

Multistate Sales Tax Issues for Contractors: *What is Subject to Tax?*

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MULTISTATE SALES TAX ISSUES FOR CONTRACTORS

I. WHAT IS SUBJECT TO TAX?

Personalty v. Realty. Since the sales and use tax is generally imposed only on transactions involving tangible personal property and specifically identified services, transactions involving the purchase and sale of real property is not, generally, subject to the sales and use tax.¹ Contractors are generally considered to be consumers of tangible personal property that is stored, used, or consumed in the construction, repair, or improvement of real property – items such as cement, lumber, paint, nursery stock, furnaces, and built-in cabinets.² Consequently, it is important for a contractor to be able to determine whether an item of tangible personal retains its character as tangible personal property after performance of the contract, rather than being “converted” or transformed into real property. Contractors are typically considered retailers of tangible personal property that retains its character as personal property after sale and installation (i.e., washer, dryer or furniture).³ To determine whether tangible personal property has been converted from tangible personal property into real property, tax administrators and courts often look at factors similar to the following:

¹ Rule R865-19S-58(2), *Utah Admin. Code*. Note that there are some states that may impose a special excise tax on construction projects.

² Rule R865-19S-58(1), *Utah Admin. Code*; and Reg. 1521. Construction Contractors, California Sales and Use Tax Regulations.

³ Rule R865-19S-58(4), *Utah Admin. Code*.

- (1) Whether the incorporated property can be removed without harm to the structure;
- (2) Whether the incorporated property is manufactured with the idea that it would be used at different locations;
- (3) Whether the parties anticipated that the incorporated property could be removed for repairs or replacement;
- (4) Whether the primary purpose of the sale agreement was the purchase and sale of property assembled subject to specifications, and the installation of the property was merely incidental to that purpose;
- (5) Whether the installation was for the convenience of the purchaser; and
- (6) Whether the incorporated property was intended to be treated as real property once the property was incorporated.⁴

A. Repairs and Installation. The taxability of repairs and installation often depends on the type of property being repaired or installed. Repair labor incurred in connection with real property, or of tangible personal property that is permanently affixed to real property, is generally not taxable. This is consistent with the treatment of labor in real property construction contracts. Similarly, installation of materials that become part of real property is not generally taxable. For example, in Kansas, if a contractor installs, services, repairs, or replaces items such as furnaces, central air conditioners, wiring,

⁴ See Rule R865-19S-58(4), *Utah Admin. Code*; *Nickerson Pump and Machinery Co. v. State Tax Comm'n.*, 361 P.2d 520 (Utah 1961); *Chicago Bridge & Iron Co. v. State Tax Comm'n.*, 839 P.2d 303 (Utah 1992); *BJ-Titan Service v. State Tax Comm'n.*, 842 P.2d 822 (Utah 1992); and *Valgardson Hous. Sys., Inc. v. State Tax Comm'n.*, 849 P.2d 618 (Utah Ct. App. 1993).

plumbing, roofing, or siding, it is considered to be a contract to improve real property.

These transactions are treated as construction contracts and not as retail sales of the repair parts or materials. Contractors are, however, still the consumers of the tangible personal property that becomes part of the real property and must pay sales tax when they purchase the parts or materials.

When a contractor installs or repairs tangible personal property that retains its character as tangible personal property, the installation or repair service is generally taxable as part of the sale of tangible personal property.⁵ A repairman is allowed to purchase the tangible personal property using a reseller's exemption, but must collect, report and remit the tax when sold to the person whose property was repaired.⁶ Some states exempt repairs or installation in these circumstances, but only if the charges for repairs or installation are separately itemized.

Under the Streamlined Sales and Use Tax Agreement, a member state is required to decide, for instance, whether all installations will be taxed or whether no installations will be taxed. There is no middle ground. Where a member state determines to not tax installation, sales tax will not apply regardless of whether the item sold is attached to real property or to other tangible personal property. The converse is true in SSUTA states that have determined to tax installation.

B. Warranty Contracts. Warranty/maintenance/service plan contract charges generally fall under the rules for repair and renovation of tangible personal property as

⁵ *Utah Code Ann.* § 59-12-103(1)(g).

⁶ Rule R865-19S-59.A., *Utah Admin. Code*.

outlined above and are taxable – unless the tangible personal property is converted to real property, in which case, the labor is generally not subject to tax . Sales tax applies on warranty or service contracts at the time the contracts are sold.⁷ As services under the contract are performed, no sales tax applies, except to the extent the customer incurs additional charges. Since the contract charges are often subject to tax, in those states that do tax the contract charges, the tax on parts and supplies used in repairs is considered prepaid at the time the warranty contract or agreement is sold. Therefore, the repairman may be able to purchase parts and supplies tax –free as a sale for re-sale since the tax is deemed to have been pre-paid with the payment of tax on the contract charge. Sales tax generally does, however, apply to any amount paid as a deductible under the warranty contract.

C. Intangible Property. The sale of intangible personal property (e.g. patents, copyrights, trademarks) is generally exempt from sales and use taxes because they generally only apply to the sale of tangible personal property and certain services. By definition, therefore, the sale of intangible property is generally not taxable. If a contractor is selling intangible personal property in connection with a construction contract, it should insure that charges for the intangible property are separately stated and clearly delineated on the invoice so as to avoid confusion.

⁷ Rule R865-19S-78, *Utah Admin. Code*.

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