

Sales Tax on Repair, Maintenance, and Installation

Revenue Laws Study Committee
March 8, 2016

Outline of Presentation

- ▶ New law treats similar transactions differently, based on:
 - ▶ Classification of provider
 - ▶ Whether the RMI is for real or tangible property
- ▶ These differences create confusion in the application of the new tax law
- ▶ Policy changes could reduce the confusion by:
 - ▶ Treating similar transactions the same
 - ▶ Identifying taxable transactions more clearly
 - ▶ Providing a grace period/safe harbor for retailers



New Sales Tax Law Treats Similar Transactions Differently

Effective March 1, 2016

Three Primary Sales Tax Law Changes

- ▶ Repealed the sales tax exemption for installation charges in conjunction with the retail sale of TPP
- ▶ Expanded the sales tax base to include repair, maintenance, and installation (RMI) services
- ▶ Expanded the sales tax base to include service contracts on TPP, regardless of whether the TPP is attached to real property



- ▶ Installation charges have always been part of the sales price of TPP sold at retail
 - ▶ Specific exemption in G.S. 105-164.13(49)
 - ▶ Separately stated on the billing document given to the purchaser at the time of sale
 - ▶ Effective March 1, 2016, exemption repealed
 - ▶ Retail sale + Installation = taxable transaction

- ▶ Retailer-Contractor
 - ▶ Person who acts as a retailer AND as a real property contractor
 - ▶ Effective March 1, 2016, a retailer may **not** be a real property contractor if **engaged in retail trade**
 - ▶ Retail sale + Installation = taxable transaction

Tax Law Change I:

Repealed Exemption for Installation Charges

Retail sale + installation

Changed definition of some from retailer-contractor to retailer

Defined retail trade



Who is engaged in Retail Trade?



- ▶ Retail trade, as of 3/1/16:
 - ▶ More than 50% of revenue from retailing TPP, digital products, or services to consumers
 - ▶ Activities classified in NAICS sector 44-45
- ▶ Unanswered questions:
 - ▶ How often should the percentage be calculated? Monthly? Yearly?
 - ▶ What is included in the determination of revenue? Revenue from nontaxable retail transactions? Revenue from service contracts?



- ▶ Is the service a taxable RMI service?
 - ▶ Repairing TPP – Taxable
 - ▶ Cleaning and altering TPP – Taxable
 - ▶ Inspecting and monitoring TPP – Not taxable

- ▶ If the service is taxable, is it performed on TPP that is subject to sales tax?
 - ▶ If no – Not Taxable
If TPP is exempt from sales tax; RMI services on TPP is exempt from sales tax
 - ▶ If yes – Taxable unless the person providing the service is excluded from the definition of retailer

Tax Law Change 2:

Imposed Tax on RMI Services

Keep TPP in working order

Restore TPP to proper working order or good condition

Identify source of problem for purpose of determining what is needed to restore TPP to proper working order

Install or apply TPP except TPP installed or applied by a real property contractor pursuant to a real property contract



Classification of Providers



Cannot be engaged in retail trade

A person is engaged in retail trade if activities classified in NAICS sector 44-45 OR more than 50% of revenue is from retailing TPP, digital property, or services to consumers.



- ▶ Retailer is a person who provides a taxable service under the sales and use tax law
- ▶ Service contract
 - ▶ Retailer is the person who sells the service contract to the consumer
- ▶ RMI services
 - ▶ Retailer is NOT a person that solely operates as a real property contractor
 - ▶ Retailer is NOT a person whose only business activity is providing RMI services

Tax Law Change 3:

Expanded Taxation of Service Contracts to TPP, regardless of whether it is attached to real property

RMI for real property may not be taxed consistently as a service contract for TPP that is attached to real property

Eg, irrigation systems, septic systems, etc.



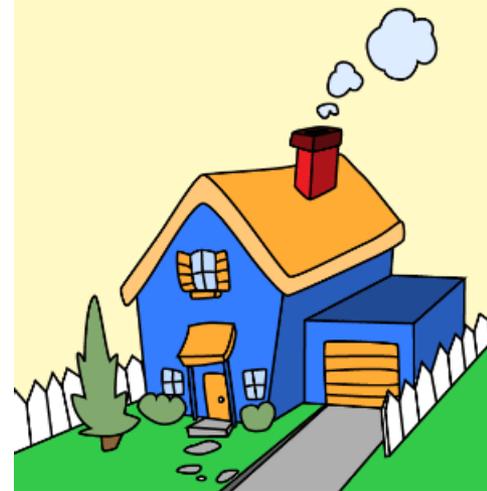
Application of New Sales Tax Law

Recap: Is a Labor Charge Taxable?

- ▶ Retail sale + installation of TPP
 - ▶ YES
- ▶ RMI of TPP
 - ▶ Retailer – YES
 - ▶ Not a retailer – No
- ▶ RMI of TPP to be installed in or attached to real property
 - ▶ Retailer – YES
 - ▶ Retailer-Contractor – Maybe
 - ▶ If engaged in retail trade, yes
 - ▶ If not engaged in retail trade, no
 - ▶ Real Property Contractor – NO
 - ▶ Person who only provides RMI services – NO



Illustration of Current Law



Replace a garage door on my home.



Buy Garage Door from Door-Mart and Have Door-Mart Install It

Taxable transaction is on door AND installation charge.



40% of revenue from installing doors
60% of revenue from selling doors at retail



Is Door-Mart a retailer-contractor?
Yes, both sells doors at retail and installs doors under a real property contract.



Is Door-Mart engaged in retail trade?

Is more than 50% of revenue from retail activity? Yes, 60% from sales at retail.

Then must operate as retailer.

Buy Garage Door from Door-Mart and Have Door-Mart Install It

Not a taxable transaction.
Door-Mart pays use tax on door.



60% of revenue from installing doors
40% of revenue from selling doors at retail



Is Door-Mart a retailer-contractor?
Yes, both sells doors at retail and installs doors under a real property contract.



Is Door-Mart engaged in retail trade?

Is more than 50% of revenue from retail activity? No, 40% from real property contracts.

Then may operate as a real property contractor.

Buy Garage Door from Door-Mart and Hire Jack to Install It

Garage door – taxable
Labor Charge – not
taxable



Is Jack's only business activity providing RMI services? Yes.

Hire Jack to Buy Garage Door and Install It

Jack's installation charge is not taxable.



Jack's purchase of door is taxable transaction. Jack is the consumer.



Does Jack solely operate as a real property contractor? Yes.



Hire Jack to Buy Garage Door and Install It



Is Jack's labor charge taxable?
It depends.



Does Jack solely operate as a real property contractor or is his only activity providing RMI services? No, has a side business.

Is Jack engaged in retail trade? If yes, Jack is a retailer and Jack's installation charge is taxable. If no, then Jack's installation charge is not taxable.



Policy Options

Policy Options

Do nothing

Treat similar transactions the same



Treat Similar Transactions the Same?

Eliminate classification of retailers

More clearly identify taxable transactions



Outcome of Treating Similar Transactions the Same?

Creates a new group of retailers

Applies sales tax to additional transactions



Eliminate Classification of Providers

- ▶ **Would require statutory changes:**
 - ▶ Remove definition of retail trade
 - ▶ Remove exception that allows a person who only provides RMI services to be a non-retailer
 - ▶ Treat RMI service of TPP attached to real property the same as service contracts on TPP attached to real property



More Clearly Identify Taxable Transactions

What transactions should be taxable?

Cleaning and alterations?

IT phone support services that remotely access and resolve problems?

TPP attached to real property that retains its visual identity?

TPP that becomes part of real property?

Septic systems?
Water systems?
HVAC systems?

New construction?
Additions to existing sq. footage?



Provide Additional Grace Period

▶ Current law

- ▶ Allows Secretary of Revenue to reduce a taxpayer's liability if:
 - ▶ The tax assessment is for an item covered by the sales tax base expansions since 2014, and
 - ▶ The taxpayer made a good faith effort to comply with the sales tax law changes.

▶ Policy Option: Additional Grace Period

- ▶ Relieve a taxpayer from liability for an undercollection or underpayment of sales and use tax on RMI services if the taxpayer made a good faith effort to comply with the sales tax base expansion.
- ▶ Effective from March 1, 2016, through _____.





End of Presentation

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