

This Week in State Tax (TWIST)

November 4, 2024



Virginia: Commissioner Rules on Treatment of “Dual Operators” and Availability of Use Tax Credit

The Virginia Tax Commissioner (Commissioner) ruled that a taxpayer that fabricated property for both retail sales and its own use and consumption as a real property contractor was a dual operator primarily fabricating products for its own use. Consequently, the taxpayer, that had considered itself to be a retailer of fabricated products, had erroneously collected and remitted sales tax from customers on transactions involving real property improvements for which the taxpayer should have instead either paid sales tax to its suppliers or accrued use tax on its purchases.

The taxpayer fabricated vinyl fencing, decking, pergolas, screen porches, and outdoor furniture. It sold these products to construction contractors, lumberyards, and other retailers; the taxpayer also sold and installed the products for its own customers. The issue in the audit centered around the taxpayer having treated itself as a retailer. On audit, the Department of Taxation reclassified the taxpayer from a retailer to a fabricator of tangible personal property for its own use and assessed use tax on untaxed purchases of tangible personal property. The taxpayer challenged the assessment arguing it was properly classified as a retailer; alternatively, it contended it should receive a credit allowed under newly amended legislation for sales tax collected and remitted.

Virginia law states that real property contractors are deemed to have purchased tangible personal property for use or consumption, and the subsequent sale of tangible personal property is not a resale. Based on the taxpayer's activities, the Commissioner determined that the taxpayer was fabricating property for both retail sale and its own use as a consuming contractor, thus classifying it as a dual operator.

In Virginia, dual operators are required to follow the primary purpose rule based on gross receipts to determine the application of sales and use tax. If a majority of gross receipts are from retail sales to customers, a taxpayer should purchase materials tax-exempt and collect sales tax from the customers; for projects involving real property contracts, the taxpayer should remit use tax on inventory used in the contracts. Alternatively, if a majority of the receipts are from fabricating products for its own use in real property contracts, a taxpayer should pay sales tax on all materials at the time of purchase. If the taxpayer cannot determine how the materials it purchases will be used, the taxpayer may apply for a direct pay permit.

Here, the audit revealed that most of the taxpayer's gross receipts were from its role as a real property contractor for its customers. Therefore, the taxpayer, by treating transactions as retail sales had erroneously charged, collected, and remitted sales tax from its customers. The taxpayer's alternative claim for a credit was based on the assertion that it had already collected and remitted sales tax exceeding the use tax assessed. Effective July 1, 2024, Virginia allows a one-time credit for erroneously collected sales tax against a use tax assessment

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for contractors. The credit is limited to the amount of use tax assessed on a contractor's purchases of tangible personal property and is allowed for first offenses only. Accordingly, the Commissioner returned the matter to audit for a determination of the taxpayer's eligibility for the credit. For more information on Virginia Public Document Ruling No. 24-87, contact David B. Meyer.

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