South Carolina, Wisconsin, Maine, California, Arizona, Colorado, and Wyoming provide partial exclusions from their state's sales tax on sales of modular housing, provided the structure is used solely for residential dwelling purposes. For example, California provides a favorable tax treatment only under the condition that the structure is used solely for dwelling purposes. In California, modular housing is taxed at 40% of the sale price if used for residential dwelling purposes only. If used for non-dwelling purposes, modular housing is taxed at 100% of the sales price. The residential dwelling requirement is a common requirement among states which provide a partial exemption for modular housing.

Types of Dwellings. In South Carolina, the partial exemption for modular housing applies to single family dwellings only. Whereas, the partial exemption in West Virginia is broader and applies not only to single-family houses but also to multi-family houses, apartment units and commercial dwellings. In other states, it is less clear whether their partial exemptions are as broad as the one in West Virginia or as limited as the one in South Carolina. In any event, it is clear that the partial exemptions are generally limited to dwelling structures, with little or no application to non-dwelling structures.

Non-dwelling structures. Most of the states which allow for a partial sales tax exemption for modular housing, do not extend the partial exemption to non-dwelling modular structures. Typically, non-dwelling structures in these states are taxed at the full sales and use tax rate. For example, South Carolina's partial exemption for modular housing does not apply to non-dwelling units such as portable classrooms and storage type manufactured buildings. The only exception found among the states was California which provides a partial exclusion (*i.e.*, a 60% exclusion from sales price) for factory-built school buildings.

Taxable base. In those states which offer a partial exemption for modular housing, most use a taxable base that is a set percentage of the retail sales price. In Connecticut, however, the taxable base is a percentage of the manufacturer's sales price. In West Virginia, the taxable base

is either (i) the actual cost of materials used in the manufacture of the modular dwelling or (ii) a percentage of the total cost of the modular dwelling as shown on the manufacturer's invoice, exclusive of transportation charges, licenses, fees or any other charges.

Permanent versus temporary structure. Some states, such as West Virginia, Maine, and Colorado, require modular housing to be designed and constructed for permanent installation, *i.e.*, to be affixed to realty, in order to receive a reduced tax treatment. In such states, temporary living quarters or other temporary structures would not qualify for the partial exemption. In other states, such as South Carolina, the partial exemption is available for both temporary and permanent modular housing structures.

Furniture and appliances installed by manufacturer. In Maine, furniture and appliances installed by the modular housing manufacturer are considered a part of the sale of the modular housing and thus entitled to the partial exemption. In other states, however, the taxation of furniture and appliances is less clear. For example, built-in furniture and appliances affixed to and sold with the structure may or may not be considered a part of the modular home. Whereas, freestanding furniture and appliances which are not attached to the structure may or may not be deemed separate from the modular home and taxed on the entire sales price charged for such articles of tangible personal property.

Foundation and finishing materials (e.g., brick and concrete for foundation, brick for the veneer). In South Carolina and Maine, their partial exemptions for modular housing do not extend to foundation and finishing materials for such modular housing.

Credit provisions of other states

An issue has been raised as to whether other states allow a tax credit for sales or use tax paid to Virginia on modular housing sections sold by Virginia modular housing manufacturers and installed by them on a permanent foundation located outside Virginia. In response, TAX surveyed several eastern states to find out whether such other states allowed a credit for taxes paid to other jurisdictions. The results of this survey are shown at Appendix K.

The general understanding is that all states surveyed, including all of the surrounding states, do provide tax credits for taxes lawfully paid to other jurisdictions. For example, when a Virginia modular housing manufacturer contracts to furnish and install modular housing sections on a permanent foundation in another state, it would be considered a real property contractor under Virginia law and would be generally required to pay the Virginia retail sales and use tax on the cost price of materials which make up the modular housing sections. Most all eastern states would recognize that the Virginia retail sales and use tax paid as a legitimate imposition and allow a tax credit against their state's sales and use tax for such tax paid.

Virginia's retail sales and use tax is generally patterned on Ohio's sales and use tax law. Although some policies may differ, we have found that the sales and use taxation of modular housing in both states to be similarly administered. For example, both of these states allow a tax credit against their state's tax for tax lawfully paid to another state on tangible personal property.

For instance, it is our understanding that Ohio would allow a tax credit against their sales tax for Virginia sales tax paid on modular housing materials by a Virginia manufacturer who has contracted to furnish and install modular housing units on permanent foundations in Ohio. It is also our understanding that a similar tax credit treatment is provided by several other states, such as Pennsylvania, Kentucky, Tennessee, Maryland, West Virginia, and New Jersey.

In North Carolina, it is our understanding that a credit for sales tax lawfully paid to Virginia on modular housing materials would be allowed against their sales tax only if the manufacturer (i) contracts to sell the land and house together, or (ii) enters into a “turn-key” contract to build a home on the customer’s lot, manufactures the house after the contract is executed, and transports it to the lot for erection and finishing.²⁶

For example, a Virginia manufacturer enters into a “turn-key” contract to fully construct, deliver and erect a modular home in North Carolina. In such instances, the manufacturer would be deemed to be a real property construction contractor under Virginia law and liable for the tax based on the cost of materials. Assuming that the materials cost is \$100,000, the Virginia manufacturer would owe Virginia retail sales and use of \$4,500 ($\$100,000 \times 4.5\%$). However, it is our understanding that North Carolina would allow a credit²⁷ against their sales tax for the Virginia sales or use tax paid. Thus, the manufacturer should only owe North Carolina use tax of \$1,500 ($\$100,000 \times 6\% = \$6,000$; $\$6,000 - \$4,500 = \$1,500$), based on a North Carolina state and local use tax rate of 6%.

Real property service transactions

Virginia and Ohio provide similar treatment of modular housing manufacturers who contract to *sell and install* modular housing on a permanent foundation. In these instances, both states would treat the manufacturer as the final taxable user or consumer of the materials which are incorporated into the modular housing sections and apply the tax to the cost price of materials. Many states which were surveyed indicated similar treatment, *e.g.*, such states as West Virginia, Kentucky, South Carolina, Georgia, Alabama, Florida, Pennsylvania, New Jersey, and Massachusetts.

Whereas, in some states such as Maryland, Maine, California, Idaho and Wyoming, manufacturers who contract to *sell and install* modular housing are taxed on a set percentage of the sales price. In some states such as Mississippi and Washington, manufacturers who contract

²⁶ Based on administrative policy set out in North Carolina’s Technical Bulletin 4-12.

²⁷ North Carolina’s General Statute § 105-164.6(c) authorizes a tax credit to be applied against its sales tax “where a retail sales and use tax is due and has been paid with respect to tangible personal property in another state by the purchaser for storage, use or consumption” in North Carolina. This statute further provides that “[i]f the amount of tax paid to another state is less than the amount of tax imposed (by North Carolina), the purchaser shall pay to (North Carolina) an amount sufficient to make the tax paid to the other state and this State equal to the amount imposed by (North Carolina).” [Inserts added.]

to *sell and install* modular housing are taxed on 100% of the sales price.

In North Carolina, the tax treatment will depend on whether there are sufficient elements in the manufacturer's contract to be deemed a "turn-key" contract. If the contract is deemed a turn-key contract, then the manufacturer is liable for the tax based on the cost of materials. If the contract is deemed a "sales" contract, the North Carolina sales and use tax would apply to the total retail sales price of the modular housing sections.

For example, the possibility exists that North Carolina may deem a contract for the sale, deliver and set up of modular housing on a permanent foundation (prepared by another party), to be a "sales contract," *i.e.*, a sale of tangible personal property. If this occurs, North Carolina could possibly deny a credit against their tax for Virginia sales and use tax owed and paid by the manufacturer to Virginia. Undoubtedly, there are potential problems if not careful. However, to receive the most favorable tax treatment in North Carolina, Virginia modular housing manufacturers need to structure their transactions accordingly.

**8/10/99
Telephone Survey
of Other States**

Other states taxing authorities were telephoned and asked about their state's sales and use tax application to (i) the sale of modular housing by the modular housing manufacturer without installation, i.e., a retail sale, and (ii) the sale of modular housing by the manufacturer with installation, i.e., manufacturer serves as a contractor providing real property installation services. Since this is a telephone survey, no guarantee is made that the responses received are totally accurate.

EASTERN STATES

<u>East States</u>	<u>(Retail Sales by Manufacturer Without Installation)</u>		<u>(Manufacturer Sells With Installation)</u>	
	<u>Taxed at 100%</u>	<u>Other</u>	<u>Tax on Cost Price Of materials</u>	<u>Other</u>
West Virginia	No	60% ¹	Yes	60% ²
Virginia	Yes		Yes	FCP ³
N. Carolina	Yes ⁴		Yes (certain conditions) ⁵	
S. Carolina	No	65% ⁶	Yes	
Georgia	Yes		Yes	
Florida	Yes		Yes	
Tennessee	Unknown ⁷		Unknown ⁸	
Alabama	Yes		Yes	
Mississippi	Yes		No ⁹	
Kentucky	Yes ¹⁰		Yes ¹¹	
Wisconsin	Yes		Yes	
Maryland	No	60% ¹²	No	60% ¹³
Pennsylvania	Yes ¹⁴		Yes ¹⁵	
New York	Yes		Depends ¹⁶	
New Jersey	Yes		Yes	
Connecticut	No	70% ¹⁷	Yes ¹⁸	
Maine	No	50%	No	50%
Ohio	Yes ¹⁹		Yes ²⁰	
Michigan	Yes		Yes	
Illinois	Yes		No	
Indiana	Yes		Yes or 65%	
D.C.	Yes		Yes	
Rhode Island	Yes		Yes	
Vermont	Yes		No	
Massachusetts	Yes		Yes	

8/10/99
Telephone Survey
of Other States
(Continued)

Other states taxing authorities were telephoned and asked about their state's sales and use tax application to (i) the sale of modular housing by the modular housing manufacturer without installation, i.e., a retail sale, and (ii) the sale of modular housing by the manufacturer with installation, i.e., manufacturer serves as a contractor providing real property installation services. Since this is a telephone survey, no guarantee can be made that the responses received are totally accurate.

WESTERN STATES

	(Retail Sales by Manufacturer Without Installation)		(Manufacturer Sells With installation)	
	<u>West States</u>	<u>Taxed at 100%</u> <u>Other</u>	<u>Taxed at Cost Price</u>	<u>Other</u>
			<u>Of materials</u>	
California	Yes ²¹	40% ²²	No	40% ²³
Arkansas	Yes ²⁴		No ²⁵	
Utah	Yes		Yes	
Washington	Yes		No ²⁶	
N. Dakota	Yes ²⁷		Yes ²⁸	
S. Dakota	No ²⁹		Yes	
Nevada	Yes		Yes	
Texas	Yes ³⁰		Yes ³¹	
Oklahoma	Unknown ³²			
Arizona	No	65% ³³	No	65% ³⁴
New Mexico	No ³⁵		No ³⁶	
Colorado	No	52% ³⁷	Yes ³⁸	
Wyoming	No	52% ³⁹	No	52% ⁴⁰
Nebraska	Yes		Yes	
Missouri	Yes		Yes	
Louisiana	Yes		Yes	
Minnesota	Yes		Yes	
Kansas	Unknown ⁴¹			
Iowa	No		Yes	
Idaho	No	55%	No	55%

Hawaii and Alaska are excluded from survey. In addition, New Hampshire, Delaware, Oregon, and Montana are not included in this survey as they do not have a general state sales or use tax. This survey is based on telephone inquiries and therefore should not be relied upon as an accurate representation of other state's taxing policies.

Endnotes:

1. Apply tax to either "value" of materials used in the manufacture of modular dwellings or 60% of total cost of modular dwellings. This favorable tax treatment applies only to residential housing, such as single and multi-family houses, apartment units, and commercial dwellings. West Virginia has interpreted "value" to mean "the actual cost."
2. Id.
3. FCP = fabricated cost price. Explanation: When a manufacturer - whose primary or principal business is the fabrication of tangible personal property for sale or resale - withdraws tangible personal property from inventory for use or consumption to perform a contract for real property construction services, it must pay the tax based on the *fabricated cost price* (i.e., total cost for materials, labor, and overhead charged to work in process). See special rules set out by Title 23 of the Virginia Administrative Code (VAC) 10-210-410(E).
4. May exclude installation cost, if separately stated.
5. Only under a "performance" contract as defined under NC law & regulation, such as those which do not set out a certain quantity or amount of materials to be furnished.
6. SC law exempts from its *state* sales and use tax 35% of the net sales price on the sale of a modular home used only as a single family dwelling. Such exemption does not apply to portable classrooms and storage type manufactured buildings, manufactured condominium units and motel units. The SC *local* sales and use tax does not apply to sales of modular homes.
7. Manufactured homes are taxed at 50% of sales price, up to maximum state sales tax of \$1600.00, if used as a dwelling. Local sales tax also applies. However, a "manufactured home" as defined in T.C.A. § 68-126-202(4) applies to "mobile homes" built "on a permanent chassis and designed to be used as a dwelling...." Modular housing addressed in this report is not built on a permanent chassis. Therefore, it is questionable whether modular housing would enjoy Tennessee's reduced tax treatment. We were unable to obtain a definite answer from the Tennessee Department of Revenue prior to the printing of this report.
8. Same comments as Endnote #8.
9. Taxed on sales price at 7%.
10. Retail sales price of modular housing sections subject to a 6% tax. Delivery charges are exempted on retail sale.
11. Manufacturer treated as consuming contractor subject to tax on the cost price of materials.
12. Maryland sales tax applies to 60% of the sales price of the first "retail" sale of a factory-built home.

13. 60% of sales price.
14. Tax applies to sales price when manufacturer sells industrialized housing structures. If manufacturer places such structures on foundations, the transaction is treated as a retail sale of tangible personal property. To be treated as a contractor of the transaction under current PA tax policy, the manufacturer must place structures on foundations plus connect at least one utility at the homesite.
15. If manufacturer cannot establish the actual value of raw materials used in fabricating an industrialized housing section, the tax may be computed based on 60% of the selling price.
16. When manufacturer sells more than 10% of modular housing sections at retail (without installation), tax applies to "catalog price" or "sales price". Only when a manufacturer installs virtually all of its homes (i.e., over 90% of the homes its sells) would it be taxed on "cost of materials" (taxed like a contractor) rather than on the catalog price (like a retailer).
17. Taxes 70% of *manufacturer's* sales price of *new* modular home, eff. 7/1/93. Modular home must not have been previously sold or occupied as a dwelling unit to gain the favorable tax treatment.
18. Taxed on 100% of cost price of materials; 70% treatment (see Endnote #17) does not apply.
19. Applies to "industrialized units."
20. Tax applies to "cost of materials" used to produce the unit if the unit is custom built for the job *or* the "produced cost" if the unit is taken from an inventory that was previously produced for sale.
21. If used for non-dwelling purpose, taxed at 100% of sales price.
22. If used for residential dwelling purposes only, or as an institution or part thereof for resident or patient care. California law actually provides for a 60% exemption from sales price for modular housing. Same exclusion applies to factory-built school buildings.
23. 40% of sales price is taxable. See comments in Endnote #22.
24. Selling price subject to the state sales tax of 4.625% and the local sales tax (varies, generally 1%). Local sales tax has a maximum cap and is applied only on the first \$2500 of the sale.
25. Taxed on selling price regardless of whether modular housing sections are installed by manufacturer or others. If out-of-state manufacturer, taxed on the value of the sections at time of delivery into Arkansas. If out-of-state manufacturer has paid a sales or use tax on the materials as a consuming contractor in its state, Arkansas will allow an out-of-state tax credit to be applied against the Arkansas sales tax owed on the sales value of the sections.
26. Taxed at retail sale price; tax also applies to charges for installation and delivery.
27. Taxed on sales price at 5% sales tax rate. [Compare to sales of new mobile homes which are taxed at a 3% tax rate and used mobile homes which are not taxed.]
28. Taxed as consuming contractor based on cost price of raw materials.
29. Told that tax applies to raw material cost, plus a contractor's excise tax of 2% applies to gross receipts. [Caution; response not verified.]

30. Sales price taxable when ready-built home is sold to person responsible for affixing the structure to realty. On separated contracts or cost-plus contracts (i.e., contract price divided into separately stated amounts for materials and labor), tax applies to the charge (agreed contract price) for incorporated materials - like any retail sales transaction.
31. Tax applies to cost of materials if the contract is for a lump-sum amount. To achieve this tax treatment, the seller is required to build, transport and affix the structure to a permanent site.
32. Could not answer on telephone inquiry. Requires a written ruling request from its policy division.
33. Tax applies to 65% of gross proceeds received under a prime contract.
34. Id.
35. New Mexico does not impose a sales tax per se, but imposes a "gross receipts" tax on the vendor who sells to a final consumer. The gross receipts tax is imposed on the gross receipts received from construction services (i.e., taxed on total charge for all materials and labor furnished). New Mexico's gross receipts tax consists of a state tax of 5% plus a local option tax.
36. Id.
37. Colorado sales tax (max of 7%) applies to 52% of structure's sales price. Colorado law actually provides for a 48% exclusion or exemption from their sales tax, if modular home is for residential occupancy.
38. If billed on a lump-sum basis. If a time and material billing contractor, tax applies to the marked up billing price of materials.
39. 52% of sales price if used for residential dwelling, effective July 1, 1999.
40. 52% of sales price if used for residential dwelling, effective July 1, 1999.
41. No response.

