



STROUD & COMPANY
CPAs

Sales and Use Tax Changes for the Construction Industry effective January 1, 2017

(Applies to both Residential and Commercial Work)

Effective January 1, 2017, the NC Department of Revenue implemented changes in the Sales and Use Tax which directly impact the construction industry. The areas covered are **Real Property Contracts** which covers capital improvements including new constructions, reconstruction, or remodeling, **repair, maintenance, and installation** work, and **service contracts**. Below is a summary of the list of changes. Following that is a more in depth discussion of the impacted areas. At the end are instructions on how to register for a sales and use tax identification number, where to find information on paying sales tax and how to file the sales tax return. This is just an overview. There are many different situations that may be applicable to your specific business. Please contact us with questions at 910-793-5454. We are happy to help.

Key Changes as of January 1, 2017

- Affidavit (Form E-589CI) required for New Construction, Reconstruction, or Remodeling Work (i.e. Capital Improvements)
 - Affidavit is the back-up documentation for not charging sales on labor.
 - Typically completed by General Contractor/Property Owner and given to Subcontractor. Subcontractor does not have to charge sales tax on this work.
 - Sales tax should be paid on materials purchased for work.
- Many more services are now classified as Repair, Maintenance, and Installation (RMI) services and sales tax must be charged to the customer on the total bill (labor and materials).
 - See page 4 for a list of example services now considered RMI work.
 - Materials for this type of work can be purchased tax free with use of Form E595E NCDOR Sales Tax Exemption Form.
- Sales Tax charged must use the state rate and the county rate in which the work is done. The state rate is 4.75% but county rates vary. For example, work done in New Hanover County would have a total sales tax charge of 7%, this is made up of the 4.75% state rate and 2.25% New Hanover County rate. See page 7 for the break out of county rates.
- Registration is required with the NC Department of Revenue in order to collect and pay sales tax. See page 5 for more information.

Real Property Contracts (Capital Improvement – New Construction, Reconstruction, or Remodeling Work):

A key change in this area for January 1, 2017 is that “Form E-589CI, *Affidavit of Capital Improvement*, must be issued and kept on file for real property contracts”. This form is to be completed by the general contractor and issued to the subcontractor. It is support that the work is subject to the Real Property Contracts rules and no sales tax should be charged on the labor involved. It should be completed for single use or blanket use. The general contractor does not need to collect the form from the person hiring him/her to do the work. Landscapers and painters do not have to collect the form. Subcontractors must collect the form and keep it on file.

“Single Use” of the Affidavit of Capital Improvement (Section I):

A person must complete “Section I - Single Use” of the affidavit for a one time use. The single use section will generally apply for the following:

- When a homeowner remodels and oversees the entire activity, including obtaining bids, selection of subcontractors, and payment of all invoices or billings issued by any real property contractor. The homeowner must complete Section I of Form E-589CI, Affidavit of Capital Improvement, and issue the Form to each subcontractor to give notice that the transaction is a real property contract with respect to a capital improvement.
- When a real property contractor hires a subcontractor to perform a portion of the overall contract and there is not a recurring business relationship between the two parties.

“Blanket Use” of the Affidavit of Capital Improvement (Section II):

A person should complete “Section II - Blanket Use” of the affidavit and issue the form to subcontractors who are used exclusively to perform any portion of real property contracts with respect to capital improvements to real property, where the person and the contractor have a recurring business relationship. This will generally apply for the following:

- Builders who hire the same contractors for new construction;
- Contractors who hire the same subcontractors for reconstruction;
- Contractors who hire the same subcontractors for remodeling and it is clear that the activities performed by the subcontractors are never repair, maintenance, and installation services for real property;
- Contractors who exclusively hire the same subcontractors to perform all or a portion of its real property contracts with respect to capital improvements.

Example: *On January 15, 2017, a builder begins new construction of a house. As the builder and general contractor, the builder coordinates, manages, and oversees the work of all subcontractors working on the project. The following subcontractors will be utilized:*

- Site Prep Crew*
- Framer*
- Plumber*
- Electrician*
- Insulation Installer*
- Dry Wall Installer*
- HVAC Installer*
- Cabinet Maker*
- Finish Carpenter*
- Painter*
- Flooring Installer*

The builder exclusively uses the same subcontractors for all of the new homes the builder constructs. In this example, the builder may issue Form E-589CI, Affidavit of Capital Improvement, using "Section II - Blanket Use" to each of these subcontractors as they will be solely hired by the builder to perform a portion of real property contracts with respect to capital improvements for real property.

Mixed Transactions, those which include both capital improvements and repair, maintenance, and installation service will be subject to sales and use tax as follows:

- 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.

Also, effective 1/1/17 many services that were previously classified as real property contracting now do not meet the state's definition for capital improvement and are considered taxable Repair, Maintenance, and Installation (RMI) services.

Examples of capital improvements include:

- Underground utilities.
- Painting or wallpapering.
- Entire systems of roofing, septic tank, plumbing, electrical, commercial refrigeration, irrigation, sprinkler system, or other similar.
- HVAC unit or system.
- Roads, driveways, parking lots, and sidewalks.
- Landscaping service.
- Fixture attached to real property so that removal of it would cause physical, functional, or economic damage to the property.
- Removal of items from real property.
- Permit required by state building coded **EXCEPT** replacing electrical components, gas logs, water heater, and similar.

It is important to note that under the guide for Real Property Contracts, the NC Department of Revenue is expecting sales tax to be paid on the materials purchased. These materials should not be purchased under an exemption waiver.

Capital Improvements for Leases is a gray area in the law. To be considered capital improvement, the work must be intended to be permanent and title vest to the owner. They are still trying to get further definition from the NC Assembly in this area.

Repair, Maintenance, and Installation Services (RMI):

A key change in this area for January 1, 2017 is that many services that had been classified as real property contracting are now considered repair, maintenance, and installation services and are required to register, collect, and remit sales tax.

"Repair, maintenance, and installation services" – The term includes the activities listed below and applies to tangible personal property, a motor vehicle, digital property, and real property except tangible personal property or digital property installed or applied by a real property contractor pursuant to a real property contract taxed in accordance with N.C. Gen. Stat. § 105-164.4H:

- a. To keep or attempt to keep property or a motor vehicle in working order to avoid breakdown and prevent deterioration or repairs. Examples include to clean, wash, or polish property.

- b. To calibrate, refinish, restore, or attempt to calibrate, refinish, or restore property or a motor vehicle to proper working order or good condition. This activity may include replacing or putting together what is torn or broken.
- c. To install, apply, connect, adjust, or set into position tangible personal property, digital property, or a motor vehicle.
- d. To inspect or monitor property or a motor vehicle, but does not include security or similar monitoring services for real property.

Below are examples of services generally considered repair, maintenance, and installation services for real property when such is a single service and subject to sales or use tax. This list is not all-inclusive. (A more comprehensive list of transactions will be published by the Department in the near future.)

- HVAC repair for an air conditioning or heating unit that is not working properly.
- Rekey locks for real property by a locksmith.
- Repair of a water pump motor.
- Repair to correct a jammed garage door.
- Electrical repair due to a light switch or receptacle not working properly.
- Plumbing services to unclog a drain.
- Plumbing services to identify and repair a leak in a pipe.
- Services by a roofing company to identify and repair a roof leak.
- Replace damaged exterior bricks.
- Replace or repair of a storm door or garage door.
- Repair or replace countertops.
- Replace or reface kitchen cabinet doors.
- Repair or replace a water heater.
- Repair of a liner for a swimming pool.
- Repair or replace a single light fixture.
- Carpet or linoleum install for a single room.
- Repair or replace single plumbing fixture (i.e. toilet or sink).
- Replacement of plate glass window.

Below are EXCLUSIONS FROM RMI:

- Car Storage.
- Towing.
- Cleaning Real Property.
- Waste removal.
- Landscaping.
- Pest control.
- Moving.
- Alteration of clothing.
- Self-service car washes.
- Legally required inspections: (example – those required for real estate sales).
- Certain labor charges related to real subcontractors.

Potential Issues:

There is the potential for double taxation on materials purchased. For RMI work, material can be purchased tax free using an Exemption Certificate. With RMI, sales tax will be charged and collected at completion of the work. However, this will require you to not mix materials used in Real Property Contracts (i.e. capital improvement.) with the materials used for RMI work. This is due to the requirement that sales tax must be paid on materials used for capital improvement.

Included for recommended reading is: The NC Department of Revenue Directive SD-16-4 which contains in depth information regarding the changes in Sales and Use Tax of Repair, Maintenance, and Installation Services. Also included is a copy of the Exemption Certificate to use to purchase materials for RMI work.

Service Contracts

Service contracts applicable to tangible personal property are subject to sales tax. Service Contracts are defined as:

- Obligor under the contract agrees to maintain, monitor, inspect, clean, restore, or repair tangible personal property for a period time or some other defined measure.
- Includes pool maintenance contract and a home warranty.

Service Contract Exemptions:

- Inspections required by law.
- Performed by related member.
- Real property contract follow up – w/in 6 mos (ex. punch list in new home construction)
- Cleaning real property
- Services on roads, driveways, parking lots, etc.
- Removal of waste (not portable toilet septage).
- Landscaping.
- Pest control.
- Real property monitoring service i.e. burglar, fire, etc.

Registration for Sales and Use Tax and Due Dates

Each business that collects sales tax must register with the NC Department of Revenue. The easiest way to do it is online at this website address: <http://www.dornc.com/electronic/registration/index.html>.

If you already have a NCDOR account set up for withholding taxes, they will try to link the sales and use tax to this account number.

If the amount of sales tax that is collected is over \$100, then the sales tax must be remitted and the sales tax report filed by the 20th day of the following month. For example, if you collect \$500 in sales tax in January, this must be reported and paid to NC Department of Revenue by the 20th of February. If sales tax collected is consistently less than \$100 a month, it can be filed quarterly. If sales tax collected is consistently at least \$20,000 a month, monthly prepayments are required.

If you need assistance with getting set up and preparing sales tax filings, please let us know. We will be happy to assist you.

Sales and Use Tax Rates Effective October 1, 2016

Listed below by county are the total (4.75% State rate plus applicable local rates) sales and use tax rates in effect:

<u>County</u>	<u>Rate</u>	<u>County</u>	<u>Rate</u>	<u>County</u>	<u>Rate</u>
Alamance	6.75%	Franklin	6.75%	Pamlico	6.75%
Alexander	7%	Gaston	6.75%	Pasquotank	6.75%
Alleghany	6.75%	Gates	6.75%	Pender	6.75%
Anson	7%	Graham	6.75%	Perquimans	6.75%
Ashe	7%	Granville	6.75%	Person	6.75%
Avery	6.75%	Greene	7%	Pitt	7%
Beaufort	6.75%	Guilford	6.75%	Polk	6.75%
Bertie	6.75%	Halifax	7%	Randolph	7%
Bladen	6.75%	Harnett	7%	Richmond	6.75%
Brunswick	6.75%	Haywood	7%	Robeson	7%
Buncombe	7%	Henderson	6.75%	Rockingham	6.75%
Burke	6.75%	Hertford	7%	Rowan	7%
Cabarrus	7%	Hoke	6.75%	Rutherford	6.75%
Caldwell	6.75%	Hyde	6.75%	Sampson	7%
Camden	6.75%	Iredell	6.75%	Scotland	6.75%
Carteret	6.75%	Jackson	7%	Stanly	6.75%
Caswell	6.75%	Johnston	6.75%	Stokes	6.75%
Catawba	7%	Jones	6.75%	Surry	7%
Chatham	6.75%	Lee	7%	Swain	6.75%
Cherokee	7%	Lenoir	6.75%	Transylvania	6.75%
Chowan	6.75%	Lincoln	6.75%	Tyrrell	6.75%
Clay	6.75%	Macon	6.75%	Union	6.75%
Cleveland	6.75%	Madison	6.75%	Vance	6.75%
Columbus	6.75%	Martin	7%	Wake	6.75%
Craven	6.75%	McDowell	6.75%	Warren	6.75%
Cumberland	7%	Mecklenburg	7.25%*	Washington	6.75%
Currituck	6.75%	Mitchell	6.75%	Watauga	6.75%
Dare	6.75%	Montgomery	7%	Wayne	6.75%
Davidson	7%	Moore	6.75%	Wilkes	7%
Davie	6.75%	Nash	6.75%	Wilson	6.75%
Duplin	7%	New Hanover	7%	Yadkin	6.75%
Durham	7.5%*	Northampton	6.75%	Yancey	6.75%
Edgecombe	7%	Onslow	7%		
Forsyth	6.75%	Orange	7.5%*		

* Includes the 0.50% transit county sales and use tax.