



STATE OF CONNECTICUT
DEPARTMENT OF REVENUE SERVICES

IP 2003(12)

25 Sigourney Street
Hartford CT 06106-5032

INFORMATIONAL PUBLICATION

Pay-When-Paid Method for Materialmen

Purpose: This Informational Publication describes how materialmen may remit sales and use taxes on certain sales of building materials and services to real property as and when actually paid by the purchasers to whom the materialmen have extended credit, instead of remitting the full amount of tax at the time of the transaction as generally required by law.

Effective Date: Effective when issued.

Statutory Authority: Conn. Gen. Stat. §§12-408(2) and 12-426(3).

Background: Generally, sellers of tangible personal property and taxable services must remit tax on the entire amount of the gross receipts from a transaction on the return for the period in which the transaction takes place. The pay-when-paid provision allows certain sellers of building materials and services related to these materials an exception to this general rule.

Definitions:

A **materialman**, for the pay-when-paid provision, is a person who furnishes building materials or services to a contractor for the construction, raising, removal, or repair of a building or the improvement of real property. To be considered a materialman, a person must also be entitled under Chapter 847 of the Connecticut General Statutes to file a mechanic's lien against the real property to ensure payment for the materials or services.

Building materials means materials that are incorporated as an improvement or repair to real property. The term also includes tools and other items that are used to improve real property.

The term **contractor** includes a general contractor, a subcontractor, a repairman, and a property owner acting as his or her own general contractor.

Qualifying for Pay-When-Paid Status: A person seeking Department of Revenue Services (DRS) permission to collect and remit sales tax on a qualifying transaction when actually paid by a contractor must file an application by July 1 of each year and demonstrate to the satisfaction of DRS that, in two out of the last four calendar quarters,

- The seller was a materialman as the term is used in Chapter 847;
- The materialman is authorized under Chapter 847 to put a mechanic's lien on real property; **and**
- At least 50% of the materialman's sales of building materials (not services) were to contractors.

DRS issues **Form REG-20**, *Application for a Materialman to Remit Sales Tax Under the Pay-When-Paid Method*. A materialman must file this application by July 1 *each* year in order to obtain pay-when-paid status. DRS will respond to a properly completed application with a letter authorizing the materialman to use the pay-when-paid method on qualifying transactions.

Deadline to Submit Application: DRS only accepts applications filed on or before **July 1** of each year. The applications are considered timely filed if received, or if the date shown by the U.S. Post Office cancellation mark is, on or before this date.

Pay-When-Paid: Under this method, a materialman that receives permission from DRS may collect and remit tax on sales of building materials and taxable services related to the materials to contractors at the time and to the extent that the materialman receives payment.

For Conn. Gen. Stat. §12-414, which governs when a return is to be filed and what is to be reported on it, tax is deemed imposed at the time the materialman receives payment. Payments received on account from a contractor should be applied in accordance with the accounting method regularly used by the materialman.

Example: A contractor buys \$2,000 in building materials from a lumberyard that has materialman status under Conn. Gen. Stat. §12-408(2). The total tax to be paid on this transaction is \$120. The contractor pays \$500 in cash and charges the remainder on account with the lumberyard. The lumberyard must allocate the payment by multiplying \$500 (assuming there are no finance charges) by .943, resulting in a credit to the sale of \$471.50 and tax of \$28.50, which the lumberyard must remit on the return for the period in which the payment is made. (If the lumberyard imposes finance charges, which are not taxed, it first subtracts them from the \$500 payment and then calculates the tax allocation.) Over the next nine months, the contractor makes three additional payments of \$500 each. The lumberyard allocates the payment as a credit to the sale of \$471.50 and tax of \$28.50 and remits the tax. After the four payments have been received, the lumberyard has remitted \$114 in tax and is still owed \$114 of the original \$2,000 purchase. The lumberyard must remit the remaining \$6 of tax within one year of the original transaction whether or not it receives the remaining \$114 of the sales price from the contractor.

Pay-When-Paid Up To One Year After Sale: If a materialman does not collect the full tax on a transaction qualifying for pay-when-paid treatment within a year of the transaction date, the materialman must remit any remaining tax due on the full gross receipts (whether or not full payment for the tangible personal property or services has been received) with the return for the period that includes the date that is the one year anniversary of the transaction.

Filing Returns and Remitting Tax: A materialman using the pay-when-paid method reports receipts from each payment as gross receipts on **Form OS-114, Sales And Use Tax Return**, for the period in which the payment is received.

Factored Receivables: Factoring is the sale of accounts receivable at a discounted price to a third party who assumes the risk of loss on the accounts. If a materialman factors a receivable that is from a qualifying sale, the materialman must remit all of the remaining sales tax on 100% of the sales price of the

qualifying sale to DRS on its next return, with a credit for any tax already paid by the purchaser. The factor is not responsible for collecting and remitting tax on factored accounts. If the purchaser later pays tax on the same transaction to the materialman, the materialman should take a credit on the next return to ensure that tax is not paid twice to DRS.

Worthless Accounts Receivable: The provisions of Conn. Gen. Stat. §12-408(2) regarding worthless accounts receivable apply to transactions under the pay-when-paid method, with the three-year deadline based on the date the tax was payable by the materialman to DRS, as determined by the pay-when-paid method. The bad debt provisions of Conn. Gen. Stat. §12-408(2) apply only to sales and use taxes that have been remitted to DRS. Therefore, if an account receivable becomes worthless for federal income tax purposes within one year of the original transaction date, the materialman must remit any remaining tax due on the account by the one year deadline, and then claim the credit under Conn. Gen. Stat. §12-408(2) on its next sales and use tax return.

Record-Keeping: In addition to the usual record-keeping requirements for retailers under Conn. Gen. Stat. §12-426, a materialman using the pay-when-paid method must keep the following records for each sale made:

1. The date of the sale;
2. Proof that the sale meets the qualifications for the pay-when-paid method;
3. The amount of credit, if any, extended by the materialman to the contractor for each sale;
4. The terms for payment of the purchase price or repayment of any credit; and
5. The date or dates on which the purchase price is paid or the credit is repaid, in whole or in part, and the amount of each payment or repayment.

The records, along with the approval letter from DRS for each year the materialman qualifies to use this method, must be kept for six years from the date the tax on each sale is paid over to DRS in full.

Statute of Limitations and Penalty: DRS may assess additional tax on a sale made under the pay-when-paid method up to three years from the date the tax must be paid over to DRS under Conn. Gen. Stat. §12-408(2).

If DRS determines that a materialman's return was willfully false or fraudulent with intent to evade tax, or where the materialman fails to file a return, Conn. Gen. Stat. §12-428 applies. Under that section, the penalty for failure to file a return or keep records required by law is, in addition to any other penalty provided by law, a fine of up to \$1,000 or imprisonment up to one year, or both. The penalty for filing a willfully false or fraudulent return is, in addition to any other penalty provided by law, a fine of up to \$5,000 or imprisonment up to five years, or both.

Effect on Other Documents: Informational Publication 2003(12) modifies and supersedes **Informational Publication 2001(13)**, "*Pay When Paid*" Method for Materialmen.

Effect of This Document: An Informational Publication is a document issued by DRS that addresses frequently asked questions about a current position, policy, or practice, usually in a less technical question and answer format.

For Further Information: Please call DRS during business hours, Monday through Friday:

- **1-800-382-9463** (in-state), or
 - **860-297-5962** (from anywhere)
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IP 2003(12)
Sales and Use Taxes
Construction Materials
Services to Real Property
Issued: 04/29/2003

TTY, TDD, and Text Telephone users only may transmit inquiries 24 hours a day by calling 860-297-4911.

Forms and Publications: Forms and publications are available all day, seven days a week:

- **Internet:** Preview and download forms and publications from the DRS Web site: **www.drs.state.ct.us**
 - **DRS TAX-FAX:** Call **860-297-5698** from the handset attached to your fax machine and select from the menu.
 - **Telephone:** Call **860-297-4753** (from anywhere), or **1-800-382-9463** (in-state) and select **Option 2** from a touch-tone phone.
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Paperless Filing Methods (fast, easy, free, and confidential):

- **For business returns:** Use *Fast-File* to electronically file sales and use taxes, business use tax, room occupancy tax, or withholding tax returns over the internet or telephone. Visit the DRS Web site at: **www.drs.state.ct.us** and click on *Fast-File Program*.
 - **For resident income tax returns:** Use *WebFile* to file personal income tax returns over the Internet. Visit the DRS Web site at: **www.drs.state.ct.us** and click on *File Tax Returns On-Line*.
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