



COLORADO
Department of Revenue

Taxation Division

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PLR-17-006

August 22, 2017

XXXXXX

Attn: XXXXXX

XXXXXX

XXXXXX

Re: Soil Erosion Control Material / Contractor's Exemption Certificate

Dear XXXXXX,

You submitted on behalf of XXXXXX ("Company") a request for a private letter ruling to the Colorado Department of Revenue ("Department") pursuant to Department Rule 1 CCR 201-1, 24-35-103.5. This letter is the Department's private letter ruling. This ruling is binding on the Department to the extent set forth in Department Rule 1 CCR 201-1, 24-35-103.5. It cannot be relied upon by any taxpayer other than the taxpayer to whom the ruling is made.

Issue

Is Company required to collect state and state-administered sales taxes on retail sales of Excelsior logs and silt fencing to construction contractors and subcontractors who present Company with their contractor's exemption certificates?

Conclusion

Company must collect state and state-administered sales taxes on the retail sales of Excelsior logs and silt fencing to construction contractors and subcontractors who present Company with their contractor's exemption certificates.

Background

Company is a seller of logs (commonly referred to as "Excelsior" logs) and silt fencing (collectively referred to here as the "Materials"). Logs are composed of biodegradable wood fiber wrapped in polypropylene netting and are used to stabilize soil and prevent erosion by reducing the velocity of water runoff and filtering sediment out of water runoff. Logs are affixed to the ground with biodegradable wood stakes and are often placed partially below grade. Logs are

designed to be left in place to degrade in the soil, which usually occurs within about twenty-four months after they are installed. On highway construction projects, logs are generally left in place at least until construction is complete. If the logs are left in place for an extended period of time, they are generally not reusable. Logs are frequently left in place to completely biodegrade.

Silt fencing consists of synthetic fabric that is stretched between a series of wood stakes and the lower portion of the fabric is typically trenched into the soil to create a pooling of runoff water. Silt fencing is typically used on construction sites for sediment control during construction and often remains after construction activities until final soil stabilization. Silt fencing that is removed after having been in place for an extended period of time generally is not reuseable.

Construction contractors use the Materials for various purposes, but primarily for soil erosion control. Other than statements in the contractor's exemption certificate, Company does not know how the Materials are used by the purchaser, whether the Materials are permanently installed, whether the Materials are removed from the jobsite, or what happens to the Materials if they are removed from the jobsite.

Discussion

The principal issue in this ruling is whether the Materials are "construction and building materials" as this term is used in § 39-26-708(1), C.R.S. This statute exempts,

... all sales of *construction and building materials* to contractors and subcontractors for use in the building, erection, alteration, or repair of structures, highways, roads, streets, and other public works owned and used by [government entities, charitable organizations, and public schools] (emphasis added)

In order to qualify for the exemption, purchased materials must be both for an exempt purpose on behalf of a public entity and be "construction and building materials". In this case, it is clear that the Materials are purchased for project for government or charitable entities for a public purpose. Company's customers (contractors and subcontractors) will have contractor's exemption certificates certifying that the projects are public works. The only remaining issue, then, is whether the Materials are "construction and building materials", and therefore exempt, or are not "construction and building materials", and, therefore, taxable.

Company requests the Department rule that "construction and building materials" are not limited only to those materials that are incorporated into a real property structure so as to lose their identity and become an integral and inseparable part of a completed structure. This issue has been addressed in *The Board of County*

Commissioners of the County of Rio Blanco, Colorado v. ExxonMobil Oil Corporation, 192 P3d 582 (Colo. App. 2008), *aff'd per curiam* 222 P.3d 303 (Colo. 2009) in which the Court held that “construction and building materials”, as this term is used in the county’s use tax resolution (importantly, which is identical to the language in subsection 708(1)), are only those items of tangible personal property that are incorporated into real property and lose their identity as tangible personal property. Specifically, the Court held that,

[c]onstruction and building materials are assembled into and become part of a structure so that they lose their individual identities and take on a new composite form - that of a building or structure that is generally associated with the realty upon which it is built.

The Court’s interpretation is reinforced by the language in § 39-26-708(1), C.R.S., which restricts “construction and building materials” to those that are used,

... in the "building, erection, alteration, or repair of structures, highways, roads, streets, and other public works,"

In other words, the construction and building materials that are eligible for the exemption are those that are incorporated as integral and inseparable parts of the buildings, highways, and other real property structures.¹

This interpretation is also consistent with the Department’s Rule that distinguishes tangible personal property from a real property improvement.

[Tangible personal property] does not include ... tangible personal property that loses its identity when it becomes an integral and inseparable part of the realty, and is removable only with substantial damage to the premises. Property severed from real estate becomes tangible personal property.²

This interpretation also appears to be the view of most other states reviewed by the Department.³

¹ “Construction and building materials” is used both in the state exemption statute (subsection 708(1)) and in the statutes governing statutory city and county sales and use taxes (§29-2-109(1), C.R.S.). Identical statutory terms should be read consistently.

² Department Rule 1 CCR 201-4, 39-26-102.15

³ “Building materials” is a term of art used by many states. The department reviewed the regulations and publications of a number of other states to understand better whether the interpretation adopted here is consistent with other states. See, e.g., Neb. Admin. R. & Regs. 1-017 Contractors (“Building materials mean any property, including fixtures, that will be annexed to the land or an improvement on the land. Building materials do not include tools, supplies, or any items that will not be annexed.”); Connecticut Informational Publication, No. 2001(13), 03/15/2001 (“Building materials means materials that are incorporated as an improvement or repair to real property.”); WV: Code of State Rules 110-15-107 Contracting: General Rules (“3.2.1 The term " building materials" means all tangible personal property, including any device or appliance used by builders, contractors, or landowners in making improvements, additions, alterations or repairs to a building or other structure or to real property in such a way that such tangible personal property becomes a part of the building or other structure or the realty.”); S.C.

For these reasons, we conclude that “construction and building materials” does not include all materials used during construction but rather only those materials that are incorporated into realty so as to lose their identity as tangible personal property and become an integral, permanent,⁴ and inseparable part of the realty.

Company anticipates this conclusion and argues that even if permanent, integral and inseparable incorporation into real property is required, the Materials do, in fact, meet this requirement. The issue, then, is whether the Materials are incorporated into real property in such a manner as to lose their individual identity as tangible personal property and become an integral and permanent, inseparable part of a structure, highway, road, street or other public work. Company points to certain characteristics of the Material that suggest the Materials qualify as construction and building materials. For example, the Materials are primarily used in construction activities. The Materials are also affixed to the ground (wood stakes), are partially buried below grade,⁵ and are often left in place after

Code Regs. 117-314.2 Building Materials. (“The term “building materials” includes such tangible personal property as lumber, timber, nails, screws, bolts, structural steel, elevators, reinforcing steel, cement, lime, sand, gravel, slag, stone, telephone poles, fencing, wire, electric cable, brick, tile, glass, plumbing supplies, plumbing fixtures, pipe, pipe fittings, prefabricated buildings, electrical fixtures, built-in cabinets and furniture, sheet metal, paint, roofing materials, road building materials, sprinkler systems, air conditioning systems, built-in-fans, heating systems, floorings, floor furnaces, crane ways, crossties, railroad rails, railroad track accessories, tanks, builders hardware, doors, door frames, window frames, water meters, gas meters, well pumps, and any and all other tangible personal property which becomes a part of real property.”); Cal. Code Regs. 1521 Construction Contractors - ((4))”Materials” means and includes construction materials and components, and other tangible personal property incorporated into, attached to, or affixed to, real property by contractors in the performance of a construction contract and which, when combined with other tangible personal property, loses its identity to become an integral and inseparable part of the real property.”); Minn. R. 8130.1200; Neb. Admin. R. & Regs. 1-017 Contractors (“Building materials mean any property, including fixtures, that will be annexed to the land or an improvement on the land. Building materials do not include tools, supplies, or any items that will not be annexed.”); N.M. Admin. Code 3.2.1.11(I); but, see IA: Iowa Admin. Code 701--19.2 (422, 423) Iowa Admin. Code subsection 422.42(15) “[S]ales of building materials, supplies and equipment to owners, contractors, subcontractors or builders for the erection of buildings or the alteration, repair or improvement of real property are retail sales in whatever quantity sold. This means that a contractor, subcontractor, or builder cannot claim an exemption for resale when purchasing building materials or supplies even if the contractor, subcontractor, or builder later separately itemizes material and labor charges for construction contracts. Building materials and supplies would generally consist of items which are incorporated into real property, lose their identity as tangible personal property and cannot be removed without altering the realty, or which are consumed by the contractor during the performance of the construction contract.”

⁴ See *Exxon*, in which the Court describes these materials as “permanent” fixtures to realty. Taxpayer correctly notes that the Department’s regulation does not expressly use the term “permanent”. However, the Department cannot by regulation either reduce or expand the scope of a statute. The Court has interpreted the scope of this statutory phrase in terms of “permanence” and, therefore, it is appropriate to apply that term here.

⁵ Taxpayer represents that approximately 6” to 12” of the fencing is placed below grade and that the excelsior logs are typically half buried.

construction⁶ to stabilize the soil on the construction site during revegetation. Moreover, the Materials are not reusable once in situs for a period of time.

However, these characteristics are of limited quality and several other characteristics of the Materials indicate that they are not incorporated into real property as a permanent, integral, and inseparable part of the realty as this phrase is commonly understood and applied. First, we considered whether the Materials are, themselves, real property structures. We conclude they are not. The Materials consist of either lightweight fabric or wood fiber that biodegrades or photodegrades within a relatively short period of time. The Materials are primarily used during construction to stabilize and maintain the soil until the real property structure is built and the soil is revegetated. Once construction is completed, the construction site is typically landscaped to eliminate soil erosion. The Materials are sometimes removed after this landscaping is completed. If not removed, the Materials generally degrade within twenty-four months of use. This suggests their usefulness after construction is limited to the construction period (including the revegetation) and that they do not constitute, in any real sense, a permanent, integral, and inseparable part of realty.

Second, whether property constitutes a real property improvement often turns on the manner and degree to which the material is attached to realty.⁷ Materials that can be removed from the realty without substantial damage to the realty are generally not classified as a fixture to realty.⁸ The Department concludes that Excelsior logs and silt fencing, by their nature, are removable without substantial damage to the realty and are temporary, and, therefore, that Excelsior logs and silt fencing cannot meet the requirements to be construction and building materials.

Finally, there is a third class⁹ of materials used in construction that is relevant to this issue. Materials consumed by the contractor, such as abrasive materials (sandpaper, blasting sand, grinding wheels, saw blades, etc.), electricity and diesel, drop cloths, and other similar materials (often referred to as “consumables”) are not exempt under subsection 708(1) because they are not incorporated into the real property. For example, temporary plastic tenting is often used by a contractor to encase a building during construction to contain dust and other debris and prevent their dispersal to other areas of the construction site or

⁶ We discuss *infra* the district court’s conclusion in *Arapahoe County District Court Case Number 2014 CV 33349* that excelsior logs and silt fencing are sometimes removed after construction, Company represents that the Materials its customers use are typically left in the ground when used for highway construction projects and must be left in the ground until there is at least 70% revegetation of the disturbed soil.

⁷ *ExxonMobil*, *supra*.

⁸ Department Regulation 1 CCR 201-4, 39-26-102.15

⁹ Materials involved in construction can be classified into real property improvements, personal property, and consumables.

neighboring land. This is also the purpose of the Materials: to contain soil on the worksite and prevent soil dispersion. The plastic tenting is affixed to the building but is not permanently incorporated into the real property. Plastic tenting is a material used and consumed, in whole or in part, by the contractor during construction and is not exempt under § 39-26-708, C.R.S. We acknowledge that this analogy is not perfect because the plastic tenting is removed while the Materials may be left in place. However, we view this as a difference in measure and not a difference in kind: both serve the same purpose.

The Materials are more properly characterized as consumables. Logs and fences are used during construction to contain disturbed soil and debris. They either biodegrade or are removed after the construction and landscaping is complete. The Department acknowledges that the Materials are sometimes left in the ground after construction while plastic tenting is typically not left on the construction site. However, and as we discussed above, the principal use of the Materials is during construction. Even if left in the ground, the Materials do not have the permanency that is commonly associated with real property improvements.

Finally, in an Arapahoe District Court case (*2014 CV 33349*), the Court addressed the question of whether certain materials, such as Excelsior logs and silt fencing, the same materials that are at issue in this ruling, qualified as “construction and building materials”, as that phrase is used in the City of Aurora sales and use tax ordinance, and concluded that they did not because they were not assembled or incorporated into real property so as to lose their identity and become an integral part and inseparable part of the real property structure. The Department agrees with the reasoning of the Court.

For these reasons, we conclude that the Materials are not construction and building materials as these terms are used in § 39-25-708(1), C.R.S. Therefore, Company must collect state and state-administered local sales taxes from retail purchasers, even if a contractor presents a contractor’s exemption certificate.

Miscellaneous

This ruling applies only to sales and use taxes administered by the Department. Please note that the Department administers state and state-collected city and county sales taxes and special district sales and use taxes, but does not administer sales and use taxes for self-collected home rule cities and counties. You may wish to consult with local governments which administer their own sales or use taxes about the applicability of those taxes. Visit our web site at www.colorado.gov/revenue/tax for more information about state and local sales taxes.

This ruling is premised on the assumption that Company has completely and accurately disclosed all material facts. The Department reserves the right, among others, to independently evaluate Company’s representations. This ruling is null and

void if any such representation is incorrect and has a material bearing on the conclusions reached in this ruling. This ruling is subject to modification or revocation in accordance to Department Regulation 24-35-103.5.

Enclosed is a redacted version of this ruling. Pursuant to statute and regulation, this redacted version of the ruling will be made public within 60 days of the date of this letter. Please let me know in writing within that 60 day period whether you have any suggestions or concerns about this redacted version of the ruling.

Sincerely,

Neil L. Tillquist
Colorado Department of Revenue

This ruling cannot be relied upon by any other taxpayer other than the taxpayer to whom the ruling is made.