

**COUNCIL ACTION FORM**

**SUBJECT: POWER PLANT COOLING TOWER REPLACEMENT – TAX LIABILITY SETTLEMENT**

**BACKGROUND:**

On March 24, 2015, the City Council awarded a contract to demolish the Power Plant's old Unit 7 and Unit 8 cooling towers and to erect new fiberglass towers to EvapTech, Inc., of Lenexa, Kansas, for this project at a contracted cost of \$2,810,000. There were a total of six change orders to this contract which increased the overall cost to \$2,919,338.15.

On November 11, 2016, the City Council accepted this project as complete at a total cost of \$2,919,338.15. As part of the closeout process, EvapTech was required to provide proof that they had paid all the applicable sales taxes for this project. This proof is one of the requirements that must be met before the retainage can be released. Unfortunately, there was confusion between EvapTech and City staff regarding handling of the sales tax payment. As a result, the retainage has still not been released.

As part of the Power Plant Gas Conversion project, several contracts were reviewed for sales tax requirements. This Cooling Tower Replacement project was originally determined to be new construction, therefore subject to sales tax for all purchases of materials incorporated into the project. After award of contracts, some of the contracts were determined (post award) to be tax exempt as personal tangible property. This project was included in that later review and was determined by City staff to be tax exempt (post award) at that time. The reason was that process equipment is considered personal tangible property; and since Electric Services charges sales tax to our customers, the equipment used in the process of generating electricity can be purchased tax exempt. A change order was to be issued along with the tax exemption certificates created for each of the projects deemed tax exempt. Although the tax-exempt certificate was issued on April 13, 2015 to EvapTech, the change order was never issued to them.

These actions and interpretations created confusion among both City staff and EvapTech. After a significant amount of time had passed, Finance Department staff determined that the Cooling Tower Replacement project had been incorrectly classified as tax exempt due to a ruling issued by the Iowa Department of Revenue for the construction of a cooling tower dated back to June 10, 1975. After review with the City's Legal Department, on June 7<sup>th</sup> a letter revoking the tax-exempt certificate was issued to EvapTech because the City did not issue a change order to change the contract. No further communication occurred between EvapTech and the City until the final project closeout process started in November 2016.

City staff's ultimate position was that the project was a taxable project based on the requirements at the time of the bid, and that a change order was never issued to modify the contract. Therefore, it would be the contractor's responsibility to provide proof that the applicable Iowa Sales Tax was paid.

EvapTech held a different position, believing it acted in good faith after the tax exemption certificate was issued to them at the start of the project, as well as that too much time has passed to revoke the tax exemption certificate since it was issued at the start of the project over a year ago.

After six months of discussion on this matter, EvapTech proposed to the City a settlement for the outstanding tax liability whereby the parties would equally split the sales tax liability. City staff evaluated the proposed settlement and determined it to be reasonable and in the City's best interest. It is critical for Electric Services to maintain a good relationship with EvapTech for further work that may be needed on the cooling towers.

There is currently \$87,640.76 in project retainage being held, which is equal to the total sales tax liability for the project.

The following steps must occur for this settlement to take effect:

1. EvapTech will provide a written agreement that it will pay the outstanding sales tax of \$87,640.76 to the State of Iowa and provide proof of the transaction to the City. **(Completed.)**
2. The settlement will be presented for City Council approval on July 11, 2017.
3. Upon approval by the City Council, the City Clerk's office will issue a resolution documenting the action taken. A copy of the resolution will be provided to EvapTech electronically.
4. Upon receipt of the City's resolution, EvapTech will pay the State of Iowa the full tax liability of \$87,640.76 and provide the City with proof of payment.
5. Upon receipt of the proof of payment to the State, the City will release the remaining \$87,640.76 in project retainage being held. In addition, the City will issue a check for \$43,820.38 to Evaptech within 10 days of proof of payment for 50% of the tax liability.

The final contract amount for the cooling tower project that was accepted by Council last November was \$2,919,338.15. The settlement proposed in the amount of \$43,820.38 will increase the final contract amount to \$2,963,158.53. This amount can still be covered by the \$4,000,000 in funding included in the Capital Improvements Plan for this project.

**ALTERNATIVES:**

- 1) Accept the tax liability settlement proposed by EvapTech, Inc. of Lenexa, KS; and authorize a payment of \$43,820.38 to EvapTech after their obligations under the agreement have been fulfilled.
- 2) Direct staff to not accept the proposed settlement and seek a legal remedy.

**CITY MANAGER'S RECOMMENDED ACTION:**

It's clear that there has been a failure to communicate in a timely fashion from both parties over the sales tax liability issue which has been going on for over a year. Both the City and EvapTech believe strongly that their positions are solid and there has been little movement. The City desires to come to a resolution, since it is critical for Electric Services to maintain a good working relationship with EvapTech for future work that may be need on the cooling towers.

City staff agrees that the contractor for the Cooling Tower Replacement project has completed all of the work specified under the contract which Council has already accepted, and feels that the City should accept the proposed settlement for the sales tax liability on this project.

Therefore, it is the recommendation of the City Manager that the City Council adopt Alternative No. 1 as stated above.