
Tax Compliance Guide

Construction Audit Procedures Topic 326

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As part of a comprehensive tax compliance program, the Sales Tax Division conducts routine audits of construction projects to determine compliance with the *Westminster Municipal Code*. The purpose of the audit is to determine whether the correct amount of tax has been reported and paid by the taxpayer.

Use tax is imposed upon the purchase price paid for tangible personal property and certain services used, consumed, stored or distributed in the City. In most cases, an estimated amount of the use tax due on construction materials is collected at the time of issuance of a building permit, or a direct payment permit, in the form of an estimated pre-payment. This estimate is calculated by applying the City use tax rate to 50% of the project's total valuation. This valuation is also an estimate, and includes labor and materials based.

It is essential to note that the pre-paid use tax is purely an estimate. In some cases, the pre-payment may exceed the actual liability (overpayment) and in some cases the actual liability may exceed the pre-payment (underpayment). For certain projects, there will not be a pre-payment, in which case the general contractor must obtain an account number from the Sales Tax Division and file monthly returns.

An audit of the project may be conducted to determine the use tax liability on the actual cost of materials, in addition to any use tax due on construction equipment used in the project. Generally, the audit process for construction projects is as follows.

Informative Phase

Prior to the expiration of the statute of limitations, the general contractor will be given written notice that the project will be audited. The engagement letter includes a general list of records required. The general contractor's records may vary from these depending on specific accounting systems. It is important to contact the auditor in advance if clarification is needed on any of the items requested so that all requested records are ready when the fieldwork is scheduled to begin.

Before conducting fieldwork, the auditor may request to review the following records:

Job Cost Reports

Final and complete job cost schedules detailing costs of construction broken down into specific categories for materials and labor may be requested. The job cost report should detail purchases for each category. Additionally, reports detailing equipment used on the job will also be required.

Complete list of Subcontractors

The auditor may request a list of subcontractors who worked on the project. Include the name, address, phone, and fax number of the company as well the total contract amount for work billed to the general contractor.

Verification Phase

In conjunction with reviewing the above reports, the project costs are verified through the examination of specific records and affidavits. Such examination may take place in the field, at your offices, the offices of your accountant, or at City Hall. The essential records for this phase are:

Purchase Invoices

Invoices for materials purchased per the job cost report are examined to determine the total tax liability. In the event the cost of materials cannot be verified through actual invoices, the total tax liability may be estimated based upon the best information available.

Equipment Records

The City reviews equipment purchase records in conjunction with the job cost worksheet to verify the accuracy and completeness of the *Construction Equipment Declaration* form.

Subcontractor/Owner Materials Costs

The City mails affidavits to each subcontractor identified by the general contractor and requests that they verify their cost of materials used during the course of the project. The City completes the collection of these affidavits. In cases where the subcontractor fails to respond, the City may estimate the cost of materials based upon the best information available. The cost of materials supplied by the owner will also be verified.

As part of the affidavit, the City requests information to verify the accuracy and completeness of any *Construction Equipment Declaration* forms filed (or required to be filed) by the subcontractor. Tax deficiencies resulting from this review are assessed against the subcontractor directly.

Calculation & Review Phase

Information collected during the previous phases is scheduled on detailed audit workpapers and forwarded to the general contractor. The contractor then has the opportunity to review the workpapers and note any items they believe should be adjusted. It is important to note that the contractor has the burden of proof and must document any claims for adjustment. After this review is complete, the information gathered is compiled to determine the use tax due. If a pre-payment was collected, this amount is credited against the total use tax due in determining the amount, if any, of overpayment or underpayment.

Final Determination

The general contractor is the taxpayer, and will receive written notice of the outcome of the audit. The general contractor is liable for any deficiency, and is solely eligible to claim a refund of any overpayment.

Deficiency Assessment

In the event of an underpayment a *Notice of Assessment* of the tax due, along with applicable penalty and interest, is issued to the general contractor. A penalty of 10% of the tax deficiency is assessed for late payment of tax. Additionally, interest is assessed on the tax deficiency at the applicable monthly rate. The assessment will include a due date for full payment. If the contractor disagrees with all or part of the assessment, a written protest must be filed by that due date. Amounts not protested must be paid by the due date.

Overpayment Claim

In the event of an overpayment a *Notice of Overpayment* for the amount of the tax overpaid is issued to the general contractor. After examining the notice, the contractor may submit a *Claim for Refund* form and obtain a refund. The claim must be signed by the contractor and submitted within thirty days of the notice. If the general contractor believes additional amounts are due, the claim should include such additional amounts, along with supporting documentation. The additional claim will be reviewed by the City, and a written determination of the amount denied, if any, will be issued. The general contractor may protest the denial within 30 days in accordance with the Code.

Statute of Limitations

Any deficiency may be assessed by the City for up to 36 months after a return is filed. If no return is filed, the tax due may be assessed at any time. This period may be extended if, prior to expiration, the City issues a notice of audit, or enters into a written agreement with the taxpayer to extend the period.

For certain construction projects where an estimated pre-payment of use tax is made, a return is not required if the estimated pre-payment is equal to or greater than the use tax due on the actual cost of materials used. Nevertheless, the 36 month statute of limitations does not start unless and until a return (a *Project Cost Report*) is filed.

Related Topics

Audits
 Construction – Equipment
 Construction – Use Tax Reconciliation
 Notice of Assessment Appeals & Protests

Citations

Westminster Municipal Code
 § 4-1-9. Duty to Keep Books and Records
 § 4-1-11. Audit of Records
 § 4-1-12. Tax Information Confidential
 § 4-1-15. Tax Overpayment Determined through Audit
 § 4-1-17. Claim for Refund
 § 4-1-20 Tax Deficiencies Determined through Audit
 § 4-1-36. Statute of Limitations
 § 4-2-9 Provisions Relative to Construction Materials
 § 4-2-10. Computation of Tax on Construction Equipment

THIS GUIDANCE IS A SUMMARY IN LAYMEN'S TERMS OF THE RELEVANT WESTMINSTER TAX LAW FOR THIS TOPIC, INDUSTRY, OR BUSINESS SEGMENT. IT IS PROVIDED FOR THE CONVENIENCE OF TAXPAYERS AND IS NOT BINDING UPON THE CITY. IT IS NOT INTENDED FOR LEGAL PURPOSES TO BE SUBSTITUTED FOR THE FULL TEXT OF THE WESTMINSTER MUNICIPAL CODE AND APPLICABLE RULES AND REGULATIONS. THIS GUIDE DOES NOT CONSTITUTE A CITY TAX POLICY.

Contact Us

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