



Bill Draft 2013-SVx-17F: Sales Tax/Retailer-Contractors.

2013-2014 General Assembly

Committee: Revenue Laws Study Committee
Introduced by:
Analysis of: 2013-SVx-17F

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SUMMARY: *This bill addresses the applicability of the sales tax laws to retailer-contractors, such as the major home improvement stores, when they are engaged in a performance contract rather than a retail sale. Specifically, a retailer-contractor would be considered the consumer of the items or materials they furnish and install or apply to real property to the extent the item becomes part of the real property. As the consumer of those items, the retailer-contractor would be responsible for payment of the tax rather than the customer. This bill would become effective January 1, 2015.*

CURRENT LAW: Under current law, retailers are required to collect and remit sales tax on retail sales of tangible personal property. Under a performance contract, the contractor agrees to furnish the necessary materials, labor, and expertise to accomplish the job; it is not a contract for the sale of specific items. Contractors are deemed to be the consumers or end users of the tangible personal property they use in fulfilling performance contracts and are liable for the tax. However, when a customer purchases an item from a home improvement store and enters into a contract with the store for the installation of the item in their home, it is not always clear whether that transaction is a retail sale plus installation or a performance contract.

The statutes provide little guidance as to what the correct interpretation is. They do not define "contractor" or "performance contract" or speak to when the installation of tangible personal property constitutes a real property improvement. The definition of "sale" refers to when title or possession is transferred. When a contractor permanently affixes an item of tangible personal property to real estate, title and possession typically transfer upon installation. However, once the item is permanently affixed to real property, general principles of real estate law provide that the item is no longer tangible personal property but has transformed into a real property fixture. Therefore, when a homeowner obtains title or possession to the property, the property is real estate and, therefore, one could argue no retail sale of tangible personal property has occurred. Adding further confusion to the mix, North Carolina's definition of "retailer" includes the business of installing tangible personal property regardless of whether it is permanently affixed to real property. This definition suggests that all contractors are also retailers, which conflicts with other principles at play.

The Department has developed guidance on this issue through its technical bulletins, and the tax treatment is ultimately determined by looking at a number of factors, such as whether an item is sold with an installation agreement, the tenor of the agreement, if there is one, whether an item is pre-fabricated, whether an item is built on-site, and whether a specific quantity is stated in the agreement. Determining the tax consequences involves a complex and fact-specific analysis. Over the years, the guidance has been inconsistent and, at the very least, confusing. For example, the sale and installation of the same item, such as carpet, may have different tax treatment depending on who the seller is and how the transaction is structured. Also, transactions that seem to be similar in nature, such as the installation of countertops and cabinets, are treated differently as well.



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For several years, the Department has sought clarification from the General Assembly on this issue. The Revenue Laws Study Committee first studied it in 2012, with no recommendation, and again in 2013 recommending this legislation.

BILL ANALYSIS: This bill provides that the general rate of tax applies to the sales price of tangible personal property sold to a real property contractor when that property is used by the contractor for the improvement, alteration, or repair of real property and the item becomes part of the real property. The bill defines the term "retailer-contractor" as an entity that can act either as a retailer or as a real property contractor. The sales tax provisions applicable to a real property contractor would apply to a retailer-contractor when it is acting as a real property contractor. Retailer-contractors may continue to make tax-exempt purchases of materials, as they do now, but would accrue and pay the tax once the items are withdrawn from inventory and used in the performance of a real estate improvement contract. If the retailer-contractor uses a subcontractor to perform the installation, then the subcontractor would pay the tax on any items the subcontractor purchases in fulfilling the contract. However, in accordance with existing use tax principles, the retailer-contractor and the subcontractor would be jointly and severally liable for the tax.

The second part of the proposal holds harmless retailers that have been following the law as interpreted by the Department, such as Home Depot, as well as retailers who have asserted that the Department's interpretation is inconsistent with existing statutes, such as Lowe's.

EFFECTIVE DATE: This bill would become effective January 1, 2015, and would apply to sales on or after that date and contracts entered into on or after that date.

BACKGROUND: This issue drew particular attention in 2009 when newspaper reports revealed a long-running dispute between Lowe's and the Department of Revenue on the application of the law in this area. The report indicated that Lowe's was not collecting sales tax when it sold and subsequently installed items such as cabinets, flooring, and countertops. The Department's position is that these transactions are retail sales plus installation and that Lowe's should be collecting sales tax on the purchases but not the installation charges as long as those charges are separately stated on the customer's invoice. Lowe's position is that these transactions are performance contracts and, therefore, they are only required to pay the use tax because they are the user or consumer of that property and that the cost is factored into the "contract price" ultimately paid by the customer, but it is not a separately stated cost.