

North Carolina RMI Sales Tax

In 2015, new legislation was enacted in North Carolina imposing a sales and use tax on certain repair, maintenance and installation (“RMI”) services and other related items effective March 1, 2016. The North Carolina RMI services tax is rather broad in its scope and applies very generally to most retail transactions for services, though there are numerous exemptions. When the statutes first came out, there was considerable uncertainty in the application of the new tax, and the disparate results created in some situations. As a result, new legislation was signed into law in July 2016 (generally effective January 1, 2017) which includes several clarifications to the initial statutes and generally provides additional exemptions to the tax, many related to real estate. On November 15, 2016, the North Carolina Department of Revenue (“NCDOR”) published updates on the 2016 changes, providing additional detail and guidance.

This is an update to the alert distributed in February 2016. In this new alert, we will attempt to explain the rules on the RMI services tax, as amended by the 2016 legislation and as clarified by the most recent NCDOR updates.

Background and Definition of RMI Services

RMI services are generally those services to repair, maintain or install personal property and include, specifically, services:

- 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.
- 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.
- To troubleshoot, identify, or attempt to identify the source of a problem for the purpose of determining what is needed to restore property or a motor vehicle to proper working order or good condition.
- To install, apply, connect, adjust, or set into position tangible personal property, digital property, or a motor vehicle.
- To inspect or monitor property or a motor vehicle, except security or similar monitoring services for real property.

The 2015 legislation was thus focused primarily on “retailers” engaged in the business of selling RMI services at retail in North Carolina.

Changes and Clarifications from 2016 Legislation

Overview of Key Changes

- The definition of retail trade is repealed
- A person whose only business activity is providing repair, maintenance, and installation services is a retailer and is required to collect and remit sales tax on taxable repair, maintenance and installation services
- Real property contractors and retailer-contractors are required to collect and remit sales or use tax on taxable repair, maintenance and installation services
- The definition of taxable RMI services has been changed for the following:
 - Amending the definition of RMI services to include cleaning, refinishing and certain inspection and monitoring services, effective January 1, 2017
 - Exempting the following services and service contracts for these services from sales tax, effective January 1, 2017:
 - Motor vehicle service contracts (see above)
 - Inspections required by law
 - Services performed by a related party
 - Services performed to resolve issues that are part of real property contract if the services are performed within six months of completion of the real property contract or within 12 months for new construction
 - Cleaning real property, except for the rental of a taxable accommodation or for a pool, fish tank, or similar aquatic feature
 - Services on roads, driveways, parking lots and sidewalks
 - Removal of waste, trash, debris, grease, snow and similar except removal of waste from portable toilets
 - Home inspections for the sale of real property
 - Landscaping
 - Alteration and repair of clothing, except for a taxable clothing rental or for alteration/ repair of belts and shoes
 - Pest control
 - Moving
 - Self-service car washes
- For real property contractors, effective January 1, 2017:
 - The definition of “real property contract” is limited to contracts for capital improvements
 - If the contract does not meet the definition of a capital improvement, it may be taxable as a repair, maintenance and installation service

- Form E-589CI, Affidavit of Capital Improvement, is required to substantiate that a contract meets the definition of a capital improvement with respect to real property with certain exceptions
- Rules are provided to determine the taxability of mixed real property and RMI contracts; if the price of RMI services does not exceed 10% of the combined contract, all of the contract qualifies as a real property contract

Definitions

NC Gen. Stat. §105-164.3(33e) defines real property contract as a contract between a real property contractor and another person to perform “construction,” “reconstruction,” or “remodeling” with respect to a “capital improvement” to “real property.”

N.C. Gen. Stat. § 105-164.3(33f) defines real property contractor as a person that contracts to perform a “real property contract” in accordance with N.C. Gen. Stat. § 105-164.4H. The term includes a general contractor, a subcontractor, or a builder for purposes of N.C. Gen. Stat. § 105-164.4H.

Capital Improvements Defined

If a transaction related to real property does not meet the definition of a capital improvement, it is not taxed as a real property contract and may instead be subject to tax as “repair, maintenance, and installation services” to real property. Thus determining whether a transaction constitutes a capital improvement becomes significant. The most recently issued directive from NCDOR defines capital improvement to generally mean:

- An addition or alteration to real property that is new construction, reconstruction or remodeling of a building, structure or fixture on land that becomes part of the real property, or is permanently installed to the real property such that removal would cause “material damage” to the property or addition.

Generally, tangible personal property becomes part of real property when it is attached in a fixed or immovable manner (an example cited being a fence built on land). “Material damage” is defined, in part, as “having real importance or great consequences”. An example of material damage cited is that of tile being installed in a bathroom and shower where the tiles would be significantly damaged if they were later removed.

A capital improvement does not include a single repair, maintenance and installation service. Such a transaction is not considered remodeling and would not generally not be taxed as a real property contract but rather as RMI services. In determining whether a transaction is remodeling and thus a capital improvement, the recent NCDOR directive provided that the following are generally considered repair, maintenance and installation services for real property when it is a single service and is subject to sales or use tax:

- 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

This list is not all-inclusive.

Mixed Transaction Contracts

The Department also provided that, where a contract provides for both a capital improvement and repair, maintenance and installation services, if the price of the taxable RMI service does not exceed ten percent of the contract price, the entire contract can be treated as a real property contract, and the contractor pays sales tax on the materials purchased. Where the price of the taxable repair, maintenance and installation services is equal to or greater than ten percent of the contract price, sales tax applies to the taxable repair, maintenance and installation services portion of the contract, and the contractor providing the service does not pay tax on the materials purchased to be used for the taxable service.

Affidavit

Form E-589CI, Affidavit of Capital Improvement, is now generally required to substantiate that a contract, or a portion of a contract, is a real property contract with respect to a capital improvement to real property.

Form E-589CI, Affidavit of Capital Improvement, is not required to be issued for contracts in the following instances:

- A real property owner or other person hires a “general contractor” to oversee the entire contract, and the contract by definition is for “new construction”
- A real property owner or other person hires a “general contractor” to oversee the entire contract, and the contract is to rebuild or reconstruct a prior existing permanent building, structure, or fixture on land

The two exceptions above do not apply to remodeling contracts. When relying on the exceptions, the general contractor is responsible for maintaining records that substantiate that the contract meets the definition of a capital improvement with respect to real property.

Retailer-Contractors

Retailer-contractors are persons who act as retailers when selling tangible personal property at retail and as real property contractors when performing real property contracts. Retailer-contractors may purchase tangible personal property or digital property to be installed or applied to real property or services to fulfill the contract exempt from tax, using Form E-595E, Certificate of Exemption, as long as the retailer-contractor also purchases inventory items or services from the seller for resale. When the property is withdrawn from inventory and installed or applied to real property, or when the service is used, use tax must be accrued and paid on the purchase price of the property. Property that the retailer-contractor withdraws from inventory for use that does not become a part of real property is also subject to sales and use tax.

Relief Provisions – Transition Period

In anticipation of difficulty with complying with the new sales tax provisions, NCDOR was authorized by the 2015 bill to “compromise” (reduce) a taxpayer's liability for taxable repair, maintenance and installation services if the taxpayer made a good-faith effort to comply with new provisions for assessments issued before July 1, 2020.

Expecting continued difficulty with complying with the changes, the following compromise of liability provisions were included in the 2016 legislation:

- From March 1, 2016, through December 31, 2016, a retailer is not liable for the under collection of sales or use tax as a result of the 2015 legislative changes imposing sales and use tax on RMI services, provided the retailer made a good-faith effort to comply.
- For assessments related to reporting periods beginning March 1, 2016 and ending December 31, 2022, the Department of Revenue can compromise a taxpayer's sales or use tax liability due because of the changes related to service contracts, RMI services or sales transactions for a person in a retail trade with a good-faith effort to comply.
- Retroactive to January 1, 2015, real property contractors who improperly collect sales tax on items for which the contractor was liable for a use tax are no longer prohibited from applying the over-collection to offset use tax liability.

We Can Help

Because many of the changes to the RMI services taxes are first effective January 1, 2017, you should review your sales tax compliance procedures currently in place. Please contact a member of your Elliott Davis Decosimo team for assistance in helping you evaluate your RMI sales tax issues.