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(LEARNING TEXAS SALES AND USE TAX LAW BY TRIAL AND ERROR CAN BE COSTLY)

ISREAL MILLER AND JP VOGEL



REAL PROPERTY REPAIR AND REMODELING

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Real Property Repair and Remodeling is subject to sales and use tax in Texas. Tex. Tax Code § 151.0047 and 34 Tex. Admin. Code § 3.357.

Sec. 151.0047. “REAL PROPERTY REPAIR AND REMODELING”.

(a) “Real property repair and remodeling” means the repair, restoration, remodeling, or modification of an improvement to real property other than:

- 1) a structure or separate part of a structure used as a residence;
- 2) an improvement immediately adjacent to a structure described by Subdivision (1) of this section and used in the residential occupancy of the structure or separate part of the structure by the person using the structure or part as a residence; or
- 3) an improvement to a manufacturing or processing production unit in a petrochemical refinery or chemical plant that provides increased capacity in the production unit.

REAL PROPERTY REPAIR AND REMODELING

(b) In this section:

- 1) “Increased capacity” means the capability to produce:
 - a) additional products or services as measured by units per hour or units per year; or
 - b) a new product or service.
- 2) “Production unit” means a group of manufacturing and processing machines and ancillary equipment that together are necessary to create or produce a physical or chemical change beginning with the first processing of the raw material and ending with the finished product.
- 3) “New product” means a product that:
 - a) has different product properties and a different commercial application than the product previously manufactured or processed by the production unit that produced the previous product; and
 - b) is not created by straining or purifying an existing product or by making cosmetic changes, such as adding or removing color or odor, to or from an existing product.



REAL PROPERTY SERVICE

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Sec. 151.0048. REAL PROPERTY SERVICE.

(a) Except as provided by Subsection (b), “real property service” means:

- 1) landscaping;
- 2) the care and maintenance of lawns, yards, or ornamental trees or other plants;
- 3) the removal or collection of garbage, rubbish, or other solid waste other than:
 - a) hazardous waste;
 - b) industrial solid waste;
 - c) waste material that results from an activity associated with the exploration, development, or production of oil, gas, geothermal resources, or any other substance or material regulated by the Railroad Commission of Texas under Section 91.101, Natural Resources Code;
 - d) domestic sewage or an irrigation return flow, to the extent the sewage or return flow does not constitute garbage or rubbish; and
 - e) industrial discharges subject to regulation by permit issued pursuant to Chapter 26, Water Code;

REAL PROPERTY SERVICE

- 4) building or grounds cleaning, janitorial, or custodial services;
- 5) a structural pest control service covered by Section 1951.003, Occupations Code; or
- 6) the surveying of real property.

(b) “Real property service” does not include a service listed under Subsection (a) if the service is purchased by a contractor as part of the improvement of real property with a new structure to be used as a residence or other improvement immediately adjacent to the new structure and used in the residential occupancy of the structure.

(b-1) “Real property service” does not include a service listed under Subsection (a) if the service is performed by a landman and is necessary to negotiate or secure land or mineral rights for acquisition or trade, including:

- 1) determining ownership;
- 2) negotiating a trade or agreement regarding land or mineral rights;
- 3) drafting and administering contractual agreements;
- 4) ensuring that all governmental regulations are complied with; and
- 5) any other action necessary to complete the transaction related to a service described by this subsection, other than an information service described by Section 151.0038.

REAL PROPERTY SERVICE

(c) In this section, “contractor” means a person who makes an improvement on real estate and who, as a necessary or incidental part of the service, incorporates tangible personal property into the property improved. The term includes a builder, developer, speculative builder, or other person acting as a builder to improve residential real property.



I FOLLOWED THE BLUEPRINTS...



AUDIT PROCEDURES FOR CONTRACTORS AND REPAIRMEN (REVISED 4/2017)

Available at: <https://comptroller.texas.gov/taxes/audit/docs/contractor-manual.pdf>

1. Real Property vs. Tangible Personal Property
2. New Construction
3. Tax Responsibilities: Taxable Customers
4. Five-Percent Taxable Charges
5. Tax Responsibilities: Exempt Customers
6. Subcontractors
7. Incorporated Materials
8. Consumables
9. Equipment & Accessories
10. Miscellaneous Topics
11. Repairing, Remodeling & Restoring Improvements to Realty
12. Services
13. Topics of Interest

REAL PROPERTY VS. TANGIBLE PERSONAL PROPERTY

Establishing whether an item is real property or tangible personal property (TPP) is the first step toward determining tax responsibility. The legal precedent is found in *Hutchins v. Masterson & Street, Assignees & Co.*, 46 Tex. 551, a court case that dates back to 1877, set three criteria to differentiate between real property and TPP that are still used today:

1. Has there been a real or constructive annexation of the article in question?
2. Was there a fitness or adaptation of such article to the uses or purposes of the realty to which it is connected?
3. Was the intention of the parties that the chattel (property) becomes a permanent accession to the free hold?

If the answers to all three questions are yes, the item is real property. Administrative hearings have held that the third criterion is preeminent, whereas the first and second criteria constitute evidence of intention.

Comptroller's Decision No. 110,309 (2015) (taxability of attaching antennas to communication towers), available at <https://star.comptroller.texas.gov/>.

NEW CONSTRUCTION

1. Construction of an Improvement to Realty
2. First Finish-Out or Initial Finish-Out
3. Addition of New Usable Square Footage
4. Hardscaping (includes installing sprinkler systems, retaining walls, rock work, ponds, pools, fences, drainage ditches, dams, and lighting permanently attached to a customer's property)
5. Demolition of an Improvement to Realty and Rebuilding (razed to the slab for a building and reduced to virgin earth for a parking lot or sidewalk)
6. Scheduled Maintenance of Nonresidential Real Property (the labor must be scheduled, periodic work on operational and functioning improvements to real property necessary to sustain or support safe, efficient, continuous operations or to keep the improvement in good working order by preventing its decline, failure, lapse or deterioration)

Comptroller's Decision No. 112,817 (2016) (new construction vs. remodeling and Comptroller's two-prong test for dominant purpose of a lease contract).

TAX RESPONSIBILITIES: TAXABLE CUSTOMERS

1. Lump-Sum Contract (the contractor owes tax on the purchases of incorporated materials, equipment, consumable items and taxable services; the contractor does not collect tax from the customer on the sale)
2. Separated Contract (the contractor is considered a retailer of the incorporated materials and must collect sales tax from the customer; tax is due on the price of the materials, as agreed in the contract, or the price of the materials to the contractor, whichever is greater)
3. Cost-Plus Contract (generally regarded as a separated contract)
4. Guaranteed Maximum (Contracts with separate charges for materials, labor and profit with a guaranteed maximum amount to be paid by the customer are separated contracts; stating a single maximum amount does not transform a contract from separated into a lump-sum)
5. Controlling Documents (contract, bid, invoice)
6. Contracting Taxability (the Comptroller is not bound by the terms of contracts he did not enter into)
7. Amending Contracts (an amended contract becomes the controlling document)
8. Change Orders (Change orders take on the same character as the original contract, regardless of the form of the change order)
9. Tax-Included Language (should state “Texas sales and use tax included”)



FIVE-PERCENT TAXABLE CHARGES

Frequently, new construction, nontaxable unrelated services, real property maintenance or residential real property remodeling and taxable services are sold or purchased for a single charge. If the portion relating to taxable services represents more than 5% of the total charge, the total charge is presumed to be taxable.

The service provider may overcome the presumption at the time the transaction occurs by separately stating to the customer a reasonable charge for the taxable services.

TAX RESPONSIBILITIES: EXEMPT CUSTOMERS

1. Exemption Certificates (good faith exemption, 60-day letter deadline)
2. Exempt Purpose of the Entity (an exempt entity must be contracting for a job that is related to the primary purpose of the exempt entity to claim the exemption)
3. Building Owned by a Taxable Entity and Leased by an Exempt Entity (if a taxable entity owns a building that is leased to an exempt entity, the exemption is applicable if the life of the lease equals or exceeds the life of the improvement to realty)
4. Development Work or Dedicated Improvements
 - Development work means improving real property for a private party who intends to donate the improvements to a governmental entity
 - Dedicated improvements generally include streets, roads, sewer lines, water lines etc. that are built to governmental entity specifications
 - When the development phase is completed, the governmental entity takes ownership of the improvements and becomes responsible for their maintenance



SUBCONTRACTORS

A subcontractor is an individual or business contracting to perform part or all of another's contract. When this happens, the subcontractor becomes the contractor and the contractor becomes the customer.

Multiple subcontractors may work on a single general contract. The law does not require that the subcontractor(s) use the same type of contract as the general contractor. Each subcontractor's individual contract governs the subcontractor's tax responsibilities.

INCORPORATED MATERIALS

1. Materials Provided by the Customer

- the person providing the skill and labor will not incur tax liability on the materials
- the customer is liable for the tax on the materials
- the tax should be paid to the supplier when the materials are purchased

2. Materials Purchased in Texas for Use Outside of Texas

- tax is due in this state on materials purchased or used in this state
- if a contractor takes possession of materials in Texas that will be used in a lump-sum contract outside Texas, the contractor must pay Texas state and local sales tax
- however, if the vendor or common carrier delivers the materials to the out-of-state job site, no Texas sales tax is due

3. Materials Purchased Outside of Texas for Use in Texas (if the materials are purchased from an out-of-state seller, a contractor must accrue and remit use tax on the materials unless the out-of-state seller collected Texas use tax or the material is for a separated job and can be purchased tax free)

4. Dirt, Sand and Gravel (the sale and/or delivery of unprocessed dirt, sand, gravel or similar materials are not taxable)

5. Agency Agreement on Incorporated Materials (the Comptroller holds both the agent and principal liable for any taxes owed by the principal for purchases made under the agency agreement)

CONSUMABLES

Consumables are nondurable tangible personal property (TPP), other than machinery and equipment that are not physically incorporated into the property of a customer and that, after being used for their intended purposes, are completely used up or destroyed. Rented or leased items are not consumables.

Consumable supplies may include: barricade tape, non-reusable concrete forms, non-reusable drop cloths, gas and electricity, plastic sheeting, survey stakes and flags, tape (except measuring tape), chalk and pens, disposable brushes, form nails, street line “guides”, blasting sand, tree markers, chalk line powder, disposable rags, form oil, masking tape, sandpaper, and welding gas.

Consumable supplies do not include items attached to equipment as accessories, such as: saw blades, drill bits, grinding disks, and cutting stars.

1. Nonexempt Customers (both lump-sum and separated contractors improving real property belonging to nonexempt customers must pay tax on consumables at the time of purchase)
2. Exempt Customers (the purchase of consumable items for use in the performance of a contract for an improvement to realty for an organization exempted under sections 151.309 (Governmental Entities) or 151.310 (Religious, Educational and Public Service Organizations) of the Texas Tax Code is exempt if the TPP is necessary and essential for the performance of the contract and completely consumed at the job site)

Not all TPP consumed at a job site is exempt. For instance, office supplies (*e.g.*, paper, pencils, note pads, coffee cups, paper clips etc.) are consumed at the job site but not actually used in improving real property.

EQUIPMENT & ACCESSORIES

Equipment is tangible personal property (TPP) that a contractor uses that is not consumed or incorporated into real property; accessories are equipment attachments. A contractor must pay tax at the time of purchase, rental or lease on tools, machinery, equipment and accessories used to perform a contract. This applies to contracts to improve realty for nonexempt and exempt customers. If the purchase is made from an out-of-state seller, the contractor must accrue and remit use tax on the total purchase price unless the out-of-state seller collects Texas use tax.

Equipment includes: barricades, tools, scaffolding, machinery not incorporated into the realty, implements, and accessories.

Accessories include: saw blades, bristles for street sweepers, and grinding/cutting stars (if used on equipment).

Equipment furnished with an operator for which there is a single charge is considered a service and is not taxable unless the service performed is taxable. For example, a contractor could rent dredging equipment with an operator for a lump-sum price. If the service provided was removing sediment from a man-made lake, then the service would be taxable.

Comptroller's Decision No. 115,602 (2020) (taxability of scaffolding used on bridge repairs on a contract with TXDOT).

MISCELLANEOUS TOPICS

1. Permit Fees (non-taxable)
2. Blueprints (taxable)
3. Natural Gas and Electricity (taxable)
4. Local Tax (capped at 2%)
5. Items Removed from a Valid Tax-Free Inventory (accurate recordkeeping is vital)
6. Homebuilders (real property services are taxable services, but they are not taxable if purchased by a homebuilder as part of a contract to build a new residential structure or other improvement next to the new residential structure and used in the residential occupancy of the structure)
7. Increased Capacity (not taxable real property repair and remodeling)
8. Contractors Who Manufacture

While a person may be a manufacturer on one job and a contractor on another job, the person cannot be both a manufacturer and a contractor on the same job. On a job where the person manufactures and sells TPP, he qualifies for manufacturing exemptions. See Rule 3.300 – Manufacturing; Custom Manufacturing; Fabricating; Processing. On a job where a person manufactures and installs TPP into real property, he is acting as a contractor and does not qualify for the manufacturing exemption.

9. Divergent Use (when TPP is purchased tax free with a manufacturing exemption and subsequently used in a nonexempt manner, then tax must be remitted to the Comptroller based on the divergent use)

REPAIRING, REMODELING & RESTORING IMPROVEMENTS TO REALTY

1. Residential vs. Nonresidential (residential includes family dwellings, multifamily apartments or housing complexes, nursing homes, and condominiums or retirement homes; but not hotels and hospitals.)
2. Maintenance vs. Repair
3. Repainting (typically a repair but could be maintenance, if scheduled and periodic)
4. Repair/Remodel – Historical Buildings (the labor to repair, remodel or restore a building listed in the National Register of Historic Places is not taxable)
5. Government-Mandated Building Changes

The repair, restoration or remodeling performed on an existing building classified as nonresidential realty is taxable, even though the modifications are mandated by local, state or federal government laws. There are no exemptions or exclusions from tax because the work is to comply with environmental or safety regulations. This includes compliance with the federal Americans with Disabilities Act and Occupational Safety and Health Administration regulations.

6. Natural Disaster

The labor to repair real or TPP damaged within a disaster area by the condition or occurrence that caused it to be declared a disaster area is exempt from tax if the charge for labor is separately stated to the customer.

SERVICES

1. Security Services (taxable)
2. Real Property Services
 - a) Landscaping (taxable)
 - b) Janitorial Services (taxable)
 - c) Care and Maintenance of Lawns (taxable)
 - d) Surveying (taxable)
 - e) Garbage Removal (taxable)
 - f) Structural Pest Control (taxable)
 - g) Real Property Service v. Maintenance

If the service is included as a real property taxable service, then the service cannot be included as maintenance, even if the service is scheduled and periodic. The service will be taxable every time it is performed when the service is considered to be a real property service, regardless of whether or not the service is performed on a periodic and scheduled basis.

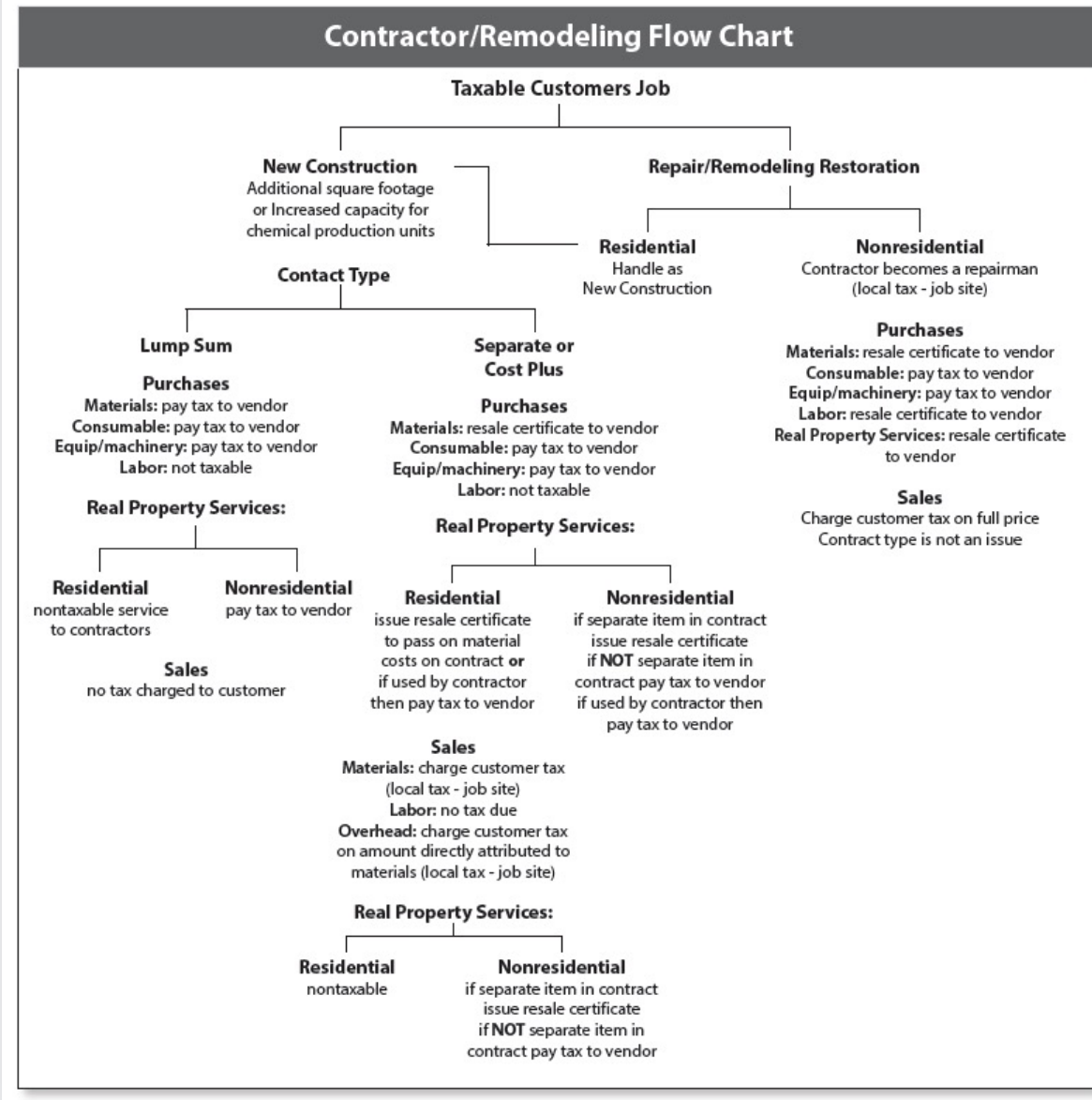


TOPICS OF INTEREST

1. Awnings/Canopies (typically do not add additional new square footage to a building)
2. Barricade Services (treated as equipment rentals)
3. Signs
4. Concrete (can be the sale of TPP or a service)
5. Manufacturing Equipment vs. Real Property (once incorporated into real property, manufacturing equipment is no longer qualifies for exempt TPP repairs)
6. Extended Warranties (not taxable if for residential real property; taxable for nonresidential real property)
7. Plant Turnaround (the maintenance of real property is not subject to sales tax during plant turnarounds that are regularly and periodically scheduled)
8. Professional Services (professional services provided by lawyers, engineers, architects et al. are nontaxable even if they provide some TPP (copies, legal documents, blueprints etc.) to their clients as part of their professional services)

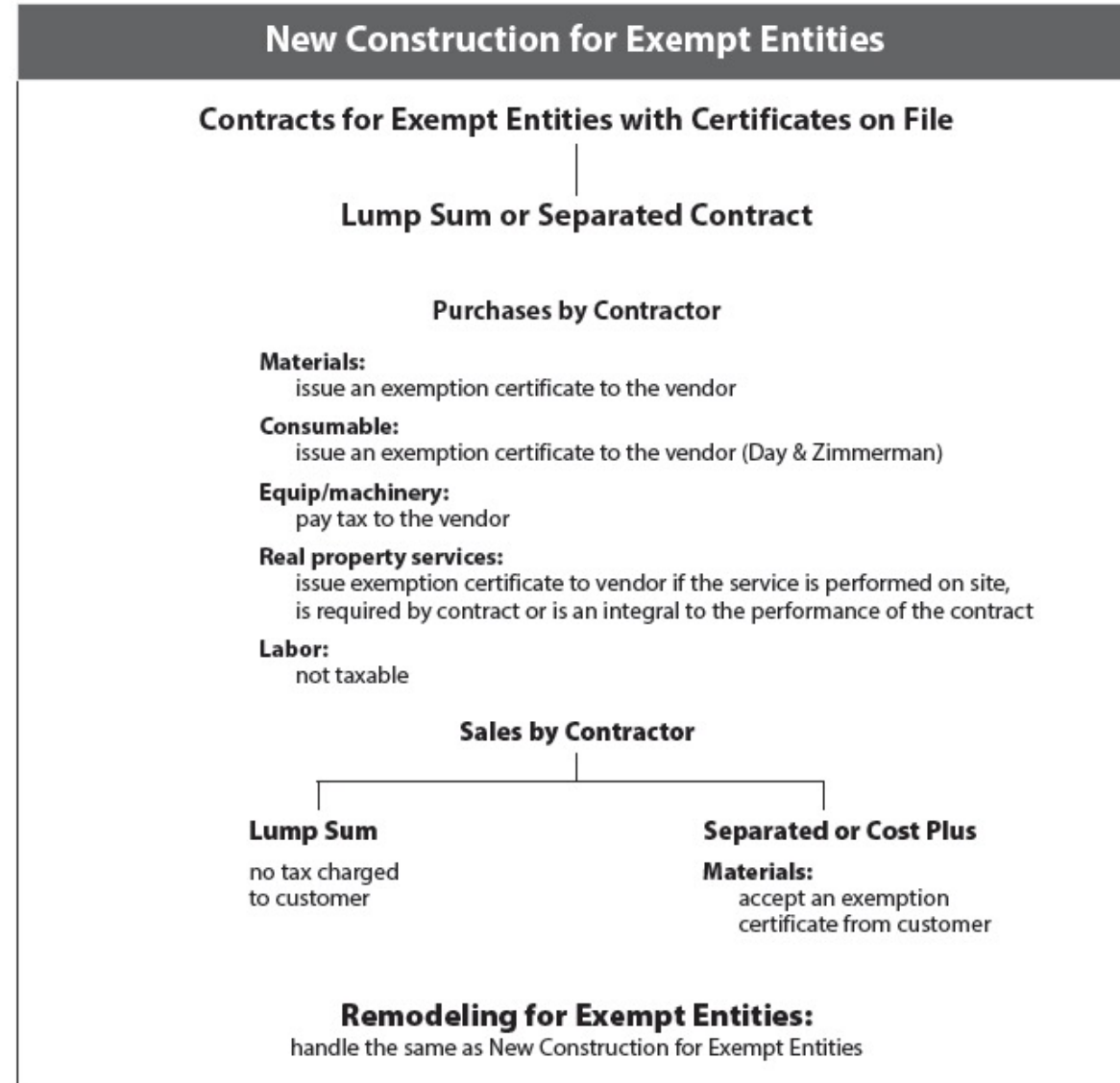
SUMMARY DECISION TREE

Contractor Flowchart – Taxable Customers



SUMMARY DECISION TREE (CONT.)

Contractor Flowchart – Exempt Customers




VOLUNTARY DISCLOSURE AGREEMENTS (96-576)

POLICY

The Texas Comptroller of Public Accounts is committed to promoting taxpayer compliance. In an effort to accomplish this objective, a Voluntary Disclosure Agreement (VDA) is available to taxpayers who want to comply with our tax laws. Standard written agreements will be made available for all taxes administered by our agency to which we can enter into such agreements.

In our commitment to fairness in the administration of our taxes, we adhere to the following general guidelines:

- Liabilities due to failure to collect taxes and/or file the applicable reports will be limited to reports due four years from the initial taxpayer contact date.
- All taxes that were actually collected by the seller need to be remitted (i.e., there is no four-year limitation on tax collected not remitted).
- Statutory penalties will be waived.
- Interest will be waived on taxes voluntarily disclosed and paid that were not collected.
- Agreements will be offered to taxpayers who have not been contacted regarding an audit or investigation, either verbally or in writing.



VOLUNTARY DISCLOSURE AGREEMENTS (96-576)

PROCESS

Initial Taxpayer Contact

A company representative initiates the process on behalf of their anonymous client by contacting the Business Activity Research Team (BART) in writing at:

Texas Comptroller of Public Accounts
Business Activity Research Team
PO Box 13003
Austin, Texas 78711-3003

(800) 688-6829
fax: (512) 305-9918

VOLUNTARY DISCLOSURE AGREEMENTS (96-576)

PROCESS

- The following information must be provided:
- The type of entity (*i.e.*, corporation, partnership, etc.)
- A brief description of the company's business including its specific activities in Texas.
- Date the company began business and date the company began business activities in Texas.
- Disclosure of the tax type (*i.e.*, sales, franchise, etc.) for which an Agreement or Agreements is/are requested and specify any taxes that the corporation is already set up for in Texas.
- Whether the company has been contacted by the Texas Comptroller of Public Accounts.
- Whether the company has collected, but not remitted, any Texas tax.
- An estimate of the amount of taxes due.
- Any additional information or extenuating circumstances to support the request.

VOLUNTARY DISCLOSURE AGREEMENTS (96-576)

GENERAL INFORMATION

- The Comptroller of Public Accounts reserves the right to deny the waiver of penalty and/or interest or to void the agreement if a taxpayer does not adhere to our program policies and procedures.
- Disclosure periods remain open to future audit.
- Any potential problems regarding full payment of the disclosed taxes should be included in the “initial taxpayer contact” letter, along with any request for payment agreement.
- These policies and procedures may be changed at any time by the Comptroller.
- As a result of House Bill 1840 of the 77th Legislative Session, the Comptroller may waive penalty and interest imposed on certain delinquent unclaimed property. Taxpayers who meet the appropriate criteria can now enter into a VDA with our agency.

Multistate taxpayers who wish to approach a number of states simultaneously may wish to use the services of the National Nexus Program of the Multistate Tax Commission.



ADDITIONAL REQUIRED DOCUMENTATION

- Limited Power of Attorney (Comptroller Form 01-137)
- Texas Nexus Questionnaire (Comptroller Form AP-114)
- Most recent 4 years of franchise tax reports
- Most recent 4 years of sales and use tax returns
(BART may request an Excel spreadsheet in lieu of the actual returns)
- Most recent 4 federal income tax returns

CONTACT US



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