

## SALES TAX ON REPAIR, MAINTENANCE AND INSTALLTION IN RESIDENTIAL CONSTRUCTON EXPLAINED IN BRIEF

*Important tax changes regarding sales and use tax applicable to residential construction take effect January 1, 2017. Here is a brief description of the sales tax fix which NCHBA helped bring about in [HB 1030 \(2016 Appropriations Act\)](#).*

**CURRENT LAW AND PROBLEM TO BE FIXED:** These tax law changes significantly modify the taxation of repair, maintenance and installation (RMI) services, which became effective on March 1, 2016. The March tax changes required subcontractors who met the definition of ‘retailer’ to charge sales tax on their labor (materials have always been, and remain, subject to sales tax). For a number of North Carolina subs who offer turn-key services to builders in both new construction and remodeling activities, this created confusion over what services are subject to taxation and which are not. The question often turned on who was performing the service rather than the service itself, creating an uneven playing field.

**THE FIX:** All labor pursuant to a “real property contract” (which is between a real property contractor and another person to perform construction, reconstruction, or remodeling with respect to a capital improvement) will, on 01/01/17, not be subject to the sales or use tax. A “capital improvement” is defined as “an alteration to real property that is new construction, reconstruction, or remodeling of a building, structure, or fixture on land that becomes part of the real property or is permanently installed in the real property”.

***In short, labor charges for new construction and most remodeling activities are not subject to sales tax on labor because they will meet the definition of “capital improvement” pursuant to a “real property contract”.***

**SPECIFIC EXAMPLES:** Among the specific examples of a “capital improvement” is “performance of work that requires the issuance of a permit under the State Building Code” (a residential project that costs \$15,000 or more). Other examples include painting, wallpapering and landscape services. Specifically excluded from taxation are services performed to resolve an issue that was part of a real property contract within twelve months of the new structure being occupied for the first time (warranty call-backs). Home inspections, debris removal, pest control and fees for inspections required by law are also specifically exempt. Those subcontractors who operate as a “retailer-contractor” (i.e., provide subcontractor services to builders and others) are also exempt when the entity acts as a real property contractor.

**TAX ON RMI LABOR DUE WHEN NOT A CAPITAL IMPROVEMENT:** A single repair, maintenance or installation service does not qualify as a capital improvement. The replacement of a fixture in or on a building or structure is not a capital improvement unless the replacement is a part of remodeling. Some remodeling projects may include activities which qualify as a capital improvement (no tax on labor) and activities that constitute a repair (tax on labor). However, no tax will be due on labor in these “mixed transactions” if the price of the repair, maintenance or installation (RMI) service does not exceed ten percent (10%) of the contract price. If it exceeds 10% of the contract price, then sales and use tax applies only to the RMI labor portion of the contract.

**GENERAL CONTRACTOR MUST PROVIDE AFFIDAVIT TO SUBCONTRACTOR (Form E-589CI):** The NC Department of Revenue (DOR) has opined that this affidavit generally must be provided to substantiate that the work is a capital improvement. This Form E-589CI was just made available on the DOR website on 12/09/16 along with the following explanation:

*The N.C. Department of Revenue has published the [Form E-589CI, Affidavit of Capital Improvement](#), and a [corresponding notice](#). The Form E-589CI is generally required to substantiate that a contract, or a portion of work to be performed to fulfill a contract, is to be taxed for sales and use tax purposes as a real property contract with respect to a capital improvement to real property. Failure of a person to issue Form E-589CI, other than for the permitted exceptions discussed within this Important Notice, to substantiate that a transaction is for a real property contract with respect to a capital improvement subjects the transaction to tax as a retail sale of repair, maintenance, and installation services for real property in accordance with N.C. Gen. Stat. § 105-164.4(a)(16).*

The instructions (printed on the reverse of the form) summarize the following exceptions to DOR's requirement to issue Form E-589CI:

*The following are exceptions for transactions where Form E-589CI is not required to be issued to substantiate that the transaction is taxed, as applicable, for sales and use tax purposes as a real property contract with respect to a capital improvement to real property.*

- *Painting or wallpapering real property, or parts thereof.*
- *Landscaping service.*

*Form E-589CI is not required to be issued by the specific person for a transaction noted below. The exceptions do not apply to transactions between a general contractor hired to oversee the entire contract and one of its subcontractors (See "Blanket Use" of Form E-589CI (Section II) for possible exceptions.). **The following exceptions do not apply to remodeling.***

- *A real property owner or other person hires a general contractor to oversee the entire contract and the contract is for "new construction" as defined in N.C. Gen. Stat. § 105-164.4H(e)(2).*
- *A real property owner or other person hires a general contractor to oversee the entire contract and the contract is to rebuild or construct again a prior existing permanent building, structure, or fixture on land (reconstruction as defined in N.C. Gen. Stat. § 105-164.4H(e)(3)).*
- *A general contractor that purchases all tangible personal property and digital property to fulfill the real property contract and provides the employee labor to fulfill the real property contract.*

With respect to the form itself, the Section 1 is for "single use" (where there is no recurring business relationship between the contractor and the subcontractor) and Section II is for "blanket use" (where there is a recurring business relationship). Experience would suggest that most residential general contractors (whether new construction or remodeling) will be able to utilize the "blanket" version as builders typically utilize the same subcontractors on a recurring basis. [NCHBA questioned DOR why this affidavit needed to be furnished with respect to new construction as it is, by definition, a capital improvement. This issue will likely be further addressed in the upcoming session.]

**DOR DIRECTIVES:** On 11/15/16, the NC Department of Revenue issued two directives relative to these changes. The first, [SD-16-3](#), addresses the application of sales and use taxes to a real property contract with respect to a capital improvement for real property. The second, [SD-16-4](#), addresses a number of

issues relative to the application of sales and use tax concerning repair, maintenance and installation (RMI). Please consult these directives for more discussion and examples.

**FOR MORE INFORMATION:** Contact Mike Carpenter, [mcarpenter@nchba.org](mailto:mcarpenter@nchba.org), or Tim Minton, [tminton@nchba.org](mailto:tminton@nchba.org), or call NCHBA at (800) 662-7129.