



## **New Directive from NC Dept of Revenue on sales and use taxes for services to real property**

**General.** On April 18, 2018, the Sales and Use Tax Division of the NC Department of Revenue (“NCDOR”) issued a “Directive” on the subject of “Repair, Maintenance, and Installation Services for Real Property and Real Property Contracts” (the “Directive”). The *Directive* replaces an “Important Notice” issued by the Sales and Use Tax Division on March 17, 2017. The *Directive* is available by clicking [here](#). The purpose of this article is to give property managers a general overview of the *Directive*.

The *Directive* addresses a number of issues relating to the application of State and applicable local and transit rates of sales and use tax for services to real property. The State sales and use tax is currently 4.75%. The *Directive* confirms that generally, services to real property are considered to be retail sales of “repair, maintenance and installation services” and subject to sales and use tax, unless it can be substantiated that a particular transaction is exempt for one of several reasons.

**Exemption for real property contracts.** One of the significant exemptions is for a transaction that is considered to be a “real property contract,” which is defined as “[a] contract between a real property contractor and another person to perform a capital improvement to real property.” For example, assume a contractor constructs a new deck for the owner of a property. The contractor pays sales and use tax on the materials purchased to construct the deck, but the contractor does not charge sales and use tax on the “sale” of the deck to the owner.

**Capital Improvement or Repair, Maintenance and Installation Service?** The *Directive* contains an extensive list of transactions to assist with making a determination as to the application of sales and use tax to various services to real property. Transactions are listed by category and are identified either as a “Capital Improvement,” which, as noted above, is exempt from sales and use tax, or “Repair, Maintenance and Installation Services,” which are generally taxable. For example, under the “Decks” category (page 11 of the *Directive*), the “Installation, replacement or expansion of decks” is identified as a “Capital Improvement,” while “Repair, maintain, or replace a component part: floor of deck, deck boards, railings, etc.” is identified as a “Repair, Maintenance and Installation Service.”

**Responsibility for collecting the tax.** If sales and use tax applies to a particular service, it must be collected by the person providing the service. **Property managers who provide services subject to the sales and use tax must collect the applicable tax.** This applies to services provided by the property manager directly and not to services provided by third parties engaged by the property manager on behalf of a landlord client. A property manager who engages a third-party service provider is not responsible for collecting or paying sales and use taxes that the third-party service provider may fail to collect.

**Listing taxable and nontaxable items separately.** The *Directive* states that a person who is subject to the collection of sales and use tax is required to keep proper books showing separately the gross proceeds of taxable and nontaxable sales of items subject to the tax “in a form that may be accurately and conveniently checked by the Secretary [of Revenue] or the Secretary’s duly authorized agent.” The *Directive* goes on to state—in bold type—that taxable and nontaxable amounts for items and services must be listed separately on an invoice or other document given to a purchaser at the time of the transaction; otherwise, the entire sales price or gross receipts derived from the transaction are subject to sales and use tax without deduction for any amount the person contends is exempt from sales and use tax.

**Substantiation of capital improvements required.** As noted above, a contract between a real property contractor and another person to perform a capital improvement to real property is exempt from sales and use tax. However, it is important to note that there needs to be substantiation of the fact that the work performed is a capital improvement; otherwise, it will be treated as the sale of a repair, maintenance and installation service that is subject to the sales and use tax. According to the “Capital Improvement Substantiation” section of the *Directive*, there are two ways to substantiate that work is a capital improvement. One, the owner of the property may issue an “Affidavit of Capital Improvement” ([NCDOR form E-589C1](#)) to substantiate that the project is a capital improvement. The owner and contractor are identified, the work performed is described, and the owner and contractor sign the form certifying that the transaction is a capital improvement. If a property manager arranges a capital improvement project on their landlord client’s behalf, may the manager complete and sign an Affidavit of Capital Improvement on the owner’s behalf? Our recommendation is that the owner should sign the affidavit. If that is not possible, the manager may sign the affidavit in the name of the owner after obtaining written authorization to do so.

In lieu of an affidavit, the capital improvement can also be substantiated by other records, such as drawings or plans of the project, the contract between the contractor and the owner, etc. The benefit of completing the Affidavit of Capital Improvement is stated in the *Directive*: “[a] person who receives an affidavit of capital improvement from another person, absent fraud or other egregious activities, is not liable for any addition tax on the gross receipts from the transaction if it is determined that the transaction is not a capital improvement.” Absent an affidavit, the *Directive* states that the owner and the contractor are jointly and severally liable for any sales and use tax that may be owed.

**Statutory exemptions.** In addition to the exemption for “real property contracts” discussed above, property managers should be aware of a list of repair, maintenance, and installation services and service contracts that are specifically exempt by State statute from sales and use tax. See [NC General Statutes Section 105-164.13](#), subsection (61a) for the list of exemptions. For example, under the “Decks” category of the list (mentioned above), “[c]leaning or power washing decks,” although identified as a repair, maintenance and installation service, is “exempt” from sales and use tax. That is because “power washing other than for a pool” is on the list of exempt services under the subsection (61a). The exemption for power washing can be found under subsection (61a)(d).

**Conclusion.** The tax issues addressed in the *Directive* are very technical in nature. Questions relating to the proper interpretation of the *Directive* as it applies to specific situations may be addressed to the Department of Revenue at 1-877-252-3052. Calls regarding sales and use taxes

are generally routed to employees with more advanced knowledge. If those employees need additional assistance, they typically work with the employees of the Sales and Use Tax Division. There is also a process for obtaining a written ruling, which may be viewed by clicking [here](#).

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