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Procedure

Miss. Court: Vendor Not Responsible For Sales Tax With Material Purchase Certificate

The Mississippi Supreme Court affirmed that a vendor has no obligation to collect tax on sales to commercial contractors possessing a valid material purchase certificate, which provides that materials and services purchased will become a component of a structure (*Miss. Dep't of Revenue v. Hotel & Rest. Supply*, Miss., No. 2014-CA-01685, order 3/10/16).

In a March 10 decision, the court upheld the lower chancery court's ruling that found no error with the state's Board of Tax Appeals' decision to absolve Hotel and Restaurant Supply from an assessment of \$422,651 for unpaid taxes on several contractor sales.

According to practitioners, the decision might prevent the state's Department of Revenue from holding vendors liable if their customers present tax exemption documents, shifting the tax responsibility from the vendor to the customer.

The court didn't take up the issue of which administrative body the lower court should have given deference, an issue that tax practitioners were watching closely. Instead, the court found that the Department of Revenue's statutory interpretation wasn't the best reading of the statute at issue.

Component Exemption. Under Mississippi Code Section 27-65-21, commercial construction contractors can pay a special 3.5 percent tax rate on their entire project, including both labor and material, instead of the regular 7 percent retail sales tax rate. The items must be purchased under a materials purchase certificate and become a component part of the structure the contractor is building.

The court said in its opinion that nowhere in the statutes nor the revenue department's rule regulation is there any language requiring Hotel and Restaurant Supply to ask the contractors if items being bought with a tax-exempt material purchase certificate were being misused.

The contractor prepays the anticipated tax or files a bond guaranteeing payment with the department before the work on contract can begin. The department can issue a material purchase certificate, which allows the contractor to purchase materials tax-free.

"The onus of complying with the statutes is placed clearly on the contractor who obtains the material purchase certificate," the order said. "MDOR's real issue should be with the contractor who misuses the material

purchase certificate to purchase items that are not or do not become components of the structure as required by statute."

Court Sets Aside Deference Issue. Hotel and Restaurant Supply was audited and the department said the company should have charged the 7 percent sales tax on certain sales because they didn't become component parts, assessing \$422,651 in unpaid taxes. The company appealed to the department's Board of Review, which upheld the tax but reduced it to \$408,740. On appeal, the Board of Tax Appeals sided with the company and reversed, which the lower chancery court upheld.

Under a prior version of Mississippi Code Section 27-77-7, the chancery court must defer to the department's interpretation and decisions. Yet, it was the Department of Revenue's appeal of the Board of Tax Appeal's decision that the court was considering. Case law suggested that since it was the Board of Tax Appeal's decision under review, deference should be given to its decision.

Instead of choosing which agency to award deference, the chancery court turned to the amended section 27-77-7, which passed in 2014 under H.B. 799. Invoking the new standard, the court said it wouldn't give deference to any of the decisions, but rather the department's interpretation and application of the law as it's reflected in published regulations.

However, the Mississippi Supreme Court set aside the deference issue and didn't address the new legal standard, though there were some pointed questions during oral argument. Instead, the court said that the Department of Revenue's interpretation was "contrary to the unambiguous terms of best reading of [the] statute."

Unanswered Questions. The Supreme Court's decision left three unanswered questions, John Fletcher, a partner at Jones Walker LLP, told Bloomberg BNA.

"The first unanswered question, which version of the statute applies on these cases that straddle the effective date of House Bill 799," Fletcher said. "The court was able to avoid to make that determination. The second big question is will the court honor the new standard of review and deference language contained in House Bill 799. The third unanswered question in the case is when the court said that the department's reading was not the best reading of the statute, are they hinting that there may be a new deference standard on the horizon."

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A copy of the opinion is at <http://src.bna.com/dyv>.

For additional discussion of sales tax on construction materials in Mississippi, see Sales and Use Tax Navigator, at Mississippi 5.10.