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DIRECTIVE

Subject: Real Property Contracts
Tax: Sales and Use Tax
Law: N.C. Gen. Stat. §§ 105-164.3(33e), 105-164.4(a)(13), & 105-164.4H
Issued By: Sales and Use Tax Division
Date: November 15, 2016
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This directive is issued under the authority granted the Secretary of Revenue pursuant to N.C. Gen. Stat. § 105-264 relative to the application of sales and use taxes to a real property contract with respect to a capital improvement for real property. The issues addressed herein are primarily based on certain laws¹ enacted by the 2016 North Carolina General Assembly effective January 1, 2017 for sales on or after such date.

Overview of Key Changes

- The term “real property” is defined by statute.
- The term “real property contract” is defined by statute.
- The term “capital improvement” is defined by statute.
- Form E-589CI, Affidavit of Capital Improvement², must be issued, except as noted herein, and kept on file for a real property contract. (See “Affidavit of Capital Improvement” section.)
- The definition for “retail trade”³ is repealed; therefore, a person’s NAICS classification or majority of revenue no longer affects the treatment of certain transactions with respect to real property.
- If the transaction does not meet the definition of a capital improvement as discussed herein, it is not taxed as a real property contract and may be taxable as “repair, maintenance, and installation services”⁴ to real property or a “service contract”⁵ for real property.
- A contract that includes both a capital improvement to real property and a repair, maintenance, and installation service is a mixed transaction contract. (See “Mixed Transaction Contracts” section.)

Imposition

The general 4.75% State, applicable local (2.00% or 2.25%), applicable transit (0.50%) rates of sales and use tax⁶ apply to the sales price⁷ or purchase price⁸ of an item or service sold to a real

¹ S.L. 2016-94 and S.L. 2016-123.

² Form E-589CI, Affidavit of Capital Improvement, will be added to the Department’s website prior to January 1, 2017.

³ N.C. Gen. Stat. § 105-164.3(34a).

⁴ N.C. Gen. Stat. § 105-164.4(a)(16).

⁵ N.C. Gen. Stat. § 105-164.4(a)(11).

⁶ Subchapter VIII of Chapter 105 and Chapter 1096 of the 1967 Session Laws

⁷ N.C. Gen. Stat. § 105-164.3(37).

⁸ N.C. Gen. Stat. §§ 105-164.3(33), 105-164.6.

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property contractor for use by the real property contractor or to fulfill a real property contract. A “real property contractor,” as defined herein, is the consumer⁹ of the tangible personal property¹⁰, digital property,¹¹ or service that the real property contractor purchases, installs, or applies for others to fulfill a real property contract and that becomes part of real property. A retailer engaged in business in the State shall collect tax on the sales price of the tangible personal property, digital property, or service sold at retail to a real property contractor unless a statutory exemption applies or unless the purchaser operates as a retailer-contractor and issues a properly completed certificate of exemption or the required data elements pursuant to N.C. Gen. Stat. § 105-164.28 to purchase items from the same retailer for resale.

Where a real property contractor purchases tangible personal property or digital property for storage,¹² use,¹³ or consumption in this State, or a service sourced to this State, and the tax due is not paid at the time of purchase, the real property contractor is liable for use tax¹⁴ on the purchase price of tangible personal property, digital property, or service sourced to this State.

Definitions

“Real property”¹⁵ - Any one or more of the following: (a) land, (b) building or structure on land, (c) permanent fixture on land (d) a manufactured home or a modular home that is placed on a permanent foundation.

“Real property contract”¹⁶ - 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.”

“Real property contractor”¹⁷ - 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.

“Person”¹⁸ - An individual, a fiduciary, a firm, an association, a partnership, a limited liability company, a corporation, a unit of government, or another group acting as a unit. The term includes an officer or employee of a corporation, a member, a manager, or an employee of a limited liability company, and a member or employee of a partnership who, as officer, employee, member, or manager, is under a duty to perform an act in meeting the requirements of Subchapter I, V, or VIII of Chapter 105, of N.C. Gen. Stat. § 55-16-22, of Article 81 of Chapter 106 of the General Statutes, or of Article 3 of Chapter 119 of the General Statutes.

“General contractor”¹⁹ - Generally any person or firm or corporation who for a fixed price, commission, fee, or wage, undertakes to bid upon or to construct or who undertakes to superintend or manage, on his own behalf or for any person, firm, or corporation that is not licensed as a general contractor pursuant to Article 1 of Chapter 87 of the N.C. Gen. Stats., the construction of any building, highway, public utilities, grading or any improvement or structure where the cost of the undertaking is thirty thousand dollars (\$30,000.00) or more, or undertakes to erect a North Carolina labeled manufactured modular building meeting the North Carolina State

⁹ N.C. Gen. Stat. § 105-164.3(5).

¹⁰ N.C. Gen. Stat. § 105-164.3(46)

¹¹ N.C. Gen. Stat. §§ 105-164.3(1f), 105-164.3(1g), and 105-164.4(a)6b).

¹² N.C. Gen. Stat. § 105-164.3(44).

¹³ N.C. Gen. Stat. § 105-164.3(49).

¹⁴ N.C. Gen. Stat. § 105-164.6.

¹⁵ N.C. Gen. Stat. § 105-164.3(33d).

¹⁶ N.C. Gen. Stat. § 105-164.3(33e).

¹⁷ N.C. Gen. Stat. § 105-164.3(33f).

¹⁸ N.C. Gen. Stat. § 105-228.90(b)(5).

¹⁹ N.C. Gen. Stat. § 87.1

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Building Code, shall be deemed to be a "general contractor" engaged in the business of general contracting in the State of North Carolina.

Classifications of general contractor typically include:

- *Building contractor*, which shall include private, public, commercial, industrial and residential building of all types.
- *Residential contractor*, which shall include any general contractor constructing only residences which are required to conform to the residential building code adopted by the Building Code Council pursuant to N.C. Gen. Stat. § 143-138.
- *Highway contractor*.
- *Public utilities contractors*, which shall include those whose operations are the performance of construction work on the following subclassifications of facilities:
 - Water and sewer mains, water service lines, and house and building sewer lines as defined in the North Carolina Building Code, and water storage tanks, lift stations, pumping stations, and appurtenances to water storage tanks, lift stations, and pumping stations.
 - Water and wastewater treatment facilities and appurtenances thereto.
 - Electrical power transmission facilities, and primary and secondary distribution facilities ahead of the point of delivery of electric service to the customer.
 - Public communication distribution facilities.
 - Natural gas and other petroleum products distribution facilities; provided the General Contractors Licensing Board may issue license to a public utilities contractor limited to any of the above subclassifications for which the general contractor qualifies.
 - Specialty contractor, which shall include those whose operations as such are the performance of construction work requiring skill and involving the use of specialized building trades or crafts, but which shall not include any operations now or hereafter under the jurisdiction, for the issuance by license, by any board or commission pursuant to the laws of the State of North Carolina.

"Retailer"²⁰ - The term is defined, in part, as a person, other than a real property contractor.

"Retailer-contractor"²¹ – A person that acts as a retailer when it makes a sale at retail and as a real property contractor when it performs a real property contract.

"Capital improvement"²² - The term is defined as:

- An addition or alteration to real property that is new construction, reconstruction, or remodeling of a building, structure, or fixture²³ on land that becomes part of the real property.
- An addition or alteration to real property that is new construction, reconstruction, or remodeling of a building, structure, or fixture on land that is permanently installed²⁴ to the real property so that removal would cause material damage to the property or article itself. (*See the "Advanced Application of Capital Improvement" section for additional details on material damage.*)

²⁰ N.C. Gen. Stat. § 105-164.3(35).

²¹ N.C. Gen. Stat. § 105-164.3(35a).

²² N.C. Gen. Stat. § 105-164.4H(e)(1).

²³ A "fixture" in this context is an item of movable property so incorporated into real property that it may be regarded as legally a part of it. Merriam-Webster Dictionary.

²⁴ Directive SD-15-1.

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- An addition or alteration to real property that is new construction, reconstruction, or remodeling of a building, structure, or fixture on land that is permanently applied²⁵ to the real property so that removal would cause material damage to the property or article itself. (See the “Advanced Application of Capital Improvement” section for additional details on material damage.)
- An addition or an alteration to real property for or by a lessee or tenant, provided it is intended to become a permanent installation and title to it vests in the owner or lessor of the real property immediately upon installation. (See the “Advanced Application of Capital Improvement” section for additional details regarding an addition or an alteration to real property for or by a lessee or tenant.)
- The term includes, but is not limited to, all of the following:
 - Removal of items from real property, such as debris, construction materials, asbestos, or excavation activities, including the removal of items from a structure such as a dumpster. (See the “Advanced Application of Capital Improvement” section for additional information.)
 - Performance of work that requires the issuance of a permit under the State Building Code, other than repair or replacement of electrical components, gas logs, water heater, and similar individual items that are not part of new construction, reconstruction, or remodeling. (See the “Advanced Application of Capital Improvement” section for additional details on permits.)
 - Installation of underground utilities, notwithstanding that charges for such are included in the gross receipts derived from services subject to the combined general rate under N.C. Gen. Stat. § 105-164.4. (See the definition of “General Contractor” for more information regarding utility contractors and information as to what are considered utilities.)
 - Installation of equipment or fixture that is attached to real property so that removal of the item would cause **physical, functional, or economic damage** to the property and that is **capitalized** under one or more of the following: the Internal Revenue Code, Generally Accepted Accounting Principles, or International Financial Reporting Standards.
 - Painting or wallpapering.
 - Replacement or installation of a roofing, septic tank, plumbing, electrical, commercial refrigeration, irrigation, sprinkler, or other similar system.
 - Replacement or installation of a heating, ventilation, and air conditioning unit or system.
 - Replacement or installation of roads, driveways, parking lots, and sidewalks.
 - “**Landscaping service.**”²⁶
- The term does not include the following:
 - An addition or an alteration to real property for or by a lessee or tenant where title to the addition or alteration to real property does not vest in the owner or lessor of the real property immediately upon installation, no matter that the addition or alteration may be intended to become a part of real property.
 - The replacement of a fixture in or on a building or structure unless the replacement is part of a remodeling.
 - A single repair, maintenance, or installation service.

²⁵ Directive SD-15-1.

²⁶ N.C. Gen. Stat. § 105-164.3(16e) defines “landscaping service” as “[a] service to maintain or improve lawns, yards, or ornamental plants and trees. Examples include the installation of trees, shrubs, or flowers; tree trimming; lawn mowing; and the application of seed, mulch, pesticide, or fertilizer to a lawn or yard.”

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“**Apply**”²⁷ – To put or spread onto a surface.

“**Install**”²⁸ – To fix in position for use.

“**New Construction**”²⁹ – Construction of or site preparation for a permanent new building, structure, or fixture on land or an increase in the square footage of an existing building, structure, or fixture on land.

“**Replacement**”³⁰ – The action or process of replacing: the state of being replaced. One that replaces another especially a job or function.

“**Reconstruction**”³¹ – Rebuild or construct again a prior existing permanent building, structure, or fixture on land and may include a change in the square footage from the prior existing building, structure, or fixture on land.

“**Remodeling**”³² – The process of improving or updating a permanent building, structure, or fixture on land or major portions thereof. The term includes renovation. (*See the “Advanced Application of Capital Improvement” section for additional information regarding remodeling.*)

Advanced Application of Capital Improvement

The following guidance is to assist with the determination as to whether a transaction for real property, other than those expressly listed as included in the term “capital improvement,” should be taxed as a real property contract.

Tangible personal property becomes a part of real property:

- Generally, tangible personal property becomes a part of real property when it is attached in a fixed or immovable manner. In other words, generally tangible personal property becomes part of real property by being annexed to it, such as when a fence is built on land, **with exceptions noted for items that are installed or affixed to real property by a lessee or tenant and title to the installed or affixed item does not immediately vest in the owner or lessor of the real property.**

An addition or an alteration to real property for or by a lessee or tenant, provided it is intended to become a permanent installation and title to it vests in the owner or lessor of the real property immediately upon installation:

- Where title to an addition or alteration to real property for or by a lessee or tenant does not vest in the owner or lessor of the real property immediately upon installation, such is not a capital improvement. “As a general rule, whatever is attached to land is understood to be a part of the realty; but as this depends, to some extent, upon circumstances, the rights involved must always be subject to explanation by evidence. Whether a thing attached to land be a fixture or chattel personal depends upon the agreement of the parties, express or implied. A building, or other fixture which is ordinarily a part of the realty, is held to be personal property when placed on the land of another by contract or consent of the owner.” J. C. SPRINGS ET AL. v. THE ATLANTIC REFINING COMPANY 205 N.C. 444; 171 S.E. 635.

²⁷ Directive SD-15-1.

²⁸ Directive SD-15-1.

²⁹ N.C. Gen. Stat. § 105-164.4H(e)(2).

³⁰ Merriam-Webster

³¹ N.C. Gen. Stat. § 105-164.4H(e)(3).

³² N.C. Gen. Stat. § 105-164.4H(e)(4).

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- A written lease agreement that contains a provision that provides that upon installation of the addition, alteration, or improvement to real property, title to the installation immediately vests with the lessor or owner of the real property and the installed property is to remain with the premises after the termination of the lease.

Material Damage

The term “**material**”³³ is defined, in part, as “having real importance or great consequences.” The term “**damage**”³⁴ is defined in part as “loss or harm resulting from injury to person, property, or reputation.” In order to establish whether the removal of building, structure, or fixture on land that is permanently installed to the real property “would cause material damage to the property or article itself,” the loss or harm resulting from injury to the property must have real importance or great consequences to the property or article itself.

Example: A homeowner contracts with a tile and flooring company to install tile on the bathroom floor and in the shower. The tile and flooring company will remove the existing flooring and furnish, deliver, install, and seal new tile flooring. Additionally the company will remove the existing plastic shower liner and replace with floor-to-ceiling tile for a total project cost of \$10,000.00. The tiles would incur material damage should the homeowner choose to have them removed at some point after installation. This project is a real property contract with respect to a capital improvement where the contractor is liable for sales or use tax on the purchase price of tangible personal property used to fulfill the real property contract. The homeowner must issue Form E-589CI, Affidavit of Capital Improvement, to the tile and flooring company and the company should not charge sales tax on the project cost of \$10,000.00.

Permits

Permits are generally required under the State Building Code when structural changes are made that will affect load-bearing walls including work that will result in a new dwelling unit or will change the use or occupancy of a structure. As of the date of this publication, for residential construction, a building permit is needed for non-structural work that exceeds fifteen thousand dollars (\$15,000). Exclusions exist for certain minor activities in existing residential and commercial applications; therefore, permits are not required for such exclusions.³⁵

Exclusion of Permit Requirements under the State Building Code for Certain Minor Activities:

No permit shall be required for any construction, installation, repair, replacement or alteration performed in accordance with the current edition of the North Carolina State Building Code costing less than fifteen thousand dollars (\$15,000.00), **unless it involves any of the following:**

- The addition, repair or replacement of load bearing structures.
- The addition or change in the design of plumbing.
- The addition, replacement or change in design of heating, air conditioning, or electrical wiring, appliances or equipment.
- The use of materials not permitted by the North Carolina Residential Code.
- The addition (excluding replacement) of roofing.

Permit not required under the State Building Code for the following:

- Replacement of exterior siding
- Replacement doors or windows
- Replacement of pickets, railings, stair treads, decking of exterior porches or decks
- Replacement of plumbing fixtures in same location (no change to size or capacity)
- Replacement of water line (no change to size or capacity)

³³ Merriam-Webster Dictionary

³⁴ Merriam-Webster Dictionary

³⁵ Pursuant to S.L. 2016-113.

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- Replacement of sewer line (no change to size or capacity)
- Replacement of back flow (no change to size or capacity)
- Replacement of roofing
- If work is performed by a person licensed by the State Board of Examiners of Electrical Contractors and no electrical wires are added or relocated in residential or commercial buildings for:
 - Repair or replace dishwasher
 - Repair or replace disposal
 - Electrical devices
 - Lighting fixtures

Example: A homeowner hires a home improvement business to reface outdated kitchen cabinets. The project requires the home improvement business to replace the exterior cabinet doors, drawer fronts, and cabinet handles. The charge by the home improvement business to the homeowner is \$2,500.00. Based on the scope of work, permits are not required to be obtained by either the homeowner or the contractor. This transaction is not a capital improvement nor considered remodeling and is, therefore, not taxed as a real property contract. Rather, the transaction is subject to sales tax as repair, maintenance, and installation services and the contractor is liable for and should collect the general State, applicable local, and applicable transit rates of sales and use tax on the sales price of \$2,500.00.

Example: A homeowner hires a general contractor to convert an attic space into an additional living space. The conversion will involve the reconfiguration of the house's truss system, the installation of a dormer window, additional plumbing, electrical wiring, framing, and new insulation. The general contractor will secure the applicable permits required by the State Building Code and all work will be inspected by the appropriate local government inspections department. The transaction is a real property contract for new construction with respect to a capital improvement and subject to sales and use tax as a real property contract. The general contractor, as real property contractor, is liable for sales and use tax on the purchase price of all tangible personal property (building materials, etc.) to fulfill the real property contract. The general contractor must issue Form E-589CI, Affidavit of Capital Improvement, to any subcontractor that is hired to perform any portion of the real property contract, provided a "blanket" Affidavit of Capital Improvement is not already on file with the subcontractor issued from the general contractor. If a subcontractor is not hired to perform any portion of the conversion, no Form E-589CI is required to be issued or completed by the general contractor.

Remodeling

As provided in the definition of "capital improvement," the term "capital improvement" does not include a single repair, maintenance, and installation service. Therefore, a transaction that is a single repair, maintenance, and installation service is not remodeling and is not taxed as a real property contract, unless such service is expressly listed as a capital improvement by statute.

The following should assist with the determination as to whether a transaction is "remodeling" and therefore a "capital improvement" and taxed as a "real property contract." The list is not all-inclusive but is included to give general guidance.

- A transaction, comprised of multiple repair, maintenance and installation services to real property, that is not a mixed transaction, and that if separately performed are taxable, single repair, maintenance, and installation services, is likely "remodeling."

Example: A homeowner decides to update the homeowner's kitchen. The activities include the following: installation of new kitchen cabinets including cabinet boxes, tile

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flooring, interior walls painted, and a new sink. Upon completion, the appearance of the room is substantially different. The transaction is remodeling.

- A service where the internal structure of a single room is substantially changed and property is installed or applied and becomes part of real property.

Example: A property owner decides to hire another person to relocate the kitchen sink, range, refrigerator, and dishwasher within the same physical room. The service requires that electrical and plumbing systems be altered and, to some degree, relocated to other areas of the room. Therefore, applicable permits are required. The transaction is a real property contract with respect to a capital improvement.

Mixed Transaction Contracts

A “mixed transaction contract”³⁶ is a contract that includes both a capital improvement to real property and a repair, maintenance, and installation service. A mixed transaction is taxable as follows:

- If the price of the taxable repair, maintenance, and installation service included in the contract does not exceed ten percent (10%) of the contract price, then the repair, maintenance, and installation service portion of the contract, and the tangible personal property, digital property, or service used to perform that service, are taxable as a real property contract.

Example: A drywall contractor is hired by a homeowner. The homeowner is in the process of a complete bathroom renovation and has hired the drywall contractor to hang and finish the drywall in the bathroom. The homeowner also wants the drywall contractor to repair a small hole in the wall in a separate part of the house. The homeowner issues Form E-589CI, Affidavit of Capital Improvement, to the contractor for the bathroom as it is part of a remodel with respect to a capital improvement to real property. The drywall contractor quotes the entire job at \$1,500.00 which includes \$1,450.00 for the bathroom and \$50.00 to repair the hole in the wall. The taxable repair, maintenance, and installation service is \$50.00 which comes to 3.33% of the contract ($50 / 1,500 = 0.0333$ or 3.33%). Since the taxable repair, maintenance, and installation service does not exceed ten percent (10%) of the contract price, the repair, maintenance, and installation service is treated as part of the real property contract and no tax is charged to the homeowner, but rather sales and use tax is due on the purchase price of any tangible personal property used to repair the hole in addition to the purchase price of drywall, mud, and accessories used by the drywall contractor to hang and finish the drywall in the bathroom.

- If the price of the taxable repair, maintenance, and installation service included in the contract is greater than or equal to ten percent (10%) of the contract price, then sales and use tax applies to the taxable repair, maintenance, and installation service portion of the contract. The person must determine an allocated price for each taxable repair, maintenance, and installation service in the contract based on a reasonable allocation of revenue that is supported by the person's business records kept in the ordinary course of business. Any purchase of tangible personal property, digital property, or services to fulfill the real property contract are taxed in accordance with N.C. Gen. Stat. § 105-164.4H.

³⁶ N.C. Gen. Stat. § 105-164.4H(d).

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Repair, maintenance, and installation service that is a portion of a capital improvement and supported by Form E-589CI, Affidavit of Capital Improvement, is not taxable repair, maintenance, and installation service and is not included in the numerator for determining whether the taxable repair, maintenance, and installation service exceeds the ten percent (10%) rule.

Retailer-Contractor

A “retailer-contractor” is a person that acts as a retailer when it makes a sale at retail and as a real property contractor when it performs a real property contract. A retailer-contractor that purchases tangible personal property or digital property to be installed or applied to real property or a service to fulfill the contract may purchase those items exempt from tax using [Form E-595E, Certificate of Exemption](#), **provided the retailer-contractor also purchases inventory items or services from the seller for resale**. When the tangible personal property is withdrawn from inventory and installed or applied to real property, or when the service is deemed used, use tax must be accrued and paid on the retailer-contractor's purchase price of the tangible personal property or service.

Example: A business fabricates, sells, installs, repairs, and maintains metal hand railings for existing residential staircases and for new construction of homes. The business is a retailer-contractor. The business maintains an inventory of metal, brackets, and handrail accessories for resale. Therefore, the business may purchase such items exempt from sales and use tax from a seller.

- *Where the business is hired by a general contractor to fabricate and install a handrail as part of a new home construction, provided the business obtains and retains Form E-589CI, Affidavit of Capital Improvement, the business is liable for accruing and remitting the use tax on the purchase price of the tangible personal property withdrawn from inventory or purchased without payment of sales and use tax and used to fabricate and install the handrail for the residential staircase. The business should accrue and remit use tax on the purchase price of the tangible personal property used to fulfill the real property contract. The business would not charge sales tax on the amount charged to the real property owner. If Form E-589CI is not obtained, the business is liable for and should collect sales tax on the sales price of the installed handrail and should exempt any amount for installation separately stated on the invoice or documentation given to the purchaser at the time of the sale.*
- *Where the business is hired to repair a handrail attached to real property that is missing brackets and falling off the wall, the business is liable for and should charge sales tax on the total charge for the repair, maintenance, and installation service. Brackets or other items withdrawn from inventory or purchased and used as part of the repair, maintenance, and installation service and transferred to the customer's property, are not subject to sales and use tax on the purchase price, as the items are transferred and included as part of the gross receipts derived from the repair of the handrail subject to sales tax.*
- *Where the business fabricates and sells a handrail to an installer, the business is liable for and should charge sales tax on the sales price of the fabricated handrail sold at retail to the installer.*

Retailer-Contractor Inventory Methodology

A retailer-contractor that acts as a real property contractor when it performs real property contracts may determine and report its use tax liability due on the purchase price of tangible personal property it withdraws from inventory and uses to fulfill a real property contract based on

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GAAP inventory method used to value the tangible personal property where the exact purchase price is unknown or cannot be determined by the retailer-contractor. The retailer-contractor must maintain records to substantiate the proper amount of use tax due on the purchase price of any items withdrawn from inventory and used to fulfill a real property contract.

Installation Charges Exempt from Sales and Use Tax – Real Property Contracts

The following charges are exempt from sales and use tax.

- Installation charges that are a part of the sales price of tangible personal property purchased by a real property contractor to fulfill a real property contract for an item that is installed or applied to real property, provided the installation charges are separately stated and identified as such on the invoice or other documentation given to the real property contractor at the time of the sale.
- Installation charges that are a part of the sales price of or gross receipts derived from a repair, maintenance, and installation services or installation services only purchased by a real property contractor to fulfill a real property contract, provided the installation charges are separately stated and identified as such on the invoice or other documentation given to the real property contractor at the time of the sale. The exemption also applies to installation charges by a retailer-contractor when performing a real property contract. Any labor costs provided by the real property contractor, including employees' wages, or labor purchased from a third party that would otherwise be included in the definition of purchase price are exempt from sales and use tax.

The language regarding separately stated installation charges is not a requirement for an invoice or billing document issued for a real property contract by a real property contractor for a transaction properly taxed in accordance with N.C. Gen. Stat. § 105-164.4H. Rather, the language was enacted so that if a person pays sales and use tax on the purchase price of tangible personal property, digital property, or a service to fulfill a real property contract, but treats the transaction as a retail sale in error, any separately stated installation charges on the invoice or other documentation given to the purchaser at the time of the sale is not subject to sales and use tax. Moreover, with the correct application of the sales and use tax laws, there should be no charge for sales tax on the amount charged for a real property contract.

Real Property Contracts with a Qualifying or Conditional Farmer

Certain qualifying items may be purchased by a contractor without payment of sales or use tax to fulfill a contract with a person who holds a qualifying farmer or conditional farmer exemption certificate. Qualifying items include:³⁷

- A grain, feed, or soybean storage facility and parts and accessories attached to the facility.
- A commercially manufactured facility to be used for commercial purposes for housing, raising, or feeding animals or for housing equipment necessary for these commercial activities. The exemption also applies to commercially manufactured equipment, and parts and accessories for the equipment, used in the facility.
- Building materials, supplies, fixtures, and equipment that become a part of and are used in the construction, repair, or improvement of an enclosure or a structure specifically designed, constructed, and used for housing, raising, or feeding animals or for housing equipment necessary for one of these commercial activities. The exemption also applies to commercially manufactured equipment, and parts and accessories for the equipment, used in the enclosure or a structure.

³⁷ N.C. Gen. Stat. § 105-164.13E(a)(5), (8), or (9)

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- A bulk tobacco barn or rack, parts and accessories attached to the tobacco barn or rack, and any similar apparatus, part, or accessory used to cure or dry tobacco or another crop.

For more detailed information see the [Important Notice: Certain Purchases by a Contractor to Fulfill a Contract with a Qualifying or Conditional Farmer \(Revisited\)](#) issued by the Department May 28, 2015.

Affidavit of Capital Improvement

Form E-589CI, Affidavit of Capital Improvement, is generally required to substantiate that a contract, or a portion of, work completed for a contract, is subject to tax as a real property contract with respect to a capital improvement to real property. Failure of a person to keep records that establish that a transaction is, or is a portion of a real property contract with respect to a capital improvement, subjects the person to liability for tax on the transaction.³⁸ Failure of a person to issue Form E-589CI, Affidavit of Capital Improvement, as discussed herein, to substantiate that a transaction is for a real property contract with respect to a capital improvement, subjects the transaction to tax as a retail sale of or the gross receipts derived from repair, maintenance, and installation services for real property in accordance with N.C. Gen. Stat. § 105-164.4(a)(16).

- Form E-589CI, Affidavit of Capital Improvement, is not an affidavit of tax paid on building materials.
- Form E-589CI, Affidavit of Capital Improvement, may not be used to purchase building materials exempt from tax.
- The person that issues the affidavit is liable for tax on the transaction if it is determined that it is not a capital improvement to real property.

Exceptions to the Requirement to issue Form E-589CI, Affidavit of Capital Improvement:

The following are exceptions where Form E-589CI, Affidavit of Capital Improvement is not required to be issued between the persons noted below to substantiate that a contract is a real property contract with respect to a capital improvement. Rather, the general contractor, as discussed below, must keep records that establish that a transaction is a real property contract with respect to a capital improvement. The exceptions are noted below and do not apply to remodeling:

- 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 construct again a prior existing permanent building, structure, or fixture on land.

“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

³⁸ N.C. Gen. Stat. § 105-164.22

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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 the 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.

Example: With the same facts as discussed in the prior example, however, the builder utilizes a cabinet installer and floor installer to perform work that in some transactions, other than new construction, are taxed as repair, maintenance, and installation services for real property and sales tax is charged to the builder on the gross receipts from such. Therefore, the builder may not issue Section II of Form E-589CI for purposes of the cabinet and flooring installations to the retailer-contractors of the cabinets and flooring. Rather, the builder must complete “Section I - Single Use” of Form E-589CI. In the situation where the cabinet installer and flooring installer are retailer-contractors where both make retail sales in addition to entering into real property contracts, the Form E-589CI issued by the builder will clarify the tax treatment of the transactions involved in the construction of the new house.

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Example A builder hires a hardwood floor business to furnish, deliver, install, sand, and finish hardwood flooring in a new home under construction. The installation of the hardwood flooring in new home construction by a subcontractor is part of a real property contract with respect to a capital improvement. The builder must issue Form E-589CI, Affidavit of Capital Improvement, to the hardwood floor business to give notice that the transaction qualifies for treatment as a real property contract and should be taxed accordingly for sales and use tax purposes. Provided the hardwood floor business obtains a completed Form E-589CI for the transaction, the hardwood floor business is the consumer of the items used to complete the hardwood flooring installation and owes sales or use tax on the purchase price of such items used to fulfill the real property contract. The hardwood floor business should not charge sales tax to the builder on the contract price of the hardwood flooring installation where the hardwood floor business obtains Form E-589CI from the builder.

Erroneous Collection of Tax if Separately Stated

An invoice or other documentation issued to a person by a real property contractor shall not separately state any amount for tax for a real property contract. Any amount for tax separately stated on an invoice or other documentation given to a person by a real property contractor is an erroneous collection and must be remitted to the Secretary.³⁹ Additionally, the following provisions⁴⁰ may apply:

- (1) If the Secretary determines that the seller overcollected tax on a transaction, the Secretary may allow a refund of the tax. The Secretary may allow the refund only if the seller gives the purchaser credit for or a refund of the overcollected tax. The Secretary shall not refund the overcollected tax to the seller if the seller has elected to offset a use tax liability on a related transaction with the overcollected sales tax under subdivision (2) of this subsection.
- (2) If the Secretary determines that a seller who overcollected sales tax on a transaction is instead liable for a use tax on a related transaction, the Secretary may allow the seller to offset the use tax liability with the overcollected sales tax. The Secretary shall not allow an offset if the seller has elected to receive a refund of the overcollected tax under subdivision (1) of this subsection. The decision by a seller to receive an offset of tax liability rather than a refund of the overcollected tax does not affect the liability of the seller to the purchaser for the overcollected tax.
- (3) If neither subdivision (1) nor (2) of this subsection applies, the Secretary shall retain the total amount collected on the transaction.

Joint and Severally Liability for Tax

If a retailer-contractor subcontracts any part of the real property contract, tax is payable by the subcontractor on the subcontractor's purchase of the tangible personal property or digital property that is installed or applied to real property or a service used to fulfill the contract. The retailer-contractor, the subcontractor, the owner of the real property, and the lessee of the real property, are jointly and severally liable for the use tax. The liability of a retailer-contractor, a subcontractor, an owner, or lessee who did not purchase the property or service is satisfied by receipt of an affidavit from the purchaser certifying that the tax has been paid.

Use tax is payable by the person who purchases, leases, or rents tangible personal property or digital property or who purchases a service. If the property purchased becomes a part of a building or structure in the State and the purchaser is a contractor or subcontractor, the contractor, the subcontractor and the owner of the building are jointly and severally liable for the tax. The liability of a contractor, a subcontractor, or an owner who did not purchase the property is satisfied

³⁹ N.C. Gen. Stat. § 105-164.4H(c).

⁴⁰ N.C. Gen. Stat. § 105-164.11(a).

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by receipt of an affidavit from the purchaser certifying that the tax has been paid. Form E-589CI, Affidavit of Capital Improvement, is not an affidavit of tax paid on tangible personal property. A separate affidavit must be received from the purchaser of the property.

Sourcing

Tangible personal property and digital property (“Building Materials,” used for purposes of this section) used to fulfill a real property contract with respect to a capital improvement are sourced in accordance with the sourcing principles set forth in [N.C. Gen. Stat. § 105-164.4B](#). Building Materials are generally sourced to the location where the purchaser can potentially make first use of the property.

Real Property Contractor Sourcing Examples:

- *A real property contractor purchases Building Materials from a seller outside this State who is not required to register and collect North Carolina sales and use tax. The Building Materials are shipped via common carrier to the real property contractor’s business location in Buncombe County for use by the real property contractor to fulfill a real property contract in Caldwell County. The real property contractor must remit the use tax at the Buncombe County tax rate for the filing period during which the Building Materials are received by the real property contractor. If the Caldwell County local sales and use tax rate is greater than the Buncombe County local sales and use tax rate, the real property contractor is allowed a credit for the Buncombe County local sales and use tax originally paid and the real property contractor is liable for reporting and payment of any additional Caldwell County local sales and use tax to the Department.*
- *A real property contractor enters into a real property contract to install a roofing system in Mecklenburg County and purchases the roofing system component parts, supplies, and accessories that will be used to fulfill the contract in Gaston County. The real property contractor pays the general 4.75% State and 2.00% Gaston County rates of sales and use tax at the time of purchase for the roofing system component parts, supplies, and accessories. Since the real property contract will be performed in Mecklenburg County, the real property contractor is also liable for use tax at the 0.50% rate for the Mecklenburg County transit tax on the purchase price of the roofing system component parts, supplies, and accessories. The additional 0.50% Mecklenburg County transit tax must be reported and remitted to the Department for the period in which the roofing system component parts, supplies, and accessories were installed in Mecklenburg County.*
- *A real property contractor enters into a real property contract to install a central air conditioning unit in Lee County. The real property contractor purchased the air conditioning unit in Wake County and paid the general 4.75% State and 2.00% Wake County rates of sales and use tax. The real property contractor will use the air conditioning unit to fulfill the real property contract in Lee County where the current county tax rate is 2.25%. The real property contractor is liable for the additional 0.25% rate of county tax for Lee County on the purchase price of the air conditioning unit. The additional 0.25% Lee County tax must be reported and remitted for the period in which the air conditioning unit is installed and becomes part of real property.*

Retailer-Contractor Sourcing Examples:

- *A retailer-contractor withdraws materials from inventory held for sale at its Pitt County location on April 10, 2017 and uses the materials to fulfill a real property contract in Craven County that was entered into on March 27, 2017. Since the retailer-contractor knows at the time of withdrawal from inventory the location where the materials will become part of real property, the retailer-contractor is liable for the applicable use tax on the purchase price of the materials*

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for Craven County (location of the real property) at the 2.00% rate of tax, as opposed to the 2.25% rate of tax for Pitt County.

- *A retailer-contractor in Ashe County makes an over-the-counter retail sale of gas logs. The sale by the retailer-contractor is sourced to Ashe County as the purchaser takes possession of the gas logs in Ashe County.*
- *A retailer-contractor in Pamlico County makes a retail sale of a refrigerator which is delivered to the purchaser in Carteret County. The sale of the refrigerator is sourced to Carteret County, the location where the purchaser receives the refrigerator from the retailer-contractor.*

Registration & Reporting

A retailer, retailer-contractor, real property contractor, or other person who is not registered with the Department and is required to collect and/or remit State and applicable local and transit sales and use tax, must complete Form NC-BR, Business Registration Application for Income Tax Withholding, Sales and Use Tax, and Machinery and Equipment Tax. Both an [online business registration portal](#) and a [web-fill version](#) of Form NC-BR are available on the Department's website, www.dornc.com. There is no fee required to register and obtain a certificate of registration.

Additionally, any retailer, retailer-contractor, real property contractor, or other person that must remit sales or use tax for more than one county for a filing period, must complete Form E-536, Schedule of County Sales and Use Taxes, and submit it along with Form E-500, Sales and Use Tax Return, or enter the applicable amounts by county during the online filing process. Form E-536 or the amounts entered during the online filing process must reflect the amount of local and transit tax due for each county by a retailer, retailer-contractor, real property contractor, or other person.

Additional Information and Assistance

Information regarding real property contracts can be found on the Department's real property contractor overview web page, <http://www.dornc.com/taxes/sales/realpropertycontractors.html>. General questions regarding this directive should be directed to the Taxpayer Assistance and Collection Center at telephone number 1-877-252-3052 (toll-free).

To the extent that there is any change in the rate or amount of tax, change to a statute or regulation, or new case law subsequent to this directive, the provisions in this directive may be superseded or voided. To the extent that any provisions in any other notice, directive, technical bulletin, or published guidance issued prior to the date of this directive conflicts with this directive, the provisions contained in this directive supersede.