**Opinion Letter**

|  |  |
| --- | --- |
| **Letter Number:** | **O-2014-001** |

|  |  |
| --- | --- |
| **Tax Type:** | **Kansas Retailers' Sales Tax** |
| **Brief Description:** | **Sales taxation of businesses that fabricate articles for third parties.** |
| **Keywords:** |  |
| **Approval Date:** | **04/22/2014** |

**Body:**

Office of Policy & Research  
  
  
April 22, 2014

XXXXX  
XXXXX  
XXXXX

RE: Your e-mail received on April 16, 2014

Dear XXXX:  
  
Your company has contracted with a third party to fabricate a piece of taxable equipment and ship it to Kansas for use here. Your company will bill the customer for fabricated article according to the following progress-billing agreement:

15% - Engineering drawings are completed  
20% -Ordering of major materials  
35% -Receipt of major materials  
20% -Completion of manufacturing  
10% - Shipment

Taxation of businesses that fabricate articles for third parties is discussed in EDU-27, *Sales Tax Guidelines for Fabricators.*It instructs:

A business that produces an article of tangible personal property to the special order of a customer is a retailer. When a business fabricates an article for a customer, a retail sale takes place when the fabricated article is delivered to and accepted by the customer. When the article is delivered to a buyer in Kansas, the fabricator is required to collect state and local Kansas sales or use tax on the "sales or selling price" of the fabricated article. This is the total amount charged to the buyer by the fabricator, including any shipping or delivery charges. Local tax is sitused to the location of delivery.  
  
The statutory definition of "sales or selling price" prohibits a fabricator from deducting any costs or expenses from the tax base of its retail sales. *K.S.A. 2004 Supp. 79-3602(ll)*. Nondeductible costs and expenses include the fabricator's production and fabrication costs, material costs, design costs, insurance, licenses, profit, travel expenses, meal expenses, mileage, and all other overhead expenses. These expenses may not be: (A) deducted from the selling price; (B) stated as a separate, untaxed line-item charge on the customer billing; or (C) contracted for separately with the buyer when the expenses are an integral part of the article's design, fabrication, and sale. This means that sales tax applies to the total amount charged for a fabricated article, including shipping or delivery charges. Taxable retail sales include those where the custom-made article is fabricated from materials furnished by the customer.*(Underlining added).*

This rule is most commonly applied to businesses such as photographers, sign makers, tailors and seamstresses, sheet metal fabricators, and taxidermists. See EDU-27, *Sales Tax Guidelines for Fabricators;*see also 68 Am.Jur.2d 130, Sales and Use Taxes, Sec. 85. *Services rendered by or to printers, publishers, photographers, and artists.* (1973). This approach for taxing fabricated goods simplifies sourcing for the fabricator, since the customer charges are taxed and sourced as the sale of tangible personal property. In general, sales of the fabricated article are sourced to the place where the buyer takes delivery of the article.  
  
This treatment also shows the sale of a article that the buyer contracts to be fabricated is subject to Kansas sales or use tax only after fabrication of the article is complete and the buyer has accepted delivery. According, none of the charges you list as agreed upon progress billings are taxable until the fabricates article is shipped to the buyer. At that time, the buyer should be billed Kansas sales tax on the entire amount that you bill, including any shipping charges that you bill to the buyer. This approach is reasonable from a taxing perspective since the fabricated article is not even in existence until after 70% of the progress-billing payments have been made.  
  
Please note that progress billing for construction projects are taxable at the time they are billed. If a contractor reports sales tax on the accrual basis, it must report the taxable services it performed during the period covered by a progress-billing statement on the return it files for the sales tax reporting period in which it recognizes the charges on its progress-billing statement in its books and records as earned. *K.A.R. 92-19-3a(f)(2);* see also Kansas Department of Revenue, *Revenue Ruling No. 19-2010-05*, *September 9, 2010.*  
  
Progress payments for construction services are treated as charges and payments for services rendered. This is not the case when fabricated articles are sold at retail, since these sales do not occur until the buyer accepts deliver of the fabricated article.

Sincerely,  
  
  
  
Thomas E. Hatten

**Date Composed: 04/22/2014 Date Modified: 04/22/2014**