

Indiana Sales Tax Increase - Notice of Claims Alert

Owners, design-builders and subcontractors doing business in Indiana will be affected by the recent passage of House Enrolled Act 1001 ("HEA 1001"), which increased the state's sales and use tax rate from 6% to 7%, effective April 1, 2008. This may lead to claims for increases in contract prices, and project participants should review their contracts for purposes of anticipating this issue and avoiding disputes.

Under HEA 1001, all materials obtained for a building project after March 31, 2008 will be taxed at the new rate – thereby increasing the expected material costs for construction projects. As a result, suppliers will be looking to recoup these costs, design-builders will be looking to pass the costs through to owners, and owners will be determining whether they are obligated to adjust their contract prices upward by honoring these "claims."

The responsibility for these price escalations depends on the contracts between the respective parties. For example, DBIA Document No. 520 – Standard Form of Preliminary Agreement Between Owner and Design-Builder allows for an automatic adjustment to the Contract Price by stating that the Contract Price "shall be deemed to include all the sales, use, consumer and other taxes mandated by applicable Legal Requirements" (Document 520, Section 6.2). "Legal Requirements" are defined in Document No. 535 – Standard Form of General Conditions of Contract Between Owner and Design-Builder to include "all applicable . . . state . . . laws" (Document 535, Section 1.2.6). Similarly, DBIA Document No. 560 – Standard Form of Agreement Between Design-Builder and Design-Build Subcontractor – Cost Plus an Option for a Guaranteed Maximum Prices allows the subcontractor to obtain payment for "sales . . . taxes . . . incurred in the performance of the Work" (Document 560, Section 6.3.1.15). Thus, the subcontractor should be allowed to bill these costs as they are "incurred." Note, however, that the design-build subcontractor could have stated an assumption in its GMP Proposal that the GMP was based on current sales tax rates (Document 560, Section 6.5.2.1.1.3). If this assumption was not in the GMP proposal, then out of an abundance of precaution, **the subcontractor should provide the design-builder with notice of the increased costs on or before April 10, 2008 pursuant to Section 13.1.1 of Document 560, which deals with "Contract Adjustments and Disputes."**

Under ConsensusDOCS No. 750, a subcontractor only is able to collect reimbursement for an increased sales tax burden when the general contractor receives such payment from the Owner. The Owner – General Contractor agreement in this "contract family," the ConsensusDOCS No. 200, states that the fixed contract price "shall be equitable adjusted by Change Order for additional costs resulting from any changes in laws...enacted after the date of [the] Agreement, including increased taxes." The Owner or Developer of the project is likely to bear a cost increase in its project in the amount of 1% of all materials not yet delivered to the jobsite. In other "contract families," such as the AIA standard form contracts, the responsibility for price increases resulting from a change in sales tax laws is largely unsettled. Your legal counsel can help you determine the responsibility you may have for the payment or recovery of these taxes.

Additionally, as referenced above, parties to agreements affected by HEA 1001 may be required by their contracts to make a formal Claim for the increased tax burden. For example, the AIA A201 General Conditions of the Contract for Construction states that a "demand...seeking, as a matter of right, adjustment...of Contract terms [or the] payment of money" must be initiated with formal written notice. The time period to make a Claim is very limited by the standard-form construction agreements, and Claims not properly and timely submitted often are deemed waived by the contractor, design-builder or subcontractor. The AIA A201 requires that a Claim be made within 21 days from "the event giving rise to [the] Claim or...21 days after the claimant first recognizes the condition giving rise to the Claim, whichever is later." Thus under AIA contracts, written notice of the cost increase should be provided on or before April 21, 2008.

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