February 17, 2016

North Carolina's New Sales Tax on Repair, Installation and Maintenance Charges
By Keith A. Wood

Beginning in March 2016, North Carolina sales and use tax will be assessed on most charges for repair, installation and maintenance services ("RIM services").

The North Carolina Department of Revenue has issued several Directives to attempt to explain how the new RIM services rules are to apply. Unfortunately, some of the language in these Directives has simply added to the confusion.

Background.
Since January 2014, sales of "service contracts" have been subject to North Carolina sales and use tax, except in very limited circumstances. The term "service contract" is defined as a "warranty agreement, maintenance agreement, repair contract or similar agreement or contract in which the seller agrees to maintain or repair tangible personal property."

In December 2013, the North Carolina Department of Revenue issued an announcement advising that the new service contract rules did not apply to "one off" service or repair transactions (such as a repair to an automobile) or to service contracts to maintain tangible personal property that is permanently attached to real property (such as an HVAC system).

2015 House Bill 97.
In September 2015, however, House Bill 97 was enacted to make two (2) significant changes to the sales and use tax rules as they apply to certain services.

First, under the new sales tax rules, effective beginning March 1, 2016, except in some very limited circumstances, most RIM services now will be fully subject to sales and use taxation (even with respect to installation and repair of tangible personal property permanently affixed to real property).

Second, House Bill 97 also amended the definition of a "real property contractor," as defined in N.C.G.S. 105-164.3(33a), to provide that, if a person or entity is engaged in "retail trade," then that person cannot operate as a real property contractor or as a retail contractor.

On October 15, 2015, the North Carolina Department of Revenue issued an announcement to explain how the new sales tax rules would operate. In this announcement, the NCDOR advised that, if a person meets the definition of a "retailer," and is deemed to be engaged in "retail trade," then that person must charge and collect sales tax on all RIM services, even if the service involves repair, installation or maintenance of tangible personal property permanently affixed to real property. The announcement further advised that the term "retail trade" is defined as a "trade in which the majority of the revenue is from retailing tangible personal property." N.C.G.S. 105-164.3(35b).

On February 5, 2016, the North Carolina Department of Revenue issued two (2) Directives (SD-16-1 and SD-16-2) in a further attempt to clarify how these new sales and use tax rules would apply to a broad range of taxpayers, such as HVAC contractors, kitchen remodelers, and carpet and flooring installers.

Although the Directives' description of the new sales and use rules is somewhat confusing, the examples provided by the NCDOR in the Directives deserve close attention.
Based upon our review of the examples contained in the Directives, we think that, in order to determine how the new sales and use tax rules apply, the first step is to determine whether the taxpayer meets the threshold test of being a "retailer." And, our interpretation is that, once the taxpayer meets the definition of being a "retailer," then that person must collect sales tax on every sale and service that taxpayer makes or provides.

So, if the taxpayer’s North Carolina revenue from the sale of service contracts and other retail sales (that are not part of a repair or installation project) are more than 50% of total N.C. revenue, then all of the taxpayer’s revenues in North Carolina from all sales and services are subject to sales tax, and sales tax must be collected and remitted.

On the other hand, if the taxpayer’s North Carolina revenue from the sale of service contracts and other retail sales (that are not part of a repair or installation project) are less than 50% of the taxpayer’s total revenues in North Carolina, then the taxpayer’s revenues from RIM services are exempt from sales tax, but all of the taxpayer’s revenues from the sale of service contracts and other retail sales (that are not part of a repair or installation) are still subject to sales tax.

Clearly, it appears that these new rules could impose very different tax compliance obligations on taxpayers within the exact same industry. For example, consider an HVAC contractor that only provides installation and repair services, but does not sell any HVAC units or service contracts separate and apart from those services. Presumably, that taxpayer would not have to charge sales tax on any RIM services, even though a competitor, that both sells HVAC units and sells service contracts, may be required to charge sales tax on all HVAC sales and RIM services, including charges for installing HVAC units onto real property.

Likewise, consider two different carpet and floor installation businesses, one of whom operates a retail showroom in North Carolina and the other that does not. Here, if sales at the retail showroom account for more than 50% of the first taxpayer’s overall North Carolina gross revenues, then the first taxpayer would have to charge sales tax on all sales and services, even if the carpet installer serves as a subcontractor on large construction projects. The second carpet installer, however, would not have to charge sales tax on sales and installation services on these large construction contracts.

A common misunderstanding is that the new sales tax on service contracts applies only in the residential consumer setting. In fact, the North Carolina sales tax, including the new tax on service contracts, applies in all cases where the sale or service is at retail to the end user, even if the purchaser is an entity engaged in business. The only exception is when the purchaser meets the requirements for a specific exemption (for example, certain farming operations, etc.).

Conclusion.

All of these changes are very confusing to say the least. However, it does not look as though our General Assembly will be able to enact any clarifying legislation before the new rules go into effect on March 1, 2016. So, between now and March 1, if you have not already done so, please make it a point to reach out to your CPA to see how the new sales tax rules may apply to your business.

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