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## Chapter 1

# Introduction

A contractor, by definition, is any person who performs work outlined in the New Construction section that follows. Contractors are difficult entities to audit because of the diversity of work they perform and varying types of contracts. This manual is a guide through the complex world of contractors, and repairmen, and real property services.

### Real Property vs. Tangible Personal Property

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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. Auditors attempt to divine intent by reviewing the contract, authorization for expenditure, corporate annual report and a variety of available documentation.

**Disclaimer:** This manual has been written for the purposes of a training tool and as a reference guide for the auditor. Any references to taxability, administrative policies, laws, and rules are subject to change due to administrative hearings and actions of the courts or legislature. While the content of the manual is current as of the revision date, the reader is responsible for any changes occurring after this date and should verify the current status of any information by contacting the Comptroller of Public Accounts toll free at 800-252-5555.

## Chapter 2

# New Construction

New construction under Rule 3.291 includes:

- construction of an improvement to residential or nonresidential realty;
- first or initial finish-out work to the interior or exterior of an improvement to realty;
- addition of new usable square footage to an existing building;
- hardscaping;
- total demolition of an improvement to realty and creating a new improvement to realty;
- increased capacity in a production unit in a petrochemical refinery or chemical plant;
- improvements to real property as part of periodic and scheduled maintenance of nonresidential real property; or
- repairing, remodeling and restoring residential property.

New construction labor is not taxable. The tax responsibility for paying tax on materials, consumables and services are discussed in the “Tax Responsibilities” sections of this manual.

### Construction of an Improvement to Realty

Construction of an improvement to residential or nonresidential realty where one did not exist is considered new construction. This includes everything from erecting a building to dredging a channel in an unimproved body of water. Once the improvement to realty is completed, changes to the form will be covered under Comptroller’s Rule 3.357, unless it qualifies as new construction under one of the criteria in the “New Construction” section.

### First Finish-out or Initial Finish-out

Completing the interior or exterior of an unfinished improvement to realty so that it complies with the owner’s or lessor’s requirements is initial finish-out. An example would be a multiple story building that has only had its first floor finished and occupied. The initial finish-out of each additional floor prior to occupancy will be deemed new construction. Finish-out work performed after initial finish-out has been done is considered remodeling even though the improvement has not been occupied. An example would be if the initial

finish-out of the first floor of a multiple story building has been completed, but no one has occupied that floor, any additional finish work would still be considered remodeling. The improvement will also be considered finished out if it is put to an alternate use. For example, an unfinished room in an office building that has been used for record storage instead of office space will be considered finished.

### Addition of New Usable Square Footage

New construction includes the addition of new footage to an existing structure. Modifying parts of existing structures for the sole purpose of supporting the addition of new space will not change a new construction contract into a remodeling contract as long as the charges attributable to remodeling are 5 percent or less of the overall charge. Contracts with remodeling charges exceeding 5 percent will be taxable in total unless the charges for remodeling are separately identified to the customer. In cases where the charge for the remodeling service is not separately stated, either the service provider or the purchaser may establish, through documentary evidence, the taxable percentage of the total contract price.

New construction based on additional footage includes but is not limited to:

- Expanding an existing one-story building from 2,000 square feet to 3,000 square feet;
- Adding floors to an existing building;
- Adding a pitched roof to a flat roof creating attic storage space;
- Installing a new story (floor) to a building without raising the roof;
- Adding additional length or width to an existing street or parking lot;
- Demolishing the foundation of a one-story building and adding a basement below ground level; and
- Adding an exterior elevator to an existing building.

Examples of additional footage jobs that do not qualify as new construction include:

- Modifying an existing nonresidential improvement to realty in conjunction with new construction when the

remodeling exceeds 5 percent of the contract charge and the contract or other controlling document does not separate charges for new construction and remodeling;

- Adding fascia or false walls around an existing nonresidential improvement to realty for appearance when no usable space is created;
- Raising the ceiling of a room or the roof of a building that does not create new usable square footage;
- Adding another layer of asphalt to a street or parking lot; or
- Paving a street or parking lot after removing asphalt but not base materials.

## Hardscaping

Hardscaping qualifies as a permanent improvement to real property. An entity performing either the first installation of hardscaping or the repair, remodeling or restoration of residential hardscaping is a contractor.

Hardscaping work is frequently performed in conjunction with landscaping and includes, but is not limited to, these improvements:

- sprinkler systems
- retaining walls
- rock work
- ponds
- pools
- fences
- drainage ditches
- dams
- lighting permanently attached to a customer's property

Hardscaping does not include activities classified as landscaping; e.g., garden planting or maintenance, arborist services, ornamental bush or shrub planting, tree planting or removal, tree surgery, pruning or spraying and lawn sodding. See Rule 3.356 for additional information on landscaping services.

## Demolition of an Improvement to Realty and Rebuilding

Demolition of an improvement to real property is not taxable. For example, if an improvement to realty, such as a building, parking lot or sidewalk, is totally demolished and another improvement to realty is built on the same site, the demolition and rebuilding is treated as new construction labor. In this case, "demolished" means razed to the slab for a building and reduced to virgin earth for the parking

lot or sidewalk. Partial demolition of a nonresidential improvement to real property is taxed as remodeling.

## Scheduled Maintenance of Nonresidential Real Property

A charge for labor to maintain real property is not taxable. To qualify for the exemption, 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.

The best way to illustrate the difference between a repair service and a maintenance service is through an example:

Mr. Smith purchased a nonresidential building with a working air conditioning unit two months ago. He did not have time to determine the maintenance needs for the building. On May 25, 1999, the air conditioning unit began to make squealing noises while operating. Mr. Smith called a repairman and scheduled a visit for May 27th. The repairman lubricated the compressor for a lump sum and got the unit operating quietly. This is a taxable repair service. Mr. Smith now realizes that periodic, scheduled maintenance is required to keep the air conditioning unit running smoothly. He asks the repairman how often the unit needs lubrication and is told every six months or 3,000 hours of operation, whichever comes first. Mr. Smith schedules in his building maintenance records a lubrication of the air conditioning unit every six months or 3,000 hours of operation. The subsequent lump-sum lubrication services performed to comply with a set maintenance schedule qualifies as maintenance. Therefore, the labor would be nontaxable, but the service provider is liable for tax on all materials used.

If the person performing the service does not have a written contract but is only hired as needed, the service provider must presume that the labor is for repair or restoration and collect tax. If the service provider's customer has documentation to prove that the labor qualifies as maintenance, the customer may issue an exemption certificate in lieu of paying tax to the service provider. The certificate must state that the labor is for the purpose of maintenance rather than repair or restoration and that the customer will be liable for any additional tax due in the event that it is determined that repairs rather than maintenance were performed.

## Chapter 3

# Tax Responsibilities: Taxable Customers

The type of contract – lump-sum or separated – determines the contractor’s tax responsibility for purchases of materials and for mark-ups related to materials. New construction labor is not taxable. See the contractor taxability flowcharts for taxable and exempt customers in the Appendix.

### Lump-sum Contract

A lump-sum contract is one in which the agreed contract price is one lump-sum amount and in which the charges for incorporated materials are not separate from the charges for skill and labor. Separated invoices issued to the customer will not change a lump-sum contract into a separated contract unless the terms of the contract require separate invoices.

Under a lump-sum contract, the contractor is considered the ultimate consumer. The contractor owes tax on the purchases of incorporated materials, equipment, consumable items and taxable services. However, as of Oct. 1, 1995, a developer or general contractor may purchase real property services incorporated into residential new construction tax free. The contractor must issue the real property service provider an exemption certificate or letter claiming the exemption.

The contractor does not collect tax from the customer on the sale. If the contractor collects tax in error, the tax must be remitted to the state. Tax collected from a customer on a lump-sum contract project cannot be applied as a credit to offset a contractor’s audit assessment because the tax was collected from the wrong party. The customer may legitimately claim a refund of tax paid. The state will refund to the contractor the tax collected in error once the contractor issues either a refund to the customer or, if the customer accepts, a credit memorandum for the tax amount.

Contractors performing lump-sum contracts for entities holding direct payment permits may not accept a direct payment exemption certificate from those entities. When performing a lump-sum contract for a direct payment permit-holder, a contractor must pay sales tax to the supplier or accrue and remit sales tax on incorporated materials or materials removed from a tax-free inventory for incorporation into the direct payment permit-holder’s realty. Direct payment permit-holders may not authorize

contractors or any other person to purchase any taxable item using their permits.

### Lump-sum Contract Examples

#### Example 1

Labor and materials	\$ 1,750,000
Total	<u>\$ 1,750,000</u>

#### Example 2

Foundation	\$ 15,000
Metal work	30,000
Plumbing	10,000
Electrical	20,000
General	<u>300,000</u>
Total	<u>\$ 375,000</u>

### Separated Contract

A separated contract is one in which the agreed contract price is divided into a separately stated agreed contract price for incorporated materials and a separately stated agreed contract price for skill and labor. If prices of incorporated materials and labor are separately stated, the fact that the charges are added together and a sum total given are irrelevant.

Under a 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.

The contractor may maintain a tax-free inventory of items held for resale. Items purchased exclusively for resale may be purchased tax free by issuing a resale certificate to suppliers in lieu of taxes. A contractor must hold a sales tax permit to issue a resale certificate.

The contractor owes tax on the purchases of equipment, accessories, most consumable items (see “Consumables” section for exception) and taxable services. As of Oct. 1, 1995, a developer or general contractor may purchase real property services incorporated into residential new construction tax free.



A contractor who performs separated contracts for a direct payment permit-holder may accept a direct payment certificate in lieu of taxes for the incorporated materials.

**Separated Contract Examples**

**Example 1**

Materials	\$15,000.00	customer owes tax on this amount
Labor	17,500.00	
Tax	<u>1,237.50</u>	[\$15,000 X tax rate (8.25%)]
	<u>\$33,737.50</u>	

**Example 2**

Materials	\$10,000.00	customer owes tax on this amount
Labor	20,000.00	
Equipment	2,000.00	
Consumables	620.00	
Permit fees	250.00	
Tax	<u>825.00</u>	[\$10,000 X tax rate (8.25%)]
	<u>\$33,695.00</u>	

**Cost-Plus Contract**

A cost-plus-a-fee contract is generally regarded as a separated contract. The taxability of the profit and overhead depends on the billing procedures. If the bill states material charges or costs without tying a profit or additional percentage charge to them, then tax is due only on the stated material charges or costs, but if the bill in any way indicates a profit or mark-up related to materials then tax is due on the combined total of those figures.

**Cost-plus Contract Examples**

**Example 1**

Materials	\$15,000.00	customer owes tax on this amount
Labor	17,500.00	
Mark-up	3,200.00	
Tax	<u>1,237.50</u>	[\$15,000 X tax rate (8.25%)]
	<u>\$36,937.50</u>	

**Example 2**

Materials	\$10,000.00	customer owes tax on this amount
Labor	20,000.00	
Mark-up on materials	1,000.00	customer owes tax on this amount
Mark-up on labor	2,000.00	
Equipment	2,000.00	
Consumables	620.00	
Permit fees	250.00	
Tax	<u>907.50</u>	[\$11,000 X tax rate (8.25%)]
	<u>\$36,777.50</u>	

**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. As with any separated contract, the tax rate is applied to the price of the materials as agreed in the contract or the price of the materials to the contractor, whichever is greater.

**Controlling Documents**

There is an established hierarchy used to determine tax responsibilities: contract, bid, invoice. The controlling document takes precedence over other documents that may be provided unless these documents are required by the controlling document. For example, separate invoices issued to a customer will not change a lump-sum contract into a separated contract unless the terms of the contract require separate invoices.

For tax purposes, the terms of a contract control over the terms of a bid. For example, when the bid is lump sum but the written contract is separated, the contract determines the tax responsibilities of both the contractor and the customer. The terms of a contract also control change orders.

If there is no written contract, a written bid becomes the controlling document. A bid is an offer to perform work for a specified amount of consideration. Awarding the work to a specific bidder constitutes an acceptance and becomes a contract.

If neither a written contract nor a written bid exists, the written invoice determines tax responsibilities. The invoice itself is not a contract because it is not generated until work is performed; therefore, it cannot be viewed as either an offer or an acceptance but simply a billing for the work.

**Examples**

**Situation 1**

Company asks Builder to bid on a project to build an office complex. Builder issues a separated bid for the job. Company and Builder sign a lump-sum contract. Builder issues monthly invoices with separately stated material and labor amounts.

The lump-sum contract will determine tax responsibility. Builder owes tax on all taxable purchases and cannot issue a resale certificate. Builder will not collect tax from Company.

**Situation 2**

Company asks Builder to bid on a project to build an office complex. Builder issues a separated bid for the job. Company accepts the bid and awards the job to Builder. Builder issues monthly lump-sum invoices to Company.

Since there is no contract, the accepted bid determines tax responsibilities. Builder owes tax on the purchases of equipment, most consumable items and taxable services but may issue a resale certificate for materials incorporated into the realty. Company owes tax on the agreed contract price of materials incorporated into the realty and must obtain a tax-paid receipt from the builder.

**Situation 3**

Company asks Builder to bid on a project to build an office complex. Builder issues a separated bid for the job. Company and Builder sign a lump-sum contract stating that the invoices become a part of the contract. Builder issues monthly invoices with separately stated material and labor amounts.

When a lump-sum contract includes documents that separate the prices of the materials incorporated and the skill or labor, the lump-sum contract becomes a separated contract. Builder owes tax on the purchases of equipment, most consumable items and taxable services but may issue a resale certificate for materials incorporated into the realty. Company owes tax on the agreed contract price of materials incorporated into the realty and must obtain a tax-paid receipt from the builder.

**Contracting Taxability**

The State of Texas clearly outlines the tax responsibilities under lump-sum and separated contracts. However, sometimes the contract language shifts the tax responsibility from one entity to another. For example, a lump-sum contract specifies that the customer will be responsible for paying all Texas sales and use taxes. While such contractual agreements may be binding between the parties, the parameters of the state's authority to impose and collect sales and use taxes are defined by applicable Tax Code provisions – namely, chapters 111, 113 and 151 – and not by agreements between private parties. Although the client may reimburse the contractor for sales and use taxes paid, the state does not recognize the client's obligation to pay sales and use tax under a lump-sum contract.

**Amending Contracts**

A contract can be renegotiated and amended as long as the project is incomplete. The amended contract is the controlling document and determines tax responsibilities.

**Change Orders**

Change orders take on the same character as the original contract, regardless of the form of the change order. If the contract is lump sum, then the change orders will be treated as lump sum even if the change orders show charges for incorporated materials separate from other charges. If the contract is separate and change orders are for lump-sum amounts, then the lump-sum amounts will be treated as charges for incorporated materials unless the contractor can reasonably demonstrate the portion attributable to labor.

**Tax-included Language**

Comptroller's decisions have stressed that, unless the taxpayer produces a written controlling document with sales tax-included language; the presumption is that sales tax is not included in the sales price. Contracts, bills or invoices stating that "all taxes" are included are not specific enough to relieve either party to the transaction of sales and use tax responsibilities. The wording on the controlling document should state, "sales and use tax included." Without this phrase, the total amount shown on the document is presumed to be the taxable item's sales price excluding tax. The seller or customer may overcome the presumption by using the seller's records to show that tax was included in the sales price. Out-of-state sellers must identify the tax as Texas sales or use tax.

## Chapter 4

# 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 percent 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.

However, if the charge for the taxable portion of the services is not separately stated at the time of the transaction, the service provider or the purchaser may later establish for the comptroller, through documentary evidence, the percentage of the total charge that relates to nontaxable unrelated services.

Examples of acceptable documentation include written contracts detailing the scope of work, bid sheets, tally sheets, schedules of values and blueprints.

## Chapter 5

# Tax Responsibilities: Exempt Customers

There are tax exemptions for governmental and specific exempt entities. The qualifying exempt entities are detailed in sections 151.309 (Governmental Entities) and 151.310 (Religious, Educational and Public Service Organizations) of the state Tax Code. See the “Statutes” section of this manual for the applicable tax code and the contractor taxability flowchart for exempt customers in the Appendix.

A contractor performing a job for an exempt entity should obtain a properly completed exemption certificate to substantiate the exemption. If the validity of the exemption is not clear, a contractor cannot accept the exemption certificate in good faith and should request additional evidence of the exempt status of the organization. A sales tax letter of exemption from the comptroller addressed to an organization is evidence of its exempt status and will relieve a contractor from further inquiry. A sale is exempt if the exemption certificate is accepted in good faith at the time of the transaction and the seller lacks actual knowledge that the claimed exemption is invalid.

Governmental entities are not required to prove their exempt status. A contract with a governmental entity is sufficient to invoke the exemption.

If the exemption certificate is not accepted in good faith **at the time the contract was entered into**, and the customer is subsequently determined to be taxable, the contractor will be liable for all taxes, penalties and interest accruing on purchases for which the contractor has issued exemption certificates to its vendors.

When the contractor accepts an exemption certificate in good faith from qualifying exempt entities, the contractor can issue an exemption certificate for items used in the performance of a contract for an improvement to realty, qualifying consumables and qualifying taxable services. A consumable item will be exempt if it is:

- necessary and essential for the performance of the contract; and
- completely consumed at the job site.

Tangible personal property (TPP) is completely consumed if, after being used once for its intended purpose, it is used up or destroyed. Tangible personal property that is rented or leased for use in the performance of the contract cannot be completely consumed for purposes of this section.

A contractor may issue an exemption certificate for an otherwise taxable service if the service is performed at the job site and:

- the contract expressly requires the specific service to be provided or purchased by the person performing the contract; or
- the service is integral to the performance of the contract.

These exemptions apply regardless of whether the contract is separated or lump sum.

The contractor must pay tax on machinery or equipment and its accessories as well as repair and replacement parts used in the performance of the contract.

## Exemption Certificates

A valid exemption certificate contains:

- the name and address of the purchaser;
- a description of the item to be purchased;
- the reason the purchase is exempt from tax;
- the signature of the purchaser and the date; and
- the name and address of the seller.

There is no provision in the sales and use tax law for an exemption number or a tax-exempt number to be issued or used in connection with an exemption certificate.

An exemption certificate must be in substantially the same form of a Texas Sales and Use Tax Exemption Certification that the comptroller adopts. A copy is included in the Appendix.

## 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 retain the exemption. Where the primary use and benefit of the job is unrelated to the primary purpose of the exempt entity, the exemption is foregone.

### Exempt Examples

A charity hospital is an exempt entity. If the charity hospital builds a fitness center for use as an integral unit in the cardiac rehabilitation program and for the practice of preventive medicine, the fitness center fulfills the exempt purpose. Therefore, the charity hospital could issue an exemption certificate to the contractor building the fitness center.

The purpose of an exempt entity is to raise money for cancer research. The entity builds an office building to lease to the public. Since the purpose of the entity is to raise money, building the office building would be exempt, and an exemption certificate could be issued.

### Taxable Examples

A charity hospital is an exempt entity. The charity hospital builds an office building to lease to the public, not to doctors with hospital privileges. The office building does not fulfill the exempt purpose. Therefore, the charity hospital could not issue an exemption certificate to the contractor.

The purpose of another exempt entity is to provide after-school activities to under-privileged children. The board of directors decides to build an apartment house so they can rent to their employees. Renting apartments is not related to the exempt purpose; thus, the exemption is lost.

## 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. If a lease between the owner and the exempt entity is for a set time period and the exempt entity has the option, but is not contractually obligated to renew the lease, the option is not considered when determining if the exemption applies.

### Exempt Example

The life of the lease is 20 years. A renewed contract (a new lease) can extend the time of use for another 20 years to 40 years. The planned improvement appears to have an anticipated life of 20 years. The initial contract is equal to the expected life of the improvement to realty; therefore, the

contract is making an improvement to realty for the exempt entity and qualifies for the exemption.

### Taxable Example

The life of the lease in question is nine years. A renewed contract (a new lease) can extend the time of use for five more years to 14 years. The planned improvement appears to have an anticipated life of more than 10 years. The initial contract is less than the expected life of the improvement to realty; therefore, the contract is making an improvement to realty for the building owner and does not qualify for the exemption.

## 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. The contractor performing the work for the developer may claim an exemption from tax on certain purchases when specific conditions are met:

- The developer must have irrevocably dedicated the realty and improvements to the governmental entity.
- The governmental entity must have conditionally or unconditionally agreed to accept the realty and the improvements at a future date.
- This dedication and acceptance must take place before the work begins for exemptions to apply. If the work begins before the dedication and acceptance occur, the exemptions will not apply. Exemptions may be claimed from the time of dedication and acceptance forward.

The governmental entity must record its decision to accept the realty and improvements in the minutes of the meeting when the decision is made, and the appropriate maps or plats must be filed.

A contractor must presume that a contract with a private party (developer) is not an exempt contract. This presumption may be overcome by the contractor's obtaining acceptable documentation from the developer. A contractor must obtain, in good faith and at the time the contract is executed, a properly completed exemption certificate or other written statement from the customer (developer) explaining that the realty being improved has

been dedicated to and accepted by a governmental entity. If the claimed exemption is not clear, the contractor may request additional proof of exemption from the customer. A letter of acceptance or other written confirmation signed by an authorized representative of the governmental entity is sufficient to relieve the contractor from further inquiry.

Once the acceptable documentation has been obtained, improvements are considered for the primary use and benefit of the exempt entity. It does not matter if the contractor's contract with the developer is separated or lump sum. The contractor may issue an exemption certificate to suppliers when purchasing incorporated materials, qualifying consumables

and qualifying taxable services. The contractor must pay tax on machinery, equipment and all other taxable items not qualifying for the exemption, even when used to perform the development work.

As of Oct. 1, 2003, the water-related exemptions in Tax Code Sec. 151.355 changed to require that the equipment, services and supplies used in water conservation, desalination, availability, precipitation enhancement or to construct certain wastewater systems be used solely for that purpose to qualify for the exemption.

## Chapter 6

# 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.



# Chapter 7

## Incorporated Materials

Incorporated materials are tangible personal property (TPP) that becomes part of the real property. Tax responsibilities on incorporated materials are outlined in the “Lump-sum Contract,” “Separated Contract” and “Cost-Plus Contract” sections. There are additional situations that need to be discussed to avoid pitfalls.

### *Incorporated materials include but are not limited to:*

lumber	nails
screws	siding
bricks	shingles
windows	cement
plumbing fixtures	lighting fixtures
electrical wiring	breaker boxes
paint	pipe
dry wall	putty
doors	rebar
corrugated metal	tile

### **Materials Provided by the Customer**

A contract may specify that a customer will provide materials and the person performing improvements will provide the skill and labor necessary to perform the contract. Under this type of contract, 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.

### **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.

If the materials purchased in Texas will be used in a separated contract, a resale certificate may be issued to the contractor in lieu of paying Texas tax.

### **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.

Prior to June 20, 2003, there existed an exception when a lump-sum contractor purchased raw materials outside Texas and transformed the materials into components of buildings before the components entered Texas. For example, a company performing a lump-sum, new construction project purchased boards and nails outside Texas to construct a wall that was shipped into Texas. Texas tax was not due on the purchase price of the boards and nails because they had been transformed before entering Texas. However, for the same project, a company might purchase a door in Oklahoma and ship it into Texas. The identity of the door had not changed, so Texas use tax was due.

As of June 20, 2003, HB 2425 amended the definition of use in Sec. 151.011(a) to include TPP, such as a raw material, that is purchased and processed out of state prior to being brought into Texas for use. Use tax is now due on the costs of the incorporated materials.

### **Dirt, Sand and Gravel**

The sale and/or delivery of unprocessed dirt, sand, gravel or similar materials are not taxable. Materials are considered unprocessed if they have been merely sorted, sized, screened, washed and/or dried. The sale of the same materials in a processed state (i.e., crushed or mixed with other materials) is taxable.

As the end-user, a lump-sum contractor must pay tax to the seller on the purchase of processed dirt, sand and gravel. A separated contractor may issue a resale certificate instead of paying tax if the materials will be incorporated into real property.

The charge attributable to hauling away excess dirt in conjunction with construction site preparation is not taxable.



Persons hauling dirt and similar unprocessed materials are considered to be performing a nontaxable service.

## **Agency Agreement on Incorporated Materials**

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The Comptroller's office recognizes agreements between a prime contractor and a direct payment permit-holder allowing the contractor to be the agent of the permittee for the purpose of purchasing materials that will be incorporated into the permittee's realty under a contract between the contractor and the permittee. This assumes that the agreement so stipulates, that the contractor is allowed

to issue purchase orders and direct payment exemption certificates to the material suppliers on the permittee's behalf, and to pay the permittee's bills.

This agency holds both the agent and principal liable for any taxes owed by the principal for purchases made under the agency agreement.

Agency agreements apply to materials incorporated into the job. The contractor must pay tax on consumable supplies, equipment and other taxable items used by the contractor in performing the construction contract.

## Chapter 8

# Consumables

Consumables are nondurable tangible personal property (TPP), other than machinery and equipment that is not physically incorporated into the property of a customer and that, after being used for its intended purpose, is 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
welding gas	

### *Consumable supplies do not include items attached to equipment as accessories, such as:*

saw blades	drill bits
grinding disks	cutting stars

When the contractor accepts an exemption certificate in good faith from qualifying exempt entities, the contractor can issue an exemption certificate for consumable items used in the performance of a contract if the consumable is:

- necessary and essential for the performance of the contract; and
- completely consumed at the job site.

## 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.

When the customer reimburses the contractor for consumables, the transaction is not taxable. If the contractor charges the customer tax on consumables, the tax – collected in error – should be remitted to the state. The state will refund the tax collected in error to the contractor once the contractor has issued either a refund to the customer or, if the customer accepts it, a credit memo for the tax amount.

## 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 Tax Code is exempt if the TPP is necessary and essential for the performance of the contract and completely consumed at the job site. The contractor may issue suppliers exemption certificates.

Contractors may on contracts with exempt customers issue a resale certificate to suppliers in lieu of tax for items indirectly consumed by the contractor if:

- the contract is separated with a separate stated amount for consumables;
- title to the property must transfer to the customer before the contractor makes any use of the property; and
- the consumables are immediately marked, labeled or otherwise physically identified as property of the customer (when feasible).

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.

# Chapter 9 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        accessories

**Accessories include:**

- saw blades            bristles for street sweepers
- 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.

## Surcharge on Off-road Equipment

In addition to sales and use tax, Texas has assessed a surcharge to comply with federal pollution standards. The Texas Emissions Reduction Plan (TERP) surcharge applies to the sale, use, lease or rental of new or used off-road,

heavy-duty diesel equipment; as such, it is a sales and use tax.

**Off-road, heavy-duty diesel equipment includes all new or used off-road, heavy-duty diesel equipment other than implements of husbandry used solely for agricultural purposes, including:**

- pavers
- trenchers
- rubber tire tractors/dozers
- rollers
- cement and mortar mixers
- off-highway tractors
- signal boards/light plants
- crushing/processing equipment
- tampers/rammers
- concrete/industrial saws
- tractors/loaders/backhoes
- scrapers
- off-highway trucks
- dumpsters/tenders
- rough-terrain forklifts
- plate compactors
- excavators
- crawler tractors/dozers
- paving equipment
- graders
- mining equipment
- bore/drill rigs
- rubber tire loaders
- concrete pavers
- cranes
- skid steer loaders
- surface equipment

The following table reflects the effective dates and rates of the surcharge:

Effective Date	Rate
Sept. 1, 2015	1.5%
July 1, 2003 – Aug. 31, 2015	2%
Sept. 1, 2001 – July 1, 2003	1%

# Chapter 10

## Miscellaneous Topics

### Permit Fees

The application/permit fee is not subject to sales or use tax. The transaction between a city and a permit applicant is neither a sale of tangible personal property (TPP) nor a taxable service. Fees charged by a city to a contractor are not taxable when passed on to the customer, as long as they are separately stated.

### Blueprints

Contractors are consumers of blueprint or design copies used for a contract to improve real property, even if the contractor separately states the charge for the copies to the owner of the real property. The contractor should pay sales tax on such copies regardless of the exempt status of the client. However, contractors must collect and remit tax on copies of plans sold to persons who are not parties to the construction contract. For example, sales tax is due on a sale to a person who seeks copies of the plan in order to bid a project. The contractor must collect and remit tax on such sales and may issue a resale certificate for copies that are in fact resold.

When an agency relationship exists between a contractor and an exempt entity, any additional copies of blueprints or design copies that are requested by the exempt entity may be purchased tax free. The original set of blueprints or design copies purchased by the contractor would be subject to sales and/or use tax.

### Natural Gas and Electricity

#### Taxable Customer

Electricity and natural gas used in the completion of a new construction contract for a taxable customer is taxable.

The service to run temporary electrical drops and connect power to the construction trailers at the job site is not taxable. The service provider should pay tax on materials used to perform the nontaxable service.

#### Exempt Customer

Electricity and natural gas used at the job site to operate power tools necessary to shape or fit materials into the

finished project; furnish power for electric welding machines used in welding steel beams; and furnish power for other tools and equipment used directly in the construction of a project of an exempt customer is exempt from the sales tax.

Tax is due on all other uses of natural gas and electricity, such as lighting and heat in the trailer at the construction site.

### Local Tax

“Local tax” is a term that encompasses city, county, special-purpose district (SPD) and transit authority taxes. A contractor’s responsibility for local sales and use taxes depends on the type of contract.

The maximum local tax rate that may be applied on any taxable transaction is 2 percent, which may be composed of a combination of city, county, SPD and transit authority taxes, in this hierarchy:

1. city
2. county
3. special-purpose district
4. transit authority

Once each level of the hierarchy is satisfied, it cannot be assessed again in the same transaction (i.e., city sales and use tax cannot be assessed twice on the same transaction). If a transaction has all levels of the hierarchy legally due, it may cause the local tax to exceed 2 percent. If this happens, the tax will be assessed in the order of the hierarchy until the 2 percent cap is reached. Do not assess any local use tax if the tax cannot be collected at its full rate without going over the 2 percent maximum.

For example, if local taxes of 1 percent city, 1/2 percent county and 1 percent transit authority are all legally due, only the city sales and county sales taxes may be assessed. The 1 percent transit authority tax causes the combined total local tax rate to exceed the 2 percent maximum, so it would not be assessed at all.

#### Resource

[Local Sales and Use Tax Collection – A Guide for Sellers](#)

**NOTE:** Contractors and vendors of TPP do not always have the same tax responsibilities.

### **Lump-sum Contractor**

Contractors performing lump-sum contracts are consumers of all materials, supplies and equipment used or incorporated into the customer's property. Contractors purchasing taxable items for use in lump-sum contracts must pay city, county, SPD and transit authority taxes based on the Texas retailer's place of business. Prior to Sept. 1, 2007, transit authority tax was due based on the point of delivery or the place the taxable item was picked-up. If the taxable purchase is made from an out-of-state vendor, the contractor will owe tax based on the first storage, use or other consumption of the taxable item.

### **Separated Contractor and Cost-Plus Contractor Sales**

Contractors performing separated contracts are required to hold permits and collect local sales taxes from customers on the sales price of the materials (contract labor is not taxable). The job site is the contractor's place of business for the purpose of determining the imposition of local tax. If the job site is located within a local taxing authority's boundaries, local tax is due for that authority on the separate charges for materials. If the job site is not inside the taxing authority's boundaries, no local tax is due.

### **Purchases**

Contractors can issue resale certificates for materials incorporated into real property. Tax should be paid on all consumables and equipment bought, leased or rented for use in completing the job. The local taxes are based on the Texas retailer's place of business. Additional local tax could be due for other jurisdictions if the 2 percent rate cap has not been reached, based on the point of delivery or the place the taxable items were picked up. If the taxable purchase is made from an out-of-state vendor, the contractor will owe tax based on the first storage, use or other consumption of the taxable item.

### **Items Removed from a Valid Tax-free Inventory**

Contractors that do not know at the time of purchase whether the goods are being purchased for resale, exempt jobs or for their own taxable use may validly issue a resale certificate at the time of purchase. This only applies to items that might be resold and not to office supplies, construction equipment etc. Local taxes will be due based upon where the goods are removed from a valid tax-free inventory.

## **Homebuilders**

A homebuilder can be a contractor, developer or a homeowner acting as a general contractor to improve a new residential structure. "Residential structures" include houses, apartments, condominiums, nursing homes and retirement homes. However, hotels, motels, hospitals, rehabilitation centers, prisons and recreational vehicle parks are not residential structures.

Examples of new improvements next to a new residential structure include new rooms, sidewalks, swimming pools, gazebos, garages, fences, sprinkler systems, decks, retaining walls, driveways, fishponds and patios. However, tax exemptions for real property services provided while constructing these new improvements apply only in connection with building a new residential structure (living quarters). The term "new improvements" does not include repairs, renovations or interior remodeling; e.g., re-roofing a house or renovating a garage.

### **Real Property Services for 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.

If a homebuilder is constructing a new residential structure under a lump-sum contract, the homebuilder is considered the ultimate consumer but does not owe tax on purchases of real property services. Under a separated contract to build a new residential structure, the homebuilder does not owe tax on purchases of real property services but must include these costs in the labor portion of the contract.

### **Model Homes**

A homebuilder may not issue an exemption certificate for services performed on a model home while the builder uses and occupies the model home as a display or as a sales office. However, during construction of the model home or conversion of the model home to residential use, the services are not taxable, and the builder may properly issue the certification.

## **Increased Capacity**

Persons who repair, remodel, restore or modify a manufacturing or processing production unit of a petrochemical refinery or chemical plant to increase the capacity in the production unit are not performing a taxable real property repair and remodeling service. Such persons are considered contractors.

Rule 3.362 – Labor Relating to Increasing Capacity in a Production Unit in a Petrochemical Refinery or Chemical Plant, applies to these individuals. It's important to note that persons repairing, remodeling, restoring or modifying other types of manufacturing facilities are performing taxable real property repair and remodeling service and are covered by Rule 3.357 – Labor Relating to Nonresidential Real Property Repair, Remodeling, Restoration, Maintenance, New Construction and Residential Property, instead of Rule 3.362.

## Contractors Who Manufacture

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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.

For example, a cabinetmaker works as both a manufacturer and a contractor. If he uses the same saw for building both the cabinets sold over the counter and the cabinets installed, the saw could be purchased tax free if an exemption

certificate (manufacturing exemption) is given to the vendor. Each time the saw is used to build the cabinets that are installed into real property, a divergent use of the saw occurs. See the “Divergent Use” section of this manual for information on how to handle the tax on this divergent use.

## Divergent Use

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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. For divergent use that occurred prior to Oct. 1, 2001, the tax is based on the purchase price of the TPP or the fair market rental value for the period of time the item was used in a nonexempt manner. For divergent use occurring after Sept. 30, 2001, the tax is based on a calculation of the percentage of the purchase price spread out over 48 months and the percentage of divergent use made within each month. If the TPP was purchased more than four years prior to the divergent use, then no tax is due on the divergent use. Also, if the taxable use of the TPP does not exceed 5 percent of the total use for a month, then this use is not subject to tax. See Rule 3.300 – Manufacturing; Custom Manufacturing; Fabricating; Processing for this new method of calculating divergent use.



## Chapter 11

# Repairing, Remodeling & Restoring Improvements to Realty

Entities and individuals repairing, remodeling and restoring nonresidential real property are considered repairmen providing a taxable service and are covered by Rule 3.357 – Nonresidential Real Property Repair, Remodeling and Restoration; Real Property Maintenance. The definitions of repairing, remodeling and restoring are included in this rule. They include rebuilding, replacing, altering, modifying, upgrading, mending and bringing back real property to its original working order, without falling under maintenance, initial finish-out, increased capacity or other new construction. These repairmen are not contractors for sales and use tax purposes, so it does not matter what type of contract is used to perform this service.

The total sales price for the services provided by a repairman, including labor, is taxable. However, separately stated charges for unrelated services would not be taxable. The repairman (service provider) may accept in good faith a valid resale, exemption or direct payment exemption certificate in lieu of tax. Local tax responsibility for these taxable services is based on the location of the job site. Prior to Sept. 1, 2007, local tax was based on the service provider's place of business, the same as for the sale or purchase of TPP. This change makes local taxes due on nonresidential real property repair and remodeling jobs consistent with the local tax due on separated contracts for residential real property repair and remodeling and for new construction jobs.

Materials that are incorporated into the customer's real property would not be taxable to the repairman when these items are purchased. Taxable services that are essential to the performance of the repair and transferred to the customer as a part of the repair or remodeling may be purchased tax free.

Tax must be paid at the time of purchase on machinery, equipment, consumables, repair parts and taxable services that are not incorporated into the customer's real property but used on the repair or remodeling job. Again, these service providers are not contractors, so different rules apply to these repairmen.

### **Residential vs. Nonresidential**

The definition of residential property is included in Rule 3.357 and includes property that is used as a family dwelling,

multifamily apartment or housing complex, nursing home, condominium or retirement home; hotels or hospitals are excluded. Generally, nonresidential is any real property that is not included as residential. "Nonresidential" is the term included in the rule and should not be used interchangeably with the term "commercial." A person who repairs, restores or remodels a residential structure is treated as a contractor.

### **Maintenance vs. Repair**

As discussed in the "New Construction" section, maintenance is defined as scheduled, periodic work on operational and functioning improvements to real property that is necessary to sustain or support safe, efficient, continuous operations or to prevent the decline, failure, lapse or deterioration of the improvement. The property must be operational and functioning in order to qualify for the maintenance exemption. If the property is damaged, broken, declined or deteriorated, then the service can be a repair, remodel or restoration and would be taxable.

### **Repainting**

The charges for interior and exterior painting are taxable as nonresidential real property repair, remodeling and maintenance services as are the maintenance charges that are not scheduled and periodic. If the painting is contracted, scheduled and periodic then the repainting can qualify as maintenance. The labor to perform the scheduled, periodic painting would be not taxable, but tax would still be due on the materials.

### **Repair/Remodel – Historical Buildings**

The labor to repair, remodel or restore a building listed in the National Register of Historic Places is not taxable. The materials incorporated into the real property, and the equipment and consumables used by the real property repairman/remodeler, are taxable. The labor must be separately stated from the incorporated materials by the repairman/remodeler to obtain the exemption. Unless the customer is an exempt entity, these projects are handled like new construction separated contracts with nonexempt customers.

### **Converting the Use of Real Property**

Frequently, residential property is converted into office buildings and warehouses are converted into residential

property. The Comptroller's policy is that the use of the property after the remodeling or conversion determines which rules cover the remodeling activities. Taxability will be determined by Rule 3.291 if the property becomes residential and by Rule 3.357 if the property becomes nonresidential.

Remodeling includes the removal of the existing roofing foam underlay, demolition of existing walls in order to expand the existing structure, "tying" the new footage to the existing footage and application of the new exterior covering to the existing structure.

## **Government-mandated Building Changes**

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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.

## **Natural Disaster**

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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. The materials used to perform the repairs are taxable. The customer contracting for the repair should issue the service provider an exemption certificate in lieu of tax. The service provider must presume that all work is taxable until the customer issues an exemption certificate covering the separately stated labor portion of the bill. If the charge for the repair is a lump sum, the total charge is taxable. Rentals and consumables used to perform the repairs are taxable to the service providers.

For this exemption to apply, the area must be declared a disaster by the Governor of Texas under Government Code Chapter 418 or by the President under 42 United States Code Sec. 5141.



# Chapter 12

## Services

### Burden of Proof for Services

Unlike the presumption that all sales of TPP are subject to sales tax, there cannot be a presumption that all services are taxable. When the transaction is for a service, the state must show, prima facie, that it was a taxable service that was purchased/sold tax free. Once the state has proven that the service performed was taxable, the burden of proving the exemption shifts to the taxpayer, who must produce sufficient documentation to prove the exemption.

### Purchases of TPP for Services

Tangible personal property (TPP) used to perform a taxable service may be purchased tax free for resale if it is transferred to the care, custody and control of the customer as part of the service. Care, custody and control means the customer has the right to move, relocate and operate the components.

### Security Services

A security service is defined as any service for which a license is required under Occupations Code sections 1702.101 or 1702.102, including any service provided within the scope of the requisite license. A security service is taxable for both residential and nonresidential property and covered by Rule 3.333.

Companies are sellers of security services when installing services or monitoring security systems and a license is required for the monitoring of the security system. Security services used by a contractor cannot be purchased tax free on a separated contract.

### Real Property Services

For taxability purposes, there are six real property services:

1. landscaping;
2. the care and maintenance of lawns, yards or ornamental trees or other plants;
3. removal or collection of garbage, rubbish or other solid waste;
4. building or grounds cleaning, janitorial or custodial services;

5. structural pest control service;
6. surveying of real property.

Entities and individuals providing these services on both residential and nonresidential real property provide a taxable service and must collect tax on the entire sale amount. Resale certificates may be accepted in lieu of tax if the real property service is being transferred as an integral part of a taxable service, or if the buyer intends to incorporate the service into TPP that will be resold. Purchases of TPP can be made tax free if the care, custody and control of the property are transferred to the customer as part of the real property service.

### Landscaping

Landscaping includes activities of arranging and modifying areas of land, natural scenery and other areas, such as indoor or outdoor patios, for aesthetic effect, considering the use to which the land is to be put. The term also includes adding, removing or arranging natural forms to fulfill aesthetic requirements. It includes the application of soil, soil additives and amendments to prepare or maintain the planting area. Some examples are garden planting or maintenance, arborist services, ornamental bush or shrub planting, tree planting or removal, tree surgery, pruning or spraying and lawn sodding.

### Janitorial Services

Keeping the inside and outside premises of a residential and nonresidential building clean, orderly and functional, including performing minor adjustments, and maintenance is considered a real property service and is taxable. Examples include, but are not limited to, window washing; floor, wall and ceiling cleaning; collection of waste inside a building or on the grounds; chimney or duct cleaning; lighting maintenance, such as bulb and fuse replacement; cleaning, disinfecting and restocking of restrooms or lounge areas; cleaning or washing sidewalks, parking garages or parking lots; and pool cleaning and maintenance. Not included in janitorial services are activities such as painting, wallpapering or performing significant repairs. Excluded are babysitters, maids or cooks employed by a private household to provide domestic services for the benefit of the household.

### **Care and Maintenance of Lawns**

Lawn and yard maintenance includes mowing, trimming, fertilizing, watering and any other treatment or service that may be performed on private or commercial lawns or yards. It also includes maintenance of trees and plants, whether inside or outside a building.

### **Surveying**

Surveying includes activities performed to determine or confirm the boundaries of real property, or to determine or confirm the location of structures or other improvements in relation to the boundaries of the property by the use of relevant elements of law, research, measurement, analysis, computation, mapping and land description. Examples include boundary recovery, residential surveying, lot surveying, title surveying, as-built title surveying and right-of-way surveying. The term does not include activities performed after taxable surveying has been completed to search the surveyed area for items of archaeological or historical significance.

### **Garbage Removal**

Removal or collection of garbage, rubbish or other solid waste is a taxable real property service and includes waste; refuse; sludge from a waste treatment plant, water supply treatment plant or an air pollution control facility; and other discarded material including solid, liquid, semisolid or contained gaseous material resulting from residential, industrial, municipal, commercial, mining and agricultural operations as well as from community and institutional activities. Excluded from the taxable service is removal of

hazardous waste, which is identified or listed as hazardous waste by the U.S. Environmental Protection Agency or other appropriate federal or state agency. Also excluded is industrial solid waste, which is defined in Chapter 361 of the Health and Safety Code. This generally is solid waste resulting from or incidental to any process of industry or manufacturing, or mining or agricultural operation, which may include hazardous waste as defined in this section.

### **Structural Pest Control**

Structural pest control services are covered by Occupations Code Sec. 1951.003 and include activities performed for the purpose of identifying, preventing, controlling or eliminating, by use of chemical or mechanical means, infestation of obnoxious or undesirable animals that may infest households, railroad cars, ships, docks, trucks, airplanes or other structures or their contents, as well as trees, shrubs or other plantings in parks, residences, business establishments or streets. It also includes inspection or evaluation concerning the extent of an infestation, as well as reports or other services to control infestation.

### **Real Property Service vs. 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.

## Chapter 13

# Topics of Interest

### Awnings/Canopies

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Generally speaking, canopies and awnings do not add additional new footage to a building. However, assuming the canopy or awning becomes an improvement to residential realty or is a part of new construction (residential or nonresidential), taxability would be based on the type of contract, whether lump sum or separated.

### Barricade Services

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Barricade services are treated as rentals to the contractor and are subject to sales tax like other rentals of equipment.

### Signs

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Erecting a sign as part of the completion or finish-out of a newly constructed building, and erecting and installing a freestanding sign on new pylons or poles where no sign previously existed are considered new construction. Remodeling jobs include attaching a new sign to an existing building or to existing pylons or poles.

### Concrete

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Generally there are two types of sales of concrete. The first – sale of TPP – is when a concrete truck delivers and dumps concrete at a specified location. The second – a service – is when there is an agreement with an entity to frame an area and pour and smooth the concrete. Taxability of the second transaction depends on whether the activity qualifies as new construction or repair, remodeling or restoration.

### Manufacturing Equipment vs. Real Property

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A contractor who incorporates into realty any equipment or materials that qualify for the manufacturing exemption may accept an exemption certificate in lieu of tax from the manufacturer for the separately stated exempt equipment or materials sold under a separated contract. The separately stated labor charges, both installation and fabrication labor, on a new construction contract would also not be taxable. If a contractor charges a lump-sum amount to perform the new

construction contract, then the entire amount is not taxable. In this case the contractor is the consumer of all the goods; therefore, the manufacturing exemption would not apply on otherwise qualifying manufacturing equipment.

Repair of manufacturing equipment is not taxable as long as the equipment maintains its identity as manufacturing equipment. Once the manufacturing equipment is installed and becomes a part of real property, the manufacturing labor exemption does not apply to the repair of the real property. Separately stated manufacturing repair parts would not be taxable.

### Extended Warranties

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An extended repair warranty on existing residential real property is not taxable. However, the warrantor should pay tax on all items used to fulfill this warranty contract.

Extended repair warranties on existing nonresidential real property are taxable. Items that are incorporated into the realty may be purchased tax free.

Extended warranties on other taxable services, such as pest control, are taxable. Sales of extended warranties on TPP are subject to sales tax.

### Plant Turnaround

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The mere scheduled shut-down of a manufacturing plant for inspection and repairs does not meet the definition of real property maintenance. Maintenance is performed to prevent the decline or failure of an improvement to realty. Real property repair, not real property maintenance, is performed when realty is broken.

The maintenance of real property is not subject to sales tax during plant turnarounds that are regularly and periodically scheduled. On the other hand, labor to repair manufacturing equipment that is classified as real property that was not in operating order prior to the turnaround is subject to sales tax. Labor to repair miscellaneous realty during the turnaround is also subject to tax. Labor to repair manufacturing equipment that is real property and

is functioning at the time of the regularly and periodically scheduled turnaround is not taxable. All taxable items purchased by the company or the maintenance service providers are taxable, and tax should be paid at the time of purchase or accrued.

## **Professional Services**

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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. This is the case even if the charges are separately stated to the client and/or marked up from the original cost. They are not required to hold a sales tax permit or collect taxes on these items transferred to the customer as part of their professional services. They cannot give a resale certificate for such purchases. When an agency relationship exists between a provider of professional services who is permitted and an exempt entity, any additional copies of blueprints or design copies that are requested by the exempt entity may be purchased tax free.

# Chapter 14

## Definitions

The following words and terms, when used in this section, shall have the following meanings, unless the context clearly indicates otherwise:

### **Agreed contract price of materials incorporated into the realty**

The price specified in the contract for the incorporated materials – i.e., tangible personal property (TPP) that becomes a part of the real property – plus any additional charges directly attributable to the incorporated materials. For example, profit calculated as a percentage of the cost of materials, cost of transporting the materials, mark-up or handling charges related directly to the materials charge are includable in the agreed contract price. A charge calculated as a percentage of the total contract cost will not be considered a part of the material's selling price. The agreed contract price of incorporated materials **cannot** be less than the price the contractor paid for the materials.

### **Consumable items**

Tangible personal property, other than machinery and equipment, that is not physically incorporated into the property of a customer and that, after being used for its intended purpose, is substantially used up, or is not retained or reusable by the contractor. These items include barricade tape, non-reusable concrete forms, plastic sheeting, survey stakes and flags and chalk.

### **Contractor**

Any person who builds new improvements to real property or repairs, restores or remodels residential real property and who, in making the improvement, incorporates TPP into the property being improved. The term includes subcontractors but does not include materialmen and suppliers. Persons who repair, restore or remodel nonresidential real property are providing taxable services under Rule §3.357 relating to real property repair and remodeling.

### **Cost-Plus contract**

A cost-plus-a-fee contract is generally regarded as a separated contract. See **Separated contract**.

### **Development work**

Development work means improving real property for a private party that is dedicated to and accepted by a governmental entity. An example would be the streets of a residential subdivision that are built by a contractor and then dedicated and accepted by the city where the subdivision is located.

### **Improvements to realty**

“Contract for the improvement to realty” includes a contract with the intended purpose to:

- erect, construct, alter or repair any building or other structure, project, development or other permanent improvement on, under the surface of or to real property, whether fee or leasehold;
- furnish and install property becoming a part of any building or other structure, project, development or other permanent improvement on or to such real property, including tangible personal property, which after installation becomes real property by virtue of being embedded in or permanently affixed to the land or to a structure constituting realty, and which property after installation is necessary to the intended usefulness of the building or other structure; or
- alter the land surface of real property by such means as creating roads, earthen dams and stock tanks. However, mining or timber operations do not, in and of themselves, constitute improvements to realty.

“Contract for the improvement to realty” does not include:

- a contract for the sale and installation of tangible personal property. This includes a contract to furnish and install machinery, equipment or other tangible property not essential to the building or structure, nor adapted or intended to become a part of the realty, but which incidentally may, on account of its nature, be temporarily attached to the realty without losing its identity as a particular piece of machinery, equipment or property and, if attached, is readily removable without substantial damage to the unit or to the realty or without destroying the intended usefulness of the realty;
- the furnishing of tangible personal property if the person furnishing the property is not responsible

for the final affixation or installation of any of the property furnished; or

- the furnishing of tangible personal property if the person furnishing the property is only responsible for supervision or warranty of installation without contractual responsibility for installation.

#### **Incorporated materials**

Incorporated materials are TPP that becomes part of an improvement to real property. These include, but are not limited to, lumber, bricks, pipe, nails, concrete, screws, sheet rock and shingles.

#### **Labor for nonresidential real property repair, remodeling and restoration**

For the purposes of this section, labor means all components of a transaction or contract directly related to the remodeling, repair or restoration other than those components attributable to materials incorporated into the realty. Unrelated components, such as charges by engineers and architects, are also part of the labor component unless separately stated to the customer.

#### **Lump-sum contract**

A contract in which the agreed contract price is one lump-sum amount and in which the charges for incorporated materials are not separate from the charges for skill and labor, nor does the contract require invoices or progress billings etc. to separately state these charges.

#### **Machinery and equipment**

Machines and their accessories used in the improvements to real property that are not incorporated into the realty. These include, but are not limited to, saws, bulldozers, hand tools, scaffolding and backhoes.

#### **Maintenance on real property**

Scheduled, periodic work performed on operational, functioning improvements to realty necessary to support safe, efficient, continuous operations or prevent the improvements' decline, failure, lapse or deterioration. Taxable real property services do not qualify as maintenance.

#### **Nonresidential real property**

Includes, but is not limited to, hospitals, office buildings, shopping malls, health clubs, rehabilitation centers and prisons.

#### **Remodel**

To make over, rebuild, replace or upgrade existing real property.

#### **Repair**

To mend or bring back as near as can be to its original working order real property that was broken, damaged or defective.

#### **Repairman**

Any person who under either a lump-sum or separated contract repairs, restores or remodels a nonresidential structure. A person who repairs, restores or remodels a residential structure is treated as a contractor.

A repairman collects tax on the full price charged to the customer. A repairman can issue a resale certificate to a vendor for materials incorporated into a repair, remodeling or restoration and for a service, if the buyer intends to transfer the service as an integral part of the taxable services. The repairman owes tax on the purchases of equipment, consumable items and other taxable services.

#### **Residential real property**

Includes, but is not limited to, houses, apartments, condominiums, nursing homes and retirement homes.

#### **Restore**

An activity performed to bring back as near as can be to its original condition real property that is still operating and functional but has faded, declined or deteriorated.

#### **Separated contract**

A contract in which the agreed contract price is divided into at least two amounts: a charge for skill and labor to perform the work and another charge for the materials incorporated into the realty. A contract that requires invoices or progress billings etc. to be separately stated is deemed a separated contract. The fact that the charges may be added together for a total sum given is irrelevant.

#### **Tangible personal property**

Personal property that can be seen, weighed, measured, felt or touched or that is perceptible to the senses in any other manner. For the purposes of this chapter, the term includes a computer program and a prepaid telephone calling card.

#### **Taxable real property services**

As of Oct. 1, 1987, these real property services became taxable:

- landscaping
- lawn maintenance
- waste collection or removal
- building or grounds cleaning and janitorial or custodial services
- pest control services
- surveying



# Chapter 15

## Statutes

### §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.
- (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.

Added by Acts 1987, 70th Leg., 2nd C.S., ch. 5, art. 1, pt. 4, Sec. 7. Amended by Acts 1991, 72nd Leg., ch. 705, Sec. 11, eff. Sept. 1, 1991; Acts 1995, 74th Leg., ch. 1000, Sec. 7, eff. Oct. 1, 1995; Acts 1997, 75th Leg., ch. 1040, Sec. 12, eff. Sept. 1, 1997.

### §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;
  - (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.

(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.

Added by Acts 1987, 70th Leg., 2nd C.S., ch. 5, art. 1, pt. 4, Sec. 8. Amended by Acts 1991, 72nd Leg., ch. 705, Sec. 12, eff. Sept. 1, 1991; Acts 1993, 73rd Leg., ch. 1031, Sec. 19, eff. Sept. 1, 1993; Acts 1995, 74th Leg., ch. 1000, Sec. 7, eff. Oct. 1, 1995; Acts 1997, 75th Leg., ch. 1040, Sec. 13, eff. Sept. 1, 1997; Acts 1999, 76th Leg., ch. 1114, Sec. 1.01, eff. Oct. 1, 1999; Acts 1999, 76th Leg., ch. 1114, Sec. 2.01, eff. Oct. 1, 2001; Acts 2003, 78th Leg., ch. 1276, Sec. 14A.815, eff. Sept. 1, 2003. Amended by Acts 2007, 80th Leg., R.S., Ch. 1266, § 1, eff. September 1, 2007.

### §151.010. Taxable Item

“Taxable item” means tangible personal property and taxable services. Except as otherwise provided by this chapter, the sale or use of a taxable item in electronic form instead of on physical media does not alter the item’s tax status.

Acts 1981, 67th Leg., p. 1547, ch. 389, Sec. 1, eff. Jan. 1, 1982. Amended by Acts 1984, 68th Leg., 2nd C.S., ch. 31, art. 7, Sec. 1, eff. Oct. 2, 1984; Acts 2001, 77th Leg., ch. 1263, Sec. 13, eff. Oct. 1, 2001.

### §151.0101. Taxable Services

(a) “Taxable services” means:

- (1) amusement services;
- (2) cable television services;
- (3) personal services;
- (4) motor vehicle parking and storage services;

(5) the repair, remodeling, maintenance, and restoration of tangible personal property, except:

- (A) aircraft;
- (B) a ship, boat, or other vessel, other than:
  - (i) a taxable boat or motor as defined by Section 160.001;
  - (ii) a sports fishing boat; or
  - (iii) any other vessel used for pleasure;
- (C) the repair, maintenance, and restoration of a motor vehicle; and
- (D) the repair, maintenance, creation, and restoration of a computer program, including its development and modification, not sold by the person performing the repair, maintenance, creation, or restoration service;

- (6) telecommunications services;
- (7) credit reporting services;
- (8) debt collection services;
- (9) insurance services;
- (10) information services;
- (11) real property services;
- (12) data processing services;
- (13) real property repair and remodeling;
- (14) security services;
- (15) telephone answering services;
- (16) Internet access service; and
- (17) a sale by a transmission and distribution utility, as defined in Section 31.002, Utilities Code, of transmission or delivery of service directly to an electricity end-use customer whose consumption of electricity is subject to taxation under this chapter.

(b) The comptroller shall have exclusive jurisdiction to interpret Subsection (a) of this section.

Added by Acts 1984, 68th Leg., 2nd C.S., ch. 31, art. 7, Sec. 2, eff. Oct. 2, 1984. Amended by Acts 1985, 69th Leg., ch. 206, Sec. 3, eff. Oct. 1, 1985; Acts 1987, 70th Leg., 2nd C.S., ch. 5, art. 1, pt. 4, Sec. 12; Acts 1989, 71st Leg., ch. 1249, Sec. 1, eff. Oct. 1, 1989; Acts 1991, 72nd Leg., 1st C.S., ch. 5, Sec. 14.021(a); Acts 1999, 76th Leg., ch. 394, Sec. 2, eff. Oct. 1, 1999; Acts 1999, 76th Leg., ch. 405, Sec. 54, eff. Sept. 1, 1999; Acts 2001, 77th Leg., ch. 1420, Sec. 18.008, eff. Sept. 1, 2001.



### §151.056. Property Consumed in Contracts to Improve Real Property

- (a) A contractor is the consumer of tangible personal property furnished by him and incorporated into the property of his customer if the contract between the contractor and his customer contains a lump-sum price covering both the performance of the service and the furnishing of the necessary incidental material.
- (b) A contractor is the seller of tangible personal property furnished by him and incorporated into the property of his customer, from whom he shall collect the tax, if the contract between the contractor and his customer contains separate amounts for the performance of the service and for the furnishing of the necessary incidental material. The tax rate is applied to the price of the materials as agreed in the contract or the price of the materials to the contractor, whichever is the greater.
- (c) If a contractor has paid the sales tax to his supplier when the tangible personal property is purchased, the contractor may credit the amount of the tax paid to the supplier against the tax imposed as provided in Subsection (b) of this section with respect to a subsequent sale of the property.
- (d) 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.
- (e) This section does not apply to the use or consumption of tangible personal property as a necessary or incidental part of a taxable service.
- (f) A contractor is not eligible for the exemption provided by Section 151.318 on items used in the performance of a contract to improve real property.
- (g) In this subsection, “ready mix concrete contractor” means a person who manufactures or produces ready mixed concrete for construction purposes and incorporates the ready mixed concrete in the property improved. A ready mix concrete contractor performing a contract must separate and individually invoice the customer for each yard of ready mixed concrete produced and consumed for the improvement of real property and collect and remit the tax imposed under this chapter on the ready mixed concrete produced and consumed. The tax rate is applied to the price of the materials determined by the greater of the invoice price or fair market value of ready mixed concrete incorporated into the project. This subsection does not apply to an invoice submitted by a ready mix concrete contractor for a public works project.

Acts 1981, 67th Leg., p. 1551, ch. 389, Sec. 1, eff. Jan. 1, 1982. Amended by Acts 1987, 70th Leg., 2nd C.S., ch. 5, art. 1, pt. 4, Sec. 17; Acts 2003, 78th Leg., ch. 209, Sec. 18, eff. Oct. 1, 2003. Amended by Acts 2007, 80th Leg., R.S., Ch. 1266, § 3, eff. September 1, 2007.

### §151.309. Governmental Entities

A taxable item sold, leased, or rented to, or stored, used, or consumed by, any of the following governmental entities is exempted from the taxes imposed by this chapter:

- (1) the United States;
- (2) an unincorporated instrumentality of the United States;
- (3) a corporation that is an agency or instrumentality of the United States and is wholly owned by the United States or by another corporation wholly owned by the United States;
- (4) this state;
- (5) a county, city, special district, or other political subdivision of this state; or
- (6) a state, or a governmental unit of a state that borders this state, but only to the extent that the other state or governmental unit exempts or does not impose a tax on similar sales of items to this state or a political subdivision of this state.

Acts 1981, 67th Leg., p. 1560, ch. 389, Sec. 1, eff. Jan. 1, 1982. Amended by Acts 1993, 73rd Leg., ch. 719, Sec. 1, eff. July 1, 1993.

### §151.310. Religious, Educational, and Public Service Organizations

- (a) A taxable item sold, leased, or rented to, or stored, used, or consumed by, any of the following organizations is exempted from the taxes imposed by this chapter:
  - (1) an organization created for religious, educational, or charitable purposes if no part of the net earnings of the organization benefits a private shareholder or individual and the items purchased, leased, or rented are related to the purpose of the organization;
  - (2) an organization qualifying for an exemption from federal income taxes under Section 501(c)(3), (4), (8), (10), or (19), Internal Revenue Code, of the item sold, leased, rented, stored, used, or consumed relates to the purpose of the exempted organization and the item is not used for the personal benefit of a private stockholder or individual;

- (3) a nonprofit organization engaged exclusively in providing athletic competition among persons under 19 years old if no financial benefit goes to an individual or shareholder;
- (4) a company, department, or association organized for the purpose of answering fire alarms and extinguishing fires or for the purpose of answering fire alarms, extinguishing fires, and providing emergency medical services, the members of which receive no compensation or only nominal compensation for their services rendered, if the taxable item is used exclusively by the company, department, or association; or
- (5) a chamber of commerce or a convention and tourist promotional agency representing at least one Texas city or county if the chamber of commerce or the agency is not organized for profit and no part of its net earnings inures to a private shareholder or other individual.
- (b) The sale of, or contracting for the sale of, concessions at an event conducted by an organization exempted under Subsection (a)(3) of this section does not prevent the application of the exemption to that organization.
- (c) An organization that qualifies for an exemption under Subsection (a)(1) or (a)(2) of this section, and each bona fide chapter of the organization, may hold two tax-free sales or auctions under this subsection during a calendar year and each tax-free sale or auction may continue for one day only. The sale of a taxable item the sales price of which is \$5,000 or less by a qualified organization or chapter of the organization at a tax-free sale or auction is exempted from the sales tax imposed by Subchapter C of this chapter, except that a taxable item manufactured by or donated to the qualified organization or chapter of the organization may be sold tax free regardless of the sales price to any purchaser other than the donor. The storage, use, or consumption of a taxable item that is acquired from a qualified organization or chapter of the organization at a tax-free sale or auction and that is exempted under this subsection from the taxes imposed by Subchapter C of this chapter is exempted from the use tax imposed by Subchapter D of this chapter until the item is resold or subsequently transferred.
- (c-1) Notwithstanding Subsection (c), an organization that qualifies for an exemption under Subsection (a) (4) may hold 10 tax-free sales or auctions during a calendar year. Each tax-free sale or auction may continue for not more than 72 hours. The storage, use, or consumption of a taxable item that is acquired from a qualified organization at a tax-free sale or auction and that is exempted under this subsection from the taxes imposed by Subchapter C is exempted from the use tax imposed by Subchapter D until the item is resold or subsequently transferred. If an organization that qualifies for an exemption under Subsection (a) (4) jointly holds a tax-free sale or auction with one or more other exempt organizations, the tax-free sale or auction is considered to be one of the organization's 10 tax-free sales or auctions authorized by this subsection during that calendar year.
- (d) If two or more organizations jointly hold a tax-free sale or auction, each organization may hold one additional tax-free sale or auction during the calendar year in which the joint sale or auction is held. The employment of and payment of a reasonable fee to an auctioneer to conduct a tax-free auction does not disqualify an otherwise qualified organization from receiving the exemption provided by Subsection (c).
- (e) A nonprofit hospital or hospital system that qualifies for an exemption under Subsection (a)(2) shall provide community benefits that include charity care and government-sponsored indigent health care as set forth in Subchapter D, Chapter 311, Health and Safety Code.
- (f) For purposes of obtaining a refund of or claiming a credit for taxes paid under this chapter on the basis of an exemption under this section, an organization is not considered exempted from the taxes imposed by this chapter before the earlier of:
- (1) the date the organization applied for the exemption with the comptroller; or
  - (2) the date of assessment of the organization's tax liability by the comptroller as a result of an audit, as applicable.

Acts 1981, 67th Leg., p. 1561, ch. 389, Sec. 1, eff. Jan. 1, 1982. Amended by Acts 1981, 67th Leg., p. 2771, ch. 752, Sec. 7(a), eff. Jan. 1, 1982; Acts 1983, 68th Leg., p. 2747, ch. 470, Sec. 2, eff. Sept. 1, 1983; Acts 1993, 73rd Leg., ch. 360, Sec. 6, eff. Sept. 1, 1993; Acts 1993, 73rd Leg., ch. 734, Sec. 1, eff. Aug. 30, 1993; Acts 1995, 74th Leg., ch. 781, Sec. 5, eff. Sept. 1, 1995; Acts 1997, 75th Leg., ch. 1040, Sec. 20, eff. Oct. 1, 1997; Acts 1999, 76th Leg., ch. 1467, Sec. 2.15, eff. Oct. 1, 1999; Acts 2001, 77th Leg., ch. 1263, Sec. 19, eff. Oct. 1, 2001. Amended by Acts 2009, 81st Leg., R.S., Ch. 1378 (S.B. 1199), Sec. 1, eff. September 1, 2009. Acts 2011, 82nd Leg., R.S., Ch. 463 (S.B. 1927), Sec. 1, eff. June 17, 2011. Acts 2015, 84th Leg., R.S., Ch. 179 (S.B. 31), Sec. 1, eff. May 28, 2015.

### **§151.311. Taxable Items Incorporated Into or Used for Improvement of Realty of an Exempt Entity**

- (a) The purchase of tangible personal property for use in the performance of a contract for an improvement to realty for an organization exempted under Section 151.309 or 151.310 of this code is exempt if the tangible personal property is incorporated into realty in the performance of the contract.
- (b) The purchase of tangible personal property, other than machinery or equipment and its accessories and repair and replacement parts, for use in the performance of a contract for an improvement to realty for an organization exempted under Section 151.309 or 151.310 of this code is exempt if the tangible personal property is:
  - (1) necessary and essential for the performance of the contract; and
  - (2) completely consumed at the job site.
- (c) The purchase of a taxable service for use in the performance of a contract for an improvement to realty that is performed for an organization exempted under Section 151.309 or 151.310 of this code is exempt if the service is performed at the job site and if:
  - (1) the contract expressly requires the specific service to be provided or purchased by the person performing the contract; or
  - (2) the service is integral to the performance of the contract.
- (d) For purposes of this section, tangible personal property is completely consumed if after being used once for its intended purpose it is used up or destroyed. Tangible personal property that is rented or leased for use in the performance of the contract cannot be completely consumed for purposes of this section.

Acts 1981, 67th Leg., p. 1561, ch. 389, Sec. 1, eff. Jan. 1, 1982. Amended by Acts 1984, 68th Leg., 2nd C.S., ch. 31, art. 12, Sec. 1, eff. Oct. 2, 1984; Acts 1985, 69th Leg., ch. 69, art. 2, Sec. 1, eff. July 30, 1985; Acts 1991, 72nd Leg., 1st C.S., ch. 5, Sec. 14.07; Acts 1993, 73rd Leg., ch. 831, Sec. 1, eff. Oct. 1, 1993.

# Chapter 16

# Rules

## Rule 3.291

Sec. 3.291. Contractors. (Tax Code secs. 151.0048, 151.056, 151.311, 151.707)

(a) Definitions. The following words and terms, when used in this section, shall have the following meanings, unless the context clearly indicates otherwise.

- (1) Agreed contract price of materials incorporated into the realty--The price specified in the contract for the incorporated materials, i.e., tangible personal property that becomes a part of the real property, plus any additional charges directly attributable to the incorporated materials. For example, profit that is calculated as a percentage of the cost of materials, cost of transportation of the materials, and markup or handling charges that relate directly to the materials charge are included in the agreed contract price. A charge that is calculated as a percentage of the total contract cost is not considered a part of the agreed contract price of materials incorporated into realty. The agreed contract price of incorporated materials cannot be less than the price that the contractor paid for the materials.
- (2) Consumable item--Nondurable tangible personal property that is used to improve realty and, after being used once for its intended purpose, is completely used up or destroyed. Examples of consumable items are nonreusable concrete forms, nonreusable drop cloths, barricade tape, natural gas, and electricity. The term «consumable item» does not include machinery, equipment, accessories to machinery or equipment, repair or replacement parts for machinery or equipment, or any rented or leased item.
- (3) Contractor--Any person who builds new improvements to residential or nonresidential real property, completes any part of an uncompleted new structure that is an improvement to residential or nonresidential real property, makes improvements to real property as part of periodic and scheduled maintenance of nonresidential real property, or repairs, restores, maintains, or remodels residential real property, and who, in making the improvement,

incorporates tangible personal property into the real property that is improved. The term includes subcontractors but does not include material men, suppliers, or persons who provide taxable real property services. Persons who provide real property services should refer to §3.356 of this title (relating to Real Property Service). Persons who repair, restore, or remodel nonresidential real property are providing taxable services and should refer to §3.357 of this title (relating to Nonresidential Real Property Repair, Remodeling, and Restoration; Real Property Maintenance). Persons who repair, restore, or remodel chemical plants or petrochemical refineries should refer to §3.362 of this title (relating to Labor Relating to Increasing Capacity in a Production Unit in a Petrochemical Refinery or Chemical Plant).

- (4) Equipment--Tangible personal property that a contractor uses that is not a consumable item or an incorporated material. Examples include tools, machinery, implements, and accessories and repair or replacement parts for the equipment.
- (5) Exempt contract--A contract for the improvement of real property with an entity that is exempted under Tax Code, §151.309 or §151.310. An example of an exempt contract is a contract with a nonexempt entity to improve real property for the primary use and benefit of an organization exempted under Tax Code, §151.309 or §151.310, provided that the improvements relate to the exempt purpose of an organization that is exempted under Tax Code, §151.310(a)(1) or (a)(2). Another example is a contract for development work covered under subsection (d) of this section. See §3.322 of this title (relating to Exempt Organizations).
- (6) Improvements to realty--See §3.347 of this title (relating to Improvements to Realty).
- (7) Incorporated materials--Tangible personal property that becomes a part of any building or other structure, project, development, or other permanent improvement on or to such real property including tangible personal property that, after installation,

becomes real property by virtue of being embedded in or permanently affixed to the land or structure constituting realty and which property after installation is necessary to the intended usefulness of the building or other structure.

- (8) Lump-sum contract--A contract in which the agreed contract price is one lump-sum amount and in which the charges for incorporated materials are not separate from any charges for skill and labor, including fabrication, installation, and other labor that the contractor performs. For example, guaranteed-maximum contracts are considered lump-sum contracts when the charges for incorporated materials and the charges for skill and all labor are not separately stated. Contracts to improve realty that do not break out all charges for labor, including fabrication labor, are considered lump-sum contracts. For example, a contractor who fabricates and incorporates cabinets into realty under a contract that includes the fabrication labor in the agreed contract price of materials is a lump-sum contractor. Contracts to improve realty that have a zero charge for materials or for labor are considered lump-sum contracts. Separated invoices issued to the customer will not change a lump-sum contract into a separated contract unless the terms of the contract require separated invoices.
- (9) New construction--All new improvements to real property, including initial finish-out work to the interior or exterior of the improvement. An example is a multiple story building that has had only its first floor finished and occupied. The initial finish-out of each additional floor before initial occupancy or use is new construction. New construction also includes the addition of new usable square footage to an existing building. Examples include the addition of a new wing onto an existing building. Reallocation of existing square footage inside a building is remodeling and does not constitute the addition of new square footage. For example, the removal or relocation of interior walls to expand the size of a room or the finish out of an office space that was previously used for storage is remodeling. Raising the ceiling of a room or the roof of a building is not new construction if new usable square footage is not created.
- (10) Ready mix concrete contractor--A contractor who manufactures or produces concrete for construction purposes and incorporates the concrete into the property improved.
- (11) Sale and installation of tangible personal property-- Includes a contract to furnish and install machinery, equipment, or other tangible property that is not essential to the building or structure, nor adapted or intended to become a part of the realty, but which incidentally may, on account of its nature, be temporarily attached to the realty without loss of its identity as a particular piece of machinery, equipment, or property and, if attached, is readily removable without substantial damage to the unit or realty or without destruction of the intended usefulness of the realty.
- (12) Residence or residential property--Property that is used as a family dwelling, a multifamily apartment or housing complex, nursing home, condominium, or retirement home. The term includes homeowners association-owned and apartment-owned swimming pools that are for the use of the homeowners or tenants, laundry rooms for tenants' use, and other common areas for tenants' use. The term does not include hotels or any other facilities that are subject to the hotel occupancy tax.
- (13) Separated contract--A contract in which the agreed contract price is divided into a separately stated agreed contract price for incorporated materials and a separately stated amount for all skill and labor that includes fabrication, installation, and other labor that is performed by the contractor. If prices of incorporated materials and labor are separately stated in any part of the contract or in a document that becomes part of the contract according to the terms of the contract, adding the charges together to give a sum total does not change the contract into a lump-sum contract. For example, a contract that requires separated invoices is a separated contract. Cost-plus contracts are considered separated contracts if the cost of labor is separately stated from the cost for incorporated materials.
- (b) Tax responsibilities of contractors who improve real property of nonexempt customers.
- (1) Equipment. A contractor must pay sales tax at the time of purchase, lease, or rental on the sales price of equipment used to perform a contract. A contractor must accrue and remit use tax on the sales price of equipment purchased, leased, or rented for use in Texas from an out-of-state seller unless the out-of-state seller collected Texas use tax. See §3.346 of this title (relating to Use Tax). Texas allows a credit against Texas use tax when the same property is subject to a legally imposed sales or use tax of another state. See §3.338 of this title (relating to Multistate Tax Credits and Allowance of Credit for Tax Paid to Suppliers).



- (2) Consumable item. Except as provided by subparagraph (B) of this paragraph, a contractor must pay tax at the time of purchase on consumable items that are not physically incorporated into the customer's property.
- (A) A contractor may not collect tax from the customer on a charge for consumable items except as provided by subparagraph (B) of this paragraph.
- (B) A contractor who has a separated contract may issue a properly completed resale certificate to a supplier in lieu of tax for consumable items if title to the consumable items transfers to the contractor's customer at or before the time that the contractor takes possession of the consumable items, and further if the consumable items are immediately marked, labeled, or otherwise physically identified as the customer's property, when practicable. The contractor must separately state the charge for these consumable items to the customer and must collect sales tax from the customer, unless the customer qualifies for exemption under Tax Code, §151.309 or §151.310, or under other provisions that grant the customer exemption from sales tax on its purchases. See §3.322 of this title (relating to Exempt Organizations).
- (3) Lump-sum contracts.
- (A) A contractor who performs lump-sum contracts owes tax on all materials, consumable items, equipment, taxable services, and other taxable items that are used by the contractor or incorporated into a customer's property. The contractor must pay tax to suppliers when the contractor purchases, leases, or rents the taxable items. The contractor must accrue and remit use tax on taxable items that are purchased, leased, or rented from an out-of-state seller unless the out-of-state seller collected and gave the contractor a receipt for Texas use tax. The contractor shall not collect from a customer any amount represented to be tax on a lump-sum charge or on any portion of the charge except as provided under subparagraph (E) of this paragraph. A lump-sum contractor must refund to the customer any tax that is collected in error or the contractor must remit the tax to the state. The contractor may not retain such tax.
- (B) A contractor who, in addition to performing lump-sum contracts, sells, leases, or rents taxable items at retail or performs separated contracts may maintain a tax-free inventory of items that are held for resale. A contractor who, in addition to performing lump-sum contracts, performs nonresidential real property repair, restoration, and remodeling services and resells taxable items as part of those taxable services may also maintain a tax-free inventory of items that are held for resale. See §3.357 of this title (relating to Nonresidential Real Property Repair, Remodeling, and Restoration; Real Property Maintenance). A contractor may issue a properly completed resale certificate instead of paying tax on items that are purchased for a tax-free inventory when the contractor does not know at the time of purchase whether the item will be resold or used in the performance of a lump-sum contract. A contractor must hold a sales tax permit to issue a resale certificate, and must collect, report, and remit tax to the comptroller as required by §3.286 of this title (relating to Seller's and Purchaser's Responsibilities) when the contractor sells, leases, or rents taxable items. A contractor who separately states a charge for equipment that the contractor uses is not renting that equipment to the customer.
- (C) A contractor who purchases taxable items under a valid resale certificate and uses the items in a taxable manner owes sales or use tax on the items. For example, a contractor who incorporates materials from a tax-free resale inventory into realty under a lump-sum contract must accrue and remit tax based on the purchase price of the materials. The contractor must remit the tax to the comptroller for the reporting period in which the materials were used. A contractor who purchases items that are specifically intended for use in a lump-sum contract may not issue resale certificates in lieu of tax for such items. See §3.285 of this title (relating to Resale Certificates; Sales for Resale).
- (D) A contractor may not accept a direct payment exemption certificate when the contractor performs a lump-sum contract for a person who holds a direct payment permit. The lump-sum contractor owes tax on all taxable items that are used on the job or that are incorporated into the direct payment permit holder's realty. A direct payment permit holder may not authorize a contractor or any other person to purchase tax free any taxable item through use of the direct payment permit holder's permit. See §3.288 of

this title (relating to Direct Payment Procedures and Qualifications).

- (E) A ready mix concrete contractor must separate the charge for the concrete from other charges associated with the contract, and invoice the customer for each yard of concrete produced and consumed for the improvement of real property. The ready mix concrete contractor may issue a resale certificate in lieu of paying sales tax on taxable items (e.g., processed materials) incorporated into the concrete. The ready mix concrete contractor must collect and remit the tax due on the concrete produced and consumed. The tax rate in effect at the job site location is applied to the greater of the actual invoice price of the component materials or the fair market value of the concrete incorporated into the project. For the purposes of this subparagraph, fair market value is the amount that a purchaser would pay on the open market for concrete. The fair market value will be determined on a case by case basis, taking into consideration relevant factors such as cost of component materials, location of job site, volume, and prices charged by other concrete contractors in the area. Contracts entered into prior to September 1, 2007, are excluded from the requirements of this subparagraph provided the contract terms do not allow for the pass-through of taxes by the ready mix concrete contractor to the purchaser for the duration of the contract period. This subparagraph does not apply to ready mix concrete contractors providing concrete for a public works project.
- (4) Separated contracts.
- (A) Except as otherwise provided in this section, a contractor who performs a separated contract is a retailer of all materials that are physically incorporated into the realty that is being improved. As a retailer, the contractor must collect tax from the customer based upon the agreed contract price of the incorporated materials. The tax rate must be applied to the agreed contract price of materials, or to the price of the materials to the contractor, whichever is greater. A contractor who performs a separated contract is also a retailer of taxable services that are sold under the provisions of subparagraph (D) of this paragraph, and of consumable items that are sold under the provisions of paragraph (2)(B) of this subsection. The contractor
- may accept a properly completed resale or exemption certificate from a customer who claims an exemption.
- (B) A contractor who performs a separated contract must hold a sales tax permit and collect, report, and remit the tax as required by §3.286 of this title (relating to Seller's and Purchaser's Responsibilities). A contractor who purchases taxable items for resale as part of a separated contract may issue resale certificates to suppliers in lieu of tax. See §3.285 of this title (relating to Resale Certificate; Sales for Resale). A contractor may not issue a resale certificate and must pay tax on the purchase, rental, or lease of equipment that is intended for use in the performance of a contract.
- (C) A contractor may maintain a tax-paid inventory of materials. If the contractor incorporates tax-paid materials into realty under a separated contract or sells them at retail or transfers the materials to a customer as part of a taxable service, then the contractor must collect tax from the customer based upon the agreed contract price of the materials or upon the sales price of the taxable service. The contractor may claim a credit for tax paid on materials resold to customers. The contractor must remit tax to the comptroller on any difference that exists between the price that the customer paid and the price that the contractor paid.
- (D) A contractor who performs separated contracts may issue properly completed resale certificates in lieu of tax on taxable services that the contractor resells to its customers. Examples include landscaping, surveying, security services (alarm systems), that are incorporated into the customer's realty, and the final clean-up (janitorial services) of the construction site. The charges for taxable services that are resold to the customer must be separated from the charges for incorporated materials and other charges, and the contractor must collect tax from the customer on charges for the taxable services and incorporated materials. A contractor who performs a separated contract may not issue a resale certificate for a taxable service that the contractor uses or consumes, such as a security service to secure the job site, telecommunication service, and daily clean-up (janitorial service or garbage collection and removal) of the construction site. A contractor

who performs residential new construction should refer to paragraph (7) of this subsection.

- (E) A contractor who improves realty for a direct payment permit holder may accept a properly completed direct payment exemption certificate in lieu of tax on all tangible personal property that is incorporated into the direct payment permit holder's realty. The contractor owes tax on equipment the contractor purchases, rents, or leases for use in the performance of the contract with a direct payment permit holder. See §3.288 of this title (relating to Direct Payment Procedures and Qualifications). A contractor who performs a separated contract may not accept a direct payment exemption certificate in lieu of tax on consumable items unless paragraph (2) (B) of this subsection applies. A contractor who performs a separated contract may accept a direct payment exemption certificate in lieu of tax on taxable services only under the circumstances set out in paragraph (4)(D) of this subsection.
- (5) Contracts versus bids and change orders. For tax purposes, the terms of a contract control over the terms of a bid. For example, if the bid is lump-sum but the written contract is separated, then the contract determines the tax responsibilities of the parties, and the customer is liable for tax on incorporated materials. The terms of a contract also control change orders. If the contract is lump-sum, then change orders will be treated as lump-sum even if the change orders show charges for incorporated materials separate from other charges. If the contract is separated and change orders are for lump-sum amounts, then the lump-sum amounts will be treated as charges for incorporated materials unless the contractor can reasonably demonstrate the portion attributable to labor.
- (6) Different types of contracts between contractors and subcontractors. For tax purposes, subcontractors are not required to use the same type of contract as the general contractor. For example, a general or prime contract may be lump-sum, while some or all subcontracts may be separated. Each subcontractor's individual contract governs the subcontractor's tax responsibilities. In the example given, the subcontractors with separated contracts must collect sales tax from the general contractor. The general contractor must not collect any tax from the general contractor's customer. When the general or prime contract separately states labor and incorporated materials but some of the subcontracts are lump-sum, the prime or general contractor should treat the lump-sum charges as part of its separately stated labor charge and should not collect tax from the prime contractor's customer on those charges from lump-sum subcontractors.
- (7) Real property services. A contractor is not required to pay tax on real property services that are purchased as part of the construction of a new residential structure or as part of an improvement that is located immediately adjacent to the new structure and that is used in the residential occupancy of the structure. The contractor must issue a properly completed exemption certificate or other acceptable documentation to the service provider. If the comptroller subsequently determines that the work is taxable, then the contractor will be liable for all taxes, penalties, and interest that accrue upon such purchases. For the purposes of this paragraph, "contractor" includes a builder, developer, speculative builder, or other person who acts as a builder to improve residential real property.
- (8) Materials that customers provide. A contract may specify that a customer will provide materials and that the person who performs improvements will provide the skill and labor that are necessary to incorporate the materials into realty. Under this type of contract, the person who provides the skill and labor will not incur tax liability on the materials. The customer is liable for the tax on the materials and must pay tax at the time of purchase of the materials.
- (9) Noninstalled items. A person who manufactures an item for sale but who is not responsible for the incorporation of the item into realty is a manufacturer who is subject to the provisions of §3.300 of this title (relating to Manufacturing; Custom Manufacturing; Fabricating; Processing). For example, cabinet makers who do not affix the cabinets to realty are manufacturers and not contractors.
- (10) Local tax. A contractor's responsibility for local sales and use taxes depends on the type of contract entered into with the customer.
- (A) A contractor who has entered into a separated contract with the customer must collect local taxes on the charge for materials based on the location of the job site.
- (B) A contractor who has entered into a lump-sum contract with the customer is the consumer



- of all materials used to perform a lump-sum contract.
- (i) The lump-sum contractor should pay tax to suppliers on all materials at the time of purchase, unless the contractor maintains a valid tax-free inventory or holds a direct pay permit.
  - (ii) When the local sales taxes collected by the supplier are less than the 2.0% local tax cap, additional local use taxes are due based on the location where the goods are first stored or used. Local use tax is not due if the supplier collected a local sales tax for the same type of taxing jurisdiction.
  - (iii) When a lump-sum contractor has items shipped to the jobsite from outside of Texas, the contractor is responsible for accruing local taxes based on the location of the jobsite.
  - (iv) The lump-sum contractor must accrue local use tax based on the purchase price of the taxable item. The local use tax is due in the reporting period in which the item was first stored, used, or otherwise consumed in a local taxing entity.
- (11) Enterprise projects and defense readjustment projects. In order for an enterprise project or a defense readjustment project to avail itself of certain sales tax refunds, the project must enter into a separated contract, and the charges for items that qualify for enterprise project or defense readjustment project refunds must be separately stated. A contractor who performs a separated contract must collect sales tax from the project on the sales price of the incorporated materials. See §3.329 of this title (relating to Enterprise Projects, Enterprise Zones, and Defense Readjustment Zones).
  - (12) Manufacturing facilities. For a manufacturer to qualify for sales tax exemptions on manufacturing equipment that is installed under a contract to improve real property, the manufacturer must enter into a separated contract. Additionally, the contract must separately state the charge for the qualifying manufacturing equipment. See §3.300 of this title (relating to Manufacturing; Custom Manufacturing; Fabricating; Processing).
- (c) Tax responsibilities of contractors who perform lump-sum and separated contracts for exempt organizations.
- (1) Exemption certificates and other required proof of exemption. A contractor must obtain properly completed exemption certificates to document exempt contracts. Written contracts or written purchase orders that are issued by governmental entities exempted under Tax Code, §151.309, are acceptable documentation of exempt contracts.
  - (2) Contractor liability.
    - (A) A contractor may claim an exemption under Tax Code, §151.311, on a purchase of a taxable item for use under a contract to improve realty for an organization that is exempt under Tax Code, §151.309 or §151.310. If the comptroller subsequently determines that the organization is not exempt, then the contractor is liable for all taxes, penalties, and interest that accrue upon such purchase. If the validity of a claimed exemption or the exempt status of the customer is unclear, then the contractor may not accept the exemption certificate in good faith and should request additional evidence of the exempt status of the contract. If the customer claims to be an exempt organization, then a letter of sales and use tax exemption from the comptroller that is addressed to the customer relieves the contractor from further inquiry regarding the exempt status of the customer. See §3.287 of this title (relating to Exemption Certificates).
    - (B) A contract with a private party to improve real property owned by an exempt entity, other than a governmental entity described in Tax Code, §151.309, is not an exempt contract if the improvement to real property is for the primary use and benefit of the private party. However, a contractor in a non-exempt contract may purchase tax free tangible personal property that is used to improve real property owned by a governmental entity described in Tax Code, §151.309, if that tangible personal property is donated to the governmental entity and if the following conditions are satisfied:
      - (i) the contract between the contractor and the private party is a separated contract. See subsection (b) of this section for a discussion of lump-sum and separated contracts;
      - (ii) the contract provides that title to the materials used to perform the contract passes to the private party when the materials are delivered to the job site but

- before they are incorporated into the realty or used by either the contractor or the private party; and
- (iii) the contract provides that the private party intends to donate the materials to the governmental entity before the materials are incorporated into the realty or used by the contractor. The private party must provide the contractor with a letter of intent or other document from the governmental entity that states its intent to accept the property.
- (3) Materials that exempt customers provide. A contract may specify that the exempt customer will provide the materials and the contractor will provide the skill and labor that are necessary to perform the contract. Under this type of contract, the contractor will not incur tax liability on the materials. The exempt customer may issue exemption certificates to suppliers in lieu of tax when purchasing the materials. Materials that are incorporated into real property improvements that are not related to the exempt purpose of the customer exempt under Tax Code, §151.310(a)(1) or (2), are taxable. In this situation, the exempt customer must pay tax to suppliers when purchasing the materials. See also §3.322 of this title (relating to Exempt Organizations).
- (4) Exempt items. The following items are exempt from sales and use tax when purchased for use in the performance of an exempt contract:
- (A) tangible personal property that is incorporated into the realty;
- (B) consumable items that are necessary and essential to the contract and are completely consumed at the job site; and
- (C) taxable services that are performed at the job site and are:
- (i) expressly required by the exempt contract to be provided or purchased by the contractor; or
- (ii) integral to the performance of the exempt contract.
- (5) Contractor's exemption or resale certificate. A contractor who performs a lump-sum or separated contract may issue a properly completed exemption certificate to a supplier for the purchase of exempt items that are identified in paragraph (4) of this subsection. The certificate must be properly completed and identify the contractor as the purchaser, the exempt entity for whom the improvements are made, and the project for which the items are being purchased. See §3.287 of this title (relating to Exemption Certificates). A contractor may choose to issue a properly completed resale certificate when purchasing materials that will be incorporated into the customer's realty under a separated contract.
- (6) Equipment. All machinery and equipment, including repair and replacement parts and accessories, that a contractor uses to perform contracts for any exempt entity are taxable. A contractor who purchases, rents, or leases equipment for use on a contract to improve realty for an exempt entity must pay tax on that purchase, rental, or lease.
- (d) Development work. For the purposes of this subsection, development work means a contract with a private party to improve real property by building public infrastructure, such as roads or sewer lines, provided that the improvements are dedicated to and will be accepted by a governmental entity. To qualify as an exempt contract, the private party must dedicate the realty and the improvements to the governmental entity before the work begins, and the governmental entity must accept or conditionally accept the realty and the improvements.

Source Note: The provisions of this §3.291 adopted to be effective July 22, 2001, 26 Tex. Reg. 5434; amended to be effective May 27, 2008, 33 Tex. Reg. 4185.

### Rule 3.357

Sec. 3.357. Nonresidential Real Property Repair, Remodeling, and Restoration; Real Property Maintenance. (Tax Code secs. 151.0047, 151.0101, 151.056, 151.058, 151.311, 151.350, 151.429)

(a) Definitions. The following words and terms, when used in this section, shall have the following meanings, unless the context clearly indicates otherwise.

- (1) Consumable items--Nondurable tangible personal property that is used to improve real property and that, after being used once for its intended purpose, is completely used or destroyed. Examples include, but are not limited to, nonreusable concrete forms, nonreusable drop cloths, barricade tape, natural gas, and electricity. Consumable items do not include incorporated materials, machinery, equipment, accessories to machinery and equipment, repair and replacement parts of machinery and equipment, or any rented or leased item.

- (2) Contractor--Any person who builds new improvements to residential or nonresidential real property; completes any part of an uncompleted structure that is an improvement to residential or nonresidential real property; makes improvements to real property as part of periodic and scheduled maintenance of nonresidential real property; or repairs, restores, maintains, or remodels residential real property; and who, in making the improvement, incorporates tangible personal property into the real property that is improved. The term includes subcontractors but does not include material men, suppliers, or persons who provide taxable real property services. Contractors should refer to Sec. 3.291 of this title (relating to Contractors). Persons who provide real property services should refer to sec. 3.356 of this title (relating to Real Property Service). Persons who repair, restore, or remodel chemical plants or petrochemical refineries should refer to Sec. 3.362 of this title (relating to Labor Relating to Increasing Capacity in a Production Unit in a Petrochemical Refinery or Chemical Plant).
- (3) Disaster area--An area that the Governor of Texas declares a disaster under the Government Code, Chapter 418, or that the President of the United States declares a disaster under 42 United States Code Sec. 5141.
- (4) Equipment--Tangible personal property that is used in the performance of a contract to improve real property, such as tools, machinery, implements, accessories, repair and replacement parts, or any item that is rented or leased. Equipment includes all items that do not meet the definitions of consumable items or incorporated materials.
- (5) Incorporated materials--Tangible personal property that loses its distinct and separate identity when incorporated into real property. Examples of incorporated materials include framing lumber, bricks, concrete, doors, and windows.
- (6) Labor--For the purposes of this section, labor means all components of a transaction or contract directly related to the remodeling, repair, or restoration other than those components attributable to materials incorporated into the realty. Unrelated components, such as charges by engineers and architects, are also part of the labor component unless separately stated to the customer.
- (7) Maintenance on real property--For operational and functional improvements to realty, maintenance means scheduled, periodic work that is necessary to sustain or support safe, efficient, continuous operations, or to prevent the decline, failure, lapse, or deterioration of the improvement. Taxable real property services that are described by Sec. 3.356 of this title (relating to Real Property Service) do not qualify as maintenance. Maintenance does not include work to remodel, modify, upgrade, perform major repair, or restore, even if the work is scheduled or periodic.
- (A) As it relates to maintenance, the term "scheduled" means anticipated and designated to occur within a given time period or production level.
- (B) As it relates to maintenance, the term "periodic" means ongoing or continual or at least occurring at intervals of time or production that are reasonably predictable.
- (C) The scheduled shutdown or turnaround of a manufacturing or processing plant is considered to be maintenance within the meaning of this definition.
- (8) New construction--All new improvements to real property including initial finish out work to the interior or exterior of the improvement. An example is a multiple story building that has had only its first floor finished and occupied. The initial finish out of each additional floor before initial occupancy or use is considered new construction. New construction also includes the addition of new, usable square footage to an existing structure. Examples are the addition of a new wing onto an existing building, or the addition of a new mezzanine level within an existing building. Reallocation of existing square footage inside a structure is remodeling and does not constitute the addition of new, usable square footage. For example, the removal or relocation of interior walls to expand the size of a room, or the finish out of an office space that was previously used for storage, is remodeling. Raising the ceiling of a room or the roof of a building is not new construction unless new, usable square footage is created.
- (9) Prior contract--A written contract, or a written bid that becomes a written contract, into which the parties enter before the effective date of the applicable section of the Tax Code. See Sec. 3.319 of this title (relating to Prior Contracts).
- (10) Real property--Land, including structures and other improvements that are embedded into or permanently affixed to the land.

- (11) Remodeling or modification--To rebuild, replace, alter, modify, or upgrade existing real property. However, the replacement of an item that is within an operational and functional improvement to realty is not taxable remodeling or modification when the work is scheduled and periodic maintenance as defined in paragraph (7) of this subsection. Improvements to manufacturing or production units of chemical plants or petrochemical refineries that meet the definition of increased capacity are not remodeling or modification services. See Sec. 3.362 of this title (relating to Labor Relating to Increasing Capacity in a Production Unit in a Petrochemical Refinery or Chemical Plant). Work that is performed after the initial finish out has been completed is remodeling even when the improvement has not been occupied or used. For example, a prospective tenant wants the unit of a completely finished out shopping complex repainted before the tenant leases the unit. The repainting is remodeling. Partial demolition of existing nonresidential realty is taxable remodeling. The complete demolition of an existing nonresidential improvement to real property is neither remodeling nor modification and is not taxable.
- (12) Repair--To mend or bring back real property that was broken, damaged, or defective as near as possible to its original working order. However, minor repair work that is performed on operational and functional improvements to realty is not taxable repair if the work is done in accordance with paragraph (7) of this subsection.
- (13) Residential property--Property that is used as a family dwelling, multifamily apartment or housing complex, nursing home, condominium, or retirement home. The term includes homeowners association-owned and apartment-owned swimming pools, laundry rooms, and other common areas for tenants' use. Common areas of mixed residential and nonresidential property are allocated or prorated based on the ratio of residential to nonresidential use of the property. The term does not include any commercial area open to nonresidents, retail outlets, hospitals, hotels, or any other facilities that are subject to the hotel occupancy tax.
- (14) Restoration--An activity that is performed to bring back real property that is still operational and functional but that has faded, declined, or deteriorated, as near as possible to its original condition. Minor restorative work that is performed within the meaning of paragraph (7) of this subsection is maintenance, not restoration.
- (15) Unrelated service. A service is unrelated if:
- (A) it is not the repair, remodeling, or restoration of nonresidential real property, nor a service or labor that is taxable under any other provision of the Tax Code, Chapter 151;
  - (B) it is of a type that is commonly provided on a stand-alone basis; and
  - (C) the performance of the service is distinct and identifiable. Examples of unrelated services that may be excluded from the tax base are the creation of engineering plans or architectural designs, new construction, increased capacity, and maintenance on real property.
- (b) Tax responsibilities of persons who repair, remodel, or restore nonresidential real property.
- (1) All persons who repair, restore, or remodel nonresidential real property must obtain Texas sales and use tax permits. Persons who construct new improvements to realty, perform maintenance on real property, or repair, restore, or remodel residential real property should refer to Sec. 3.291 of this title (relating to Contractors).
  - (2) All persons who repair, restore, or remodel nonresidential real property must collect tax on the total sales price to the customer less separately stated charges for unrelated services. The total sales price does not include Texas sales or use tax that the service provider must collect from customers. See Sec. 3.286 of this title (relating to Seller's and Purchaser's Responsibilities). The service provider may, in good faith, accept valid resale, exemption, or direct payment exemption certificates in lieu of tax. Previously, lump-sum and separated contracts were treated differently for tax purposes. This distinction is no longer valid when the contract is for the repair, remodeling, or restoration of nonresidential real property.
  - (3) A contract that involves both nonresidential repair, restoration, or remodeling and new construction is taxable in total unless the charge for new construction labor is separately stated to the customer as outlined in paragraph (7) of this subsection. An example is remodeling a restaurant's kitchen at the same time that a new dining area outside the existing structure is added. Work on the kitchen is taxable as remodeling, while the construction of the new dining area is nontaxable new construction. Minor repair, restoration, or remodeling that is performed in connection with new construction is not taxable if the portion of the charge that is attributed to



repair, restoration, or remodeling is 5.0% or less of the overall lump-sum charge. All separately stated charges for repair, restoration, remodeling, or other taxable services are taxable, even if they constitute 5.0% or less of the total contract price.

- (4) All persons who repair, restore, or remodel nonresidential real property owe tax at the time of purchase on all machinery, equipment, materials, and supplies that are used but not incorporated into the realty. The service provider is not entitled to a credit for tax paid on taxable items that are used but not incorporated into the realty.
- (5) Items used in performing repairs, remodeling, or restoration for exempt entities.
  - (A) Persons who repair, remodel, or restore real property or make improvements to real property for entities exempted by Tax Code, Sec. 151.309 or Sec. 151.310, may claim an exemption for tangible personal property used in those activities if the tangible personal property is incorporated into real property in the performance of the contract.
  - (B) Person who repair, remodel, or restore real property or make improvements to real property for entities that are exempted under Tax Code, Sec. 151.309 or Sec. 151.310, may claim an exemption for the purchase of taxable services that are used in those activities if the service is performed at the job site and if the contract requires the specific service to be provided or purchased by the person who makes the improvement to realty, or the service is integral to the performance of the contract.
  - (C) Persons who use consumable items in the improvement of realty that is repaired, remodeled, or restored for entities that are exempt under Tax Code, Sec. 151.309 or Sec. 151.310, may claim an exemption for the purchase of a consumable item if use of the item is necessary for the performance of the contract and the item is completely consumed at the job site.
  - (D) Persons who repair, restore, or remodel real property may issue a properly completed exemption certificate in lieu of tax for the purchase of items that are identified in subparagraphs (A) through (C) of this paragraph. The exemption certificate must show the service provider as the purchaser and must identify the exempt entity for whom the improvements are made and the project for which the items are purchased.
- (6) Repair, restoration, or remodeling that is performed upon a structure that is used both for residential and commercial purposes is taxable in total unless the labor on the residence is separately identified. The labor to repair, restore, or remodel the residence will not be taxable if separately stated. The charge for repair, restoration, or remodeling to common areas of mixed residential and nonresidential property is taxed based upon the ratio of residential to nonresidential use of the property.
- (7) If a combination of repair, restoration, or remodeling and new construction is performed under the same contract, and the repair, restoration, or remodeling portion exceeds 5.0% of the overall charge, then the parties to the contract must separately identify taxable and nontaxable labor along with the charges that apply to each or else the entire contract is presumed to be for repair, restoration, and remodeling and is taxable. Both parties must retain documentation that clearly defines the work that is performed to show that, had the new construction and remodeling been done independently, the charge for each would reasonably approximate the amount allocated. Examples of acceptable documentation are written contracts that detail the scope of work, bid sheets, tally sheets, schedules of values, and blueprints. If no written contract clearly shows agreement on the taxable and nontaxable work that is performed, then the customer and the service provider must prepare a written certification that verifies the allocation of charges for repair, restoration, or remodeling and new construction. The comptroller may recalculate the charges if the allocation appears unreasonable, and either party may be held responsible for the additional tax due.
- (8) Repainting is presumed to be a restoration or remodeling activity. Either party may overcome the presumption by showing that the scope of the work meets the definition of maintenance found in subsection (a)(7) of this section. Persons who perform repainting or other restoration activities should collect sales tax on the total charge to the customer unless the customer provides a properly completed exemption certificate as outlined in subsection (c)(2) or (4) of this section.
- (9) If a combination of taxable services (e.g., repair of nonresidential property), nontaxable services (e.g., new construction, residential repair, or maintenance), and nontaxable unrelated services are sold or purchased for a single charge and the portion that relates to taxable services represents more than 5.0% of the total

charge, the total charge is presumed to be taxable. The service provider may overcome this presumption by submission of documentary evidence that establishes the percentages of the total charge that relate to taxable services and to nontaxable services. Examples of acceptable documentation include written contracts that detail the scope of work, bid sheets, tally sheets, schedules of values, and blueprints.

- (c) Tax responsibilities of persons who perform maintenance on real property.
    - (1) A person who performs maintenance on real property and incorporates tangible personal property into the realty acts as a contractor and is subject to Sec. 3.291 of this title (relating to Contractors).
    - (2) A person who performs maintenance on real property and does not incorporate tangible personal property into the realty as part of that service provides nontaxable services and owes tax on all taxable items that are used to perform those services.
  - (d) Exemptions, exceptions, and exclusions.
    - (1) A person who performs taxable services has the burden of obtaining an exemption certificate for any exemption that a customer claims. However, if the customer is a governmental entity, a purchase order from the governmental entity is sufficient documentation.
    - (2) Maintenance on real property is a nontaxable service.
      - (A) To qualify a purchase as nontaxable real property maintenance, a service provider's customer must prove by way of maintenance schedules or work orders or other similar forms of evidence that the services meet the definition of maintenance on real property that is stated in subsection (a)(7) of this section. If the service provider does not have a written contract, but is only hired on a per job basis, then the service provider must presume that the service is repair or restoration and must therefore collect tax. If the customer has documentation to prove that the service qualifies as maintenance, then the customer may issue to the service provider an exemption certificate in lieu of paying tax or provide the documentation required to overcome the presumption. The certificate must state that the labor is maintenance as defined in subsection (a)(7) of this section, rather than repair or restoration as defined in subsection (a)(13) and (15) of this section, and that the customer is liable for any additional tax that is due in the event that the comptroller determines that a taxable service was performed.
- (B) Repairs or restoration that are performed under a claimed maintenance contract will not change a nontaxable maintenance contract into a taxable repair or restoration contract so long as the charges that are attributable to the repairs or restoration are 5.0% or less of the overall charge. Note: The 5.0% test applies to each contract and subcontract. For example, if five different companies provide lump-sum contracts for services, then each contract stands alone for the purposes of determining whether the taxable services are 5.0% or less of that contract. In the absence of a written contract, the 5.0% test will apply to the total charge billed by each service provider.
  - (C) A contract that includes maintenance and repair or restoration will be taxable in total if the charges for repairs and/or restoration services exceed 5.0% of the total charges and are not separately identified to the customer in the contract or billing. All separately stated charges for repair, restoration, remodeling, or other taxable services are taxable, even when the taxable services constitute 5.0% or less of the total contract price.
- (3) The modification of parts of existing structures solely to support the addition of new space will not change a new construction contract into a remodeling contract so long as the charges that are attributable to remodeling are 5.0% or less of the overall charge. Examples are conversion of a one-story building into a two-story building with the addition of a stairway to the existing structure to provide access to the new space, or the removal of an existing wall to allow the addition of structural support in the process of construction of a new room outside of the existing structure. Contracts with remodeling charges that exceed 5.0% are taxable in total unless the charges for remodeling are separately identified to the customer. However, see subsection (b)(9) of this section.
  - (4) A service provider may accept a properly completed exemption certificate in place of tax for the separately stated charges for labor to remodel, restore, or repair buildings that are listed in the National Register of Historic Places. The service provider is a contractor under Sec. 3.291 of this title (relating to Contractors).

- (5) A service provider may accept a properly completed exemption certificate in lieu of tax for both materials and labor charges from an entity that is exempt under Tax Code, Sec. 151.309 or Sec. 151.310(a) (3), (4), or (5), or that is exempt under Texas Civil Statutes. A service provider may accept a properly completed exemption certificate for both materials and labor charges from an entity that is exempted by Tax Code, Sec. 151.310(a)(1) or (2), if the repair, restoration, or remodeling appears reasonably related to the exempt purpose of the organization. See Sec. 3.322 of this title (relating to Exempt Organizations).
- (6) A service provider who enters into a contract with a nonexempt entity to improve real property for the primary use and benefit of an entity that is exempted under Tax Code Sec. 151.309 or Sec. 151.310 may accept a properly completed exemption certificate in lieu of tax. If the improvement is for the primary use and benefit of an entity that is exempted under Tax Code, Sec. 151.310(a)(1) or (2), then the primary use and benefit must relate to the exempt purpose of that entity.
- (7) A service provider who enters into a contract with a nonexempt entity to add improvements to real property that will become government property may accept a properly completed exemption certificate if the nonexempt entity dedicates the real property and the improvement to a governmental entity before any work begins and the governmental entity accepts the real property and the improvement. If, at a later date, the governmental entity fails to accept the improvement, the non-exempt entity will owe tax on the service.
- (8) A service provider may accept a properly completed exemption certificate from a manufacturer for separately stated charges for equipment that qualifies for the manufacturing exemption. See Sec. 3.300 of this title (relating to Manufacturing; Custom Manufacturing; Fabricating; Processing).
- (9) The labor to repair real or tangible personal property that is damaged within a disaster area by the condition or occurrence that caused the area to be declared a disaster area is exempt from tax if the charge for labor is separately stated to the customer. The materials that are used to perform the repairs are taxable. A person who has property repaired under this paragraph should issue to the service provider an exemption certificate in lieu of tax. The service provider must presume that all work is taxable until the customer issues an exemption certificate that covers the separately stated labor portion of the bill. If the charge for the repair is lump-sum, the total charge is taxable.
- (10) No sales tax is due on the wages or salary paid by an employer to an employee who provides the labor to repair, remodel, or restore real property that belongs to and is used by the employer. A person is considered the employee of the employer if the employer pays the person's wages or salary, withholds applicable federal taxes from the employee's wages or salary, pays employment-related benefits such as health insurance, and exercises direct control over the work that the employee performs.
- (e) Resale certificates.
- (1) Persons who repair, restore, and remodel real property may issue a resale certificate in lieu of tax to suppliers of tangible personal property only if the tangible personal property will be incorporated into the customer's realty. For example, a repairman or remodeler purchases paint to repaint a repaired or remodeled area. The paint is transferred to the customer as a part of the finished job. The repairman or remodeler may purchase the paint tax free by issuing a resale certificate. Tax is due on the total amount that is charged the customer, including amounts that are charged for the paint and for the services. A resale certificate may not be issued for materials and supplies used or consumed by the repairman or remodeler that are not incorporated into the customer's realty.
- (2) A resale certificate may be issued for a service if the buyer intends to transfer the service as an integral part of taxable services. A service will be considered as an integral part of a taxable service if the service purchased is essential to the performance of the taxable service and is of a type without which the taxable service could not be performed. Examples of services for which a resale certificate may be issued in lieu of tax are landscaping and surveying services if the landscaping or surveying is performed upon the property that is remodeled.
- (f) Local taxes. Local taxes (city, county, transit authority, city transit department, and special purpose districts) apply to services in the same way as they apply to tangible personal property.
- (1) Generally, service providers must collect local sales taxes if their place of business is within a local taxing jurisdiction, even if the service is actually provided at a location outside that jurisdiction.



- (2) Transit sales taxes do not apply to services that are provided outside the boundaries of a transit area.
  - (3) If the service provider's place of business is outside a local taxing jurisdiction but the service is provided to a customer who is located within a local taxing jurisdiction, then local use taxes apply and the service provider is required to collect the local taxes.
  - (4) For information on the collection and reporting responsibilities of providers and purchasers of taxable services, see Sec. 3.374 of this title (relating to collection and allocation of the city sales tax), Sec. 3.375 of this title (relating to City Use Tax), Sec. 3.424 of this title (relating to Collection and Allocation of Transit Sales Tax), and Sec. 3.425 of this title (relating to Transit Use Tax).
  - (g) Use tax. If a seller of a service is not engaged in business in Texas or in a specific local taxing jurisdiction, and is not required to collect Texas tax, then the Texas customer must report and pay the use tax directly to the Texas comptroller.
  - (h) Enterprise project. An entity that qualifies as an enterprise project may qualify to claim a refund of sales tax that is paid on the total charge for nonresidential repair, restoration, or remodeling. See Sec. 3.329 of this title (relating to Enterprise Projects, Enterprise Zones, and Defense Readjustment Zones).
  - (i) Prior contracts. Prior contracts that are signed before the effective date of a statutory change that affects nonresidential real property repair, remodeling, and restoration shall be governed by the provisions of Sec. 3.319 of this title (relating to Prior Contracts).
- (2) Employer – In determining which of several persons is the employer of an individual, factors which will be considered include:
    - (A) who exercises direct control over the details of how the work is performed by the employee;
    - (B) who pays the employee's salary;
    - (C) who withholds applicable federal taxes from the employee's salary;
    - (D) who provides employment-related benefits such as health insurance, eligibility to participate in a retirement plan, sick leave, vacation, etc., to the employee; and
    - (E) who has the right to terminate the employment of the individual employee.
  - (3) Garbage or other solid waste – Waste; refuse; sludge from a waste treatment plant, a water supply treatment plant, or an air pollution control facility; and other discarded material, including solid, liquid, semisolid, or contained gaseous material, resulting from residential, industrial, municipal, commercial, mining, and agricultural operations, and resulting from community and institutional activities. The term does not include any of the following:
    - (A) solid or dissolved material in domestic sewage; or solid or dissolved material in irrigation return flows; or industrial discharges subject to regulation by permit issued pursuant to the Texas Water Code, Chapter 26;
    - (B) waste materials which result from activities 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 pursuant to Natural Resources Code, Sec. 91.101;
    - (C) any waste which requires specific licensing under Health and Safety Code, Chapter 401, and the rules adopted by the Texas Board of Health under that law, which for the purposes of this rule shall be referred to as radioactive waste;
    - (D) hazardous waste, as identified or listed as a hazardous waste by the administrator of the United States Environmental Protection Agency or by other appropriate federal or state agency; or
    - (E) industrial solid waste, as that term is defined in Health and Safety Code, Chapter 361, with the exception of industrial solid waste which meets the definition of garbage or municipal solid waste.

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### Rule 3.356

Sec. 3.356. Real Property Service. (Texas Tax Code secs. 151.057, 151.0101, 151.0048, 151.007)

- (a) Definitions. The following words and terms, when used in this section, shall have the following meanings, unless the context clearly indicates otherwise.
  - (1) Employee – A person providing services for another for consideration where the employer has the right to control and direct the employee in the material details of how the work is to be performed, both under the contract of employment and in fact. The term also includes personnel provided by a temporary help service, as defined in paragraph (10) of this subsection.

- (4) Landscaping – The activity of arranging and modifying areas of land, natural scenery and other areas, such as indoor or outdoor patios, for aesthetic effect, considering the use to which the land is to be put. The term includes adding, removing, or arranging natural forms, features, and plantings, including vegetation, and other features to fulfill aesthetic requirements. It includes the application of soil, soil additives, and amendments to prepare or maintain the planting area. Some examples are garden planting or maintenance, arborist services, ornamental bush or shrub planting, tree planting or removal, tree surgery, pruning or spraying, and lawn sodding. The term does not include the addition of sprinkler systems, retaining walls, ponds, pools, or fences, or other construction activities or services provided by landscape designers or landscape architects such as consultation, research, preparation of general or specific design or detail plans, studies, specifications, or supervision, or any other professional services or functions within the definition of the practice of engineering or architecture. Landscaping services performed by landscape designers or landscape architects are taxable.
- (5) Lawn and yard maintenance – Mowing, trimming, fertilizing, watering and any other treatment or service which may be performed on private or commercial yards or lawns. It also includes maintenance of trees and plants whether inside or outside a building. The term does not include clearing land for buildings, power line rights-of-way, pipeline rights-of-way, or maintenance on land belonging to a governmental entity when the service is required by the governmental entity.
- (6) Property management company – A person who, for consideration, operates and manages all the activities at a property held by the owner for purposes of rental, such as: an office building, mall or other retail or office complex, an apartment complex, duplex, or home. In the context of this rule, the responsibilities of a property management company must include, but are not limited to, securing tenants, hiring and supervising employees for operation or upkeep of the property, receiving and applying revenues, and incurring and paying expenses derived from the operation of the property as directed by the owner. The term does not include a person performing taxable services at a manufacturing facility or at a property held by the owner for purposes other than rental.
- (7) Residential or nonresidential building or grounds cleaning, janitorial, or custodial services – The activities of keeping the inside and outside premises of a building clean, orderly, and functional, including performing minor adjustments, maintenance, or repairs. Examples include, but are not limited to: window washing; floor, wall, and ceiling cleaning; collection of waste on the premises, whether from inside a building or on the grounds; chimney or duct cleaning; lighting maintenance, such as bulb and fuse replacement; the cleaning, disinfecting, and restocking of restrooms or lounge areas; cleaning or washing sidewalks, parking garages, or parking lots; and pool cleaning and maintenance. The term does not include activities such as painting; wallpapering; or performing significant repairs; nor domestic services such as those of a baby-sitter, maid or cook employed by a private household to provide domestic services for the benefit of the household.
- (8) Structural pest control services – Activities performed for the purpose of identifying, preventing, controlling, or eliminating, by use of chemical or mechanical means, infestation of any of the following:
- (A) insects, spiders, mites, ticks, ants, bees, and other related pests, wood infesting organisms, rodents, weeds, nuisance birds, or any other obnoxious or undesirable animals which may infest households, railroad cars, ships, docks, trucks, airplanes or other structures or their contents;
  - (B) pests or diseases of trees, shrubs or other plantings in a park or adjacent to a residence, business establishment, industrial plant, institutional building, or street; and
  - (C) the term “structural pest control services” includes related activities, such as inspection or evaluation concerning the nature or extent of an infestation; reports; or performance of services to control pest or insect infestation.
- (9) Surveying of real property – Activities performed to determine or confirm the boundaries of real property, or to determine or confirm the location of structures or other improvements in relation to the boundaries of the property by the use of relevant elements of law, research, measurement, analysis, computation, mapping and land description. Examples include, but are not limited to, boundary recovery, residential surveying, lot surveying, title surveying, as-built title surveying, and right-of-way surveying. The

term does not include activities performed after taxable surveying has been completed to search the surveyed area for items of archaeological or historic significance.

- (10) Temporary help service – An individual, company, or corporation covered by Industry Group 7363, Group 736, Major Group 73 of the Standard Industrial Classification Manual, 1989, and includes an individual, company, or corporation that supplies personnel on a temporary basis to supplement a customer's existing work force. In the context of this section, such temporary personnel must perform a service that is normally performed by the customer's own employees; the customer must provide all supplies and equipment necessary; and the temporary personnel must be under the direct or general supervision of the customer to whom the help is furnished.
- (b) Responsibilities of persons providing real property services on both residential and nonresidential real property. With the exception of terms defined by subsection (a)(6) and (10) of this section, persons providing services defined in subsection (a) of this section are performing real property services. Persons performing real property services must obtain a tax permit and collect and remit sales or use taxes on all charges for real property services.
- (c) Resale certificates.
- (1) A properly completed resale certificate may be used to purchase tangible personal property tax free if the care, custody, and control of the property is transferred to the customer as part of the real property service. For example, a taxpayer purchases paper products to be left at the customer's premises when providing janitorial services, or garbage dumpsters to leave on the customer's premises as a part of the garbage collection service. Taxpayer may purchase the paper products and dumpsters tax free by issuing a resale certificate. Tax is due on the total amount charged the customer, including amounts for the paper products, dumpster, and for the services.
  - (2) A properly completed resale certificate may be issued for a service if the buyer intends to transfer the service as an integral part of a taxable service. A service will be considered an integral part of a taxable service if the service purchased is essential to the performance of the taxable service and without which the taxable service could not be rendered. See Sec. 3.285 of this title (relating to Resale Certificate; Sales for Resale).
- (3) A properly completed resale certificate may be issued to purchase a taxable service tax free if the buyer intends to incorporate the service into tangible personal property which will be resold. If the entire service is not incorporated into the tangible personal property, it will be presumed the service is subject to tax and the service will only be exempt to the extent the buyer can establish the value of that portion of the service actually incorporated into the tangible personal property. If the buyer does not intend to incorporate the entire service into the tangible personal property, the buyer may not issue a resale certificate but he may claim credit at the time of sale of the tangible personal property for the portion of the service that was actually incorporated into the tangible personal property.
- (d) Exemption certificates. Persons providing real property services may accept a properly completed exemption certificate in lieu of tax when the service is purchased by an exempt entity. See Sec. 3.322 of this title (relating to Exempt Organizations), Sec. 3.287 of this title (relating to Exemption Certificates) and Sec. 3.288 of this title (relating to Direct Payment Procedures and Qualifications).
- (e) Landscaping, lawn, and yard maintenance provided by persons under 18 years old or by persons 65 years old or older. Charges for the performance of landscaping, lawn, and yard maintenance services (subsection (a)(4) and (5) of this section) are exempt if performed by:
- (1) a self-employed person under 18 years of age whose total receipts from providing landscaping, lawn, or yard maintenance are \$1,000 or less during either the preceding calendar quarter or the same calendar quarter of the preceding year; or
  - (2) an individual 65 years of age or older whose total receipts from providing landscaping or yard maintenance are \$5,000 or less for the four most recent quarters.
- (f) Landfill charges connected with garbage collection services. Persons providing garbage collection services may not separate in the bill to their customers the charge for garbage collection from the charge for use of the landfill for the purpose of reducing the amount upon which tax must be collected. The charge paid by the service provider for access to the landfill, while not taxable to the service provider, is a necessary expense in providing the garbage collection service and is not excludable from the fee to the service provider's customer for garbage collection.

- (g) Garbage removal facilities. When a city, county, or any other entity provides a facility where garbage may be left and which will, at another time, be moved to a landfill, the fee charged to persons depositing garbage into such a facility is considered to be a charge for garbage collection and is taxable.
- (h) Garbage collection services that may be excluded from tax. Persons providing collection services for customers having waste excluded from the definition of “garbage or other solid waste” may accept an exemption certificate from the customer in lieu of tax. The exemption certificate must state the type of waste being excluded, and that either the waste to be collected is totally excludable or that the customer has both taxable and nontaxable waste and the customer will be responsible for accruing tax on that portion of the charge which represents taxable services. The customer may use any reasonable allocation for reporting tax on taxable services which is supportable by books and records.
- (i) Unrelated services.
  - (1) A service will be considered as unrelated if:
    - (A) it is not a real property service, nor a service or labor taxable under another provision of the Tax Code, Chapter 151;
    - (B) it is not provided as a part of the taxable service and is of a type which is commonly provided on a stand-alone basis; and
    - (C) the performance of the unrelated service is distinct and identifiable. Examples of an unrelated service which may be excluded from the tax base include maintenance charges meeting the definition in Sec. 3.357 of this title (relating to Labor Relating to Nonresidential Real Property Repair, Remodeling Restoration, Maintenance, New Construction, and Residential Property), engineering studies, and architectural or landscaping designs.
  - (2) When nontaxable unrelated services and taxable services are sold or purchased for a single charge and the portion relating to taxable services represents more than 5.0% of the total charge, the total charge is presumed to be taxable. The presumption may be overcome by the service provider at the time the transaction occurs by separately stating to the customer a reasonable charge for the taxable services. However, if the charge for the taxable portion of the services is not separately stated at the time of the transaction, the service provider or the purchaser may later establish for the comptroller, through documentary evidence, the percentage of the total charge that relates to nontaxable unrelated services. A customer may presume that a separately stated charge from a service provider for taxable services is reasonable, in the context of this section. The service provider’s books must support the apportionment between exempt and nonexempt activities based on the cost of providing the service or on a comparison to the normal charge for each service if provided alone. If the charge for exempt services is unreasonable when the overall transaction is reviewed, considering the cost of providing the service or a comparable charge made in the industry for each service, the comptroller will adjust the charges and assess the service provider the additional tax, penalty, and interest on the taxable services.
- (3) Charges for services or expenses directly related to or incurred while providing the taxable service are taxable and may not be separated for the purpose of excluding these charges from the tax base. Examples include charges for meals, telephone calls, hotel rooms, or airplane tickets.
- (j) Governmental entities. When garbage collection services are provided by a governmental entity without a specific charge being assessed, such as when this service is provided as a basic part of services funded by a tax or a set fee structure of the governmental entity, sales or use taxes are not due. This section does not apply if the fee changes each billing period based on quantity of consumption of tangible personal property or service provided individual service recipients.
- (k) Local taxes. With the exception of garbage or other solid waste removal services, local sales and use taxes apply to services in the same way as they apply to tangible personal property. Generally, service providers must collect local sales taxes if their place of business is within a local taxing jurisdiction, even if the service is actually provided at a location outside that jurisdiction. However, transit sales taxes do not apply to services provided outside the boundaries of the transit area. If the service provider’s place of business is outside a local taxing jurisdiction but the service is provided to a customer within a local taxing jurisdiction, local use taxes apply and the service provider is required to collect them. Local taxes for garbage or other solid waste removal services are allocated to the local taxing jurisdiction in which the garbage or other solid waste is located when its collection or removal begins.
- (l) For general information on the collection and reporting responsibilities of providers and purchasers of taxable services, see secs. 3.286, 3.374, 3.375, 3.424, and



3.425 of this title (relating to Seller's and Purchaser's Responsibilities; Imposition of the Sales Tax; Collection by Retailer; Bracket System Formula; Determining City Tax, Administration of Use Tax; Collection by Retailer, Imposition of Sales Tax, and Administration of Use Tax; Imposition and Collection).

- (m) Use tax. If a seller of a taxable service is not doing business in Texas or a specific local taxing jurisdiction and is not required to, or does not voluntarily, collect and report the applicable Texas tax, it is the Texas customer's responsibility to report and pay the use tax directly to this office.
- (n) Property management companies.
- (1) Employees permanently assigned to one rental property are considered employees of that property when the property manager is reimbursed by the property owner on a dollar-for-dollar basis. On managed rental properties, the employees remain assigned to the property while employed by successive owners or management companies. The reimbursement charge for taxable services performed on a managed rental property by management company employees assigned to it will not be taxable. However, if these same employees provide real property services for other properties, the property manager must collect tax on the total charge for those services. The management company owes tax on the purchase price of all taxable items purchased and provided to the employees providing services on managed rental property.
  - (2) Property management companies whose employees provide taxable services as part of their overall management and operation of a rental property need not collect tax on those services if their value is insignificant.
    - (A) Such taxable services will be considered insignificant in any billing period in which their value is 5.0% or less of the amount charged by the management company for services. The amount charged by the management company for taxable services is to be determined by deducting from the management company's total charge any mortgage payments made by the management company for the property owner and any amounts paid to persons other than employees of the management company for goods and services.
    - (B) If the value of the taxable services exceeds the 5.0% limit, the entire amount charged by the management company will be considered

taxable unless charges for taxable services are separately itemized and taxed as provided under subsection (i)(2) of this section.

- (3) Purchases by the property management company for use by the property owner of taxable goods, labor, or services from third-party suppliers may be handled in either of the following ways:
  - (A) the management company may issue a resale certificate to the supplier and collect tax from the property owner on the itemized charge for the goods, labor, or service; or
  - (B) the management company may pay tax to the supplier and collect from the property owner an amount equal to the total of the amount paid by the management company for the goods, labor, or services and the tax paid.

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### **Rule 3.362**

Sec. 3.362. Labor Relating to Increasing Capacity in a Production Unit in a Petrochemical Refinery or Chemical Plant. (Tax Code Sec. 151.0047)

- (a) Definitions. The following words and terms when used in this section, shall have the following meanings, unless the context clearly indicates otherwise.
- (1) Allied chemical product – A consumer or end-user product manufactured from basic or intermediate chemicals. Examples include drugs, soaps, detergents, paints and agricultural chemical formulations.
  - (2) Basic or intermediate chemical – Basic chemicals are the initial building blocks or raw materials that are processed and combined to manufacture intermediate chemicals. Intermediate chemicals are products that are manufactured from basic chemicals and other intermediate chemicals and are manufactured into finished chemical products. Examples of basic chemicals include alkalies, chlorine, nitrogen, sulfur, benzene, ethylene, propylene methane, and sodium carbonate. Examples of intermediate chemicals include synthetic fibers, polymers, resins, elastomers, dyes, and pigments.
  - (3) Chemical plant –
    - (A) A facility that in a single continuous operation or using a batch processing method manufactures a basic or an intermediate chemical.

- (B) A chemical plant may be either a single facility existing by itself or a facility within a chemical plant complex consisting of a number of separate chemical plants each of which produces a single basic or intermediate chemical product. A chemical plant complex may include any combination of distinct facilities that manufacture basic chemicals, intermediate chemicals, or allied chemical products. In a chemical plant complex, each facility is considered individually to determine whether it qualifies as a chemical plant.
- (C) The term does not include:
- (i) a facility that manufactures “allied chemical products”; or
  - (ii) a facility, other than one that produces a basic or an intermediate chemical, that generates any chemical as a waste product or a by-product.
- (4) Crude oil – A mixture of hydrocarbons that exists in liquid phase in underground reservoirs and remains liquid at atmospheric pressure after passing through surface-separating facilities. The term includes liquid condensate and liquid hydrocarbons produced from tar sands, gilsonite, and oil shale. Drip gases are also included, but topped crude oil (residual oil) and other unfinished oils are excluded. Liquids produced at natural gas processing plants and mixed with crude oil are likewise excluded where identifiable.
- (5) Increased capacity –
- (A) Increasing the capability of the manufacturing or processing production unit to produce:
    - (i) more of the same product measured by units per hour or units per year; or
    - (ii) a new product.
  - (B) Increasing a unit’s capability to produce more of an existing product and less of another existing product is not increasing the unit’s capacity unless the overall production unit capability is increased. For example, if a production unit that produces 50 units of product X and 50 units of product Y is modified so that it produces 60 units of product X and 40 units of product Y, the production unit’s capacity has not been increased.
- (6) Manufacturing or processing production unit – 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 a finished product. Examples of such equipment include reactors, distillation columns, catalytic crackers, fractionators, or other primary process equipment, and ancillary equipment such as heat exchangers, cooling towers, computer control units, piping, valves, and actuators. Another example of ancillary equipment is quality control equipment that is used during the manufacturing process, but not equipment used to test products before the process begins or after it is completed. The production unit does not include maintenance equipment; research and development laboratory equipment; waste handling or treatment equipment; equipment for the storage of feedstock, catalysts, or finished products; loading and unloading equipment; or any other equipment that is not used in the actual processing or manufacturing operation.
- (7) New product – A product that has different product properties and a different commercial application than the product previously manufactured or processed by that production unit. Examples of new products include chlorine produced from sodium chloride; styrene from benzene; aqueous hydrogen chloride (HCl) from anhydrous HCl; and soft polyethylene from hard polyethylene if the soft polyethylene is used to manufacture different end products than the hard polyethylene. Producing gasoline with a 91-octane rating instead of an 89-octane rating for use in motor vehicle engines is not producing a new product. Changes caused by straining or purifying an existing product or cosmetic changes such as adding or removing color or odor to or from an existing product will not create a new product. For example, the manufacture of a different grade of the same product, such as technical sulfuric acid which is colored and contains impurities and anhydrous 100% sulfuric acid which is colorless and odorless, does not qualify one as a new or different product from the other.
- (8) Petrochemical refinery – A facility that manufactures finished petroleum products from crude oil, unfinished oils, natural gas liquids, other hydrocarbons, and oxygenates. Products of these refineries include gasoline, diesel, kerosene, distillate fuel oils, liquefied petroleum gas (LPG), residual fuel oils, lubricants, and other products refined through alkylation, coking, cracking, dewaxing, desulphurization, distillation, hydrotreating, isomerization, polymerization,



or other chemical processes. These facilities also produce petrochemical feedstock for use by chemical plants. The term does not include facilities at an oil or gas lease site that remove water or other impurities and merely make the product more marketable.

- (b) Tax responsibilities of persons who make improvements to a manufacturing or processing production unit of a petrochemical refinery or chemical plant.
- (1) Persons who repair, remodel, restore, or modify a manufacturing or processing production unit of a petrochemical refinery or chemical plant to increase the capacity in the production unit are not performing a taxable real property repair and remodeling service. Such persons are governed by the provisions of Sec. 3.291 of this title (relating to Contractors).
    - (A) Contractors performing lump-sum contracts as defined in Sec. 3.291 of this title (relating to Contractors) are consumers of all materials, consumable items, and equipment used or incorporated into a customer's property. As a consumer, a contractor must pay tax to on all such all materials, consumable items, and equipment. See Sec. 3.291 of this title (relating to Contractors) for more information on lump-sum contracts. Contractors performing lump-sum contracts for persons having direct payment permits may not accept a direct payment exemption certificate from those persons. When performing lump-sum contracts for a direct payment permit holder, the contractor must pay sales tax to the supplier or accrue and remit sales tax on incorporated materials removed from a tax-free inventory for incorporation into the direct payment permit holder's realty. Direct payment permit holders cannot authorize the contractor or any other person to purchase any taxable item using their permit. See Sec. 3.288 of this title (relating to Direct Payment Procedures and Qualifications).
    - (B) Contractors performing separated contracts as defined in Sec. 3.291 of this title (relating to Contractors) are considered retailers of all materials physically incorporated into the realty being improved. As a retailer, a contractor must collect tax from the customer based upon the agreed contract price of the incorporated materials. See Sec. 3.291 of this title (relating to Contractors) for more information on separated contracts. Contractors performing separated contracts for persons having direct payment permits may accept a direct payment exemption certificate from those persons in lieu of tax for all tangible personal property incorporated into customer's realty. A direct payment exemption certificate may not be accepted for tax liability incurred by the contractor on machinery or equipment rented or leased by the contractor and used in the performance of the contract. See Sec. 3.288 of this title (relating to Direct Payment Procedures and Qualifications).
  - (2) Repairs, remodeling, restorations, or modifications other than to the processing production unit or that do not increase the capacity of the processing production unit are governed by the provisions of Sec. 3.357 of this title (relating to Labor Relating to Nonresidential Real Property Repair, Remodeling Restoration, Maintenance, New Construction, and Residential Property).
  - (3) Persons who perform repair, remodeling, maintenance, or restoration services on tangible personal property are governed by the provisions of Sec. 3.292 of this title (relating to Repair, Remodeling, Maintenance, and Restoration of Tangible Personal Property). These services may be exempt under the Tax Code, Sec. 151.3111, that exempts services performed on tangible personal property if the property is exempt because of the nature of the property, its use, or a combination of its nature and its use.
  - (4) Where increased capacity improvements and taxable services are sold or purchased for a single charge and the portion relating to taxable services represents more than 5.0% of the total charge, the total charge is presumed to be taxable. The presumption may be overcome by the service provider at the time the transaction occurs by separately stating to the customer a reasonable charge for the taxable services. However, if the charge for the taxable portion of the services is not separately stated at the time of the transaction, the service provider or the purchaser may later establish for the comptroller, through documentary evidence, the percentage of the total charge that relates to nontaxable unrelated services. Examples of acceptable documentation include written contracts detailing the scope of work, bid sheets, tally sheets, schedules of values, and blueprints.
  - (5) When both increased capacity improvements and taxable services are being performed under the same contract, the parties to the contract should

separately identify taxable from nontaxable labor in a contract and the charges applicable to each or the entire contract will be presumed to be for taxable services. Documentation which clearly defines the work being performed should be retained by both parties to show that had the increased capacity improvements and taxable services been done independently of each other, the cost of each would be reasonably near the allocation of charges. Examples of acceptable documentation include written contracts which detail the scope of work, bid sheets, tally sheets, schedules of values, and blueprints. If there is not a written contract signed by both parties clearly showing agreement as to the taxable and nontaxable work being performed, the customer and the service provider must prepare, at the time of the transaction, a written certification verifying the allocation of charges for increased capacity improvements and taxable services. The comptroller may recalculate the charges if the allocation appears unreasonable and either party may be held responsible for the additional tax due.

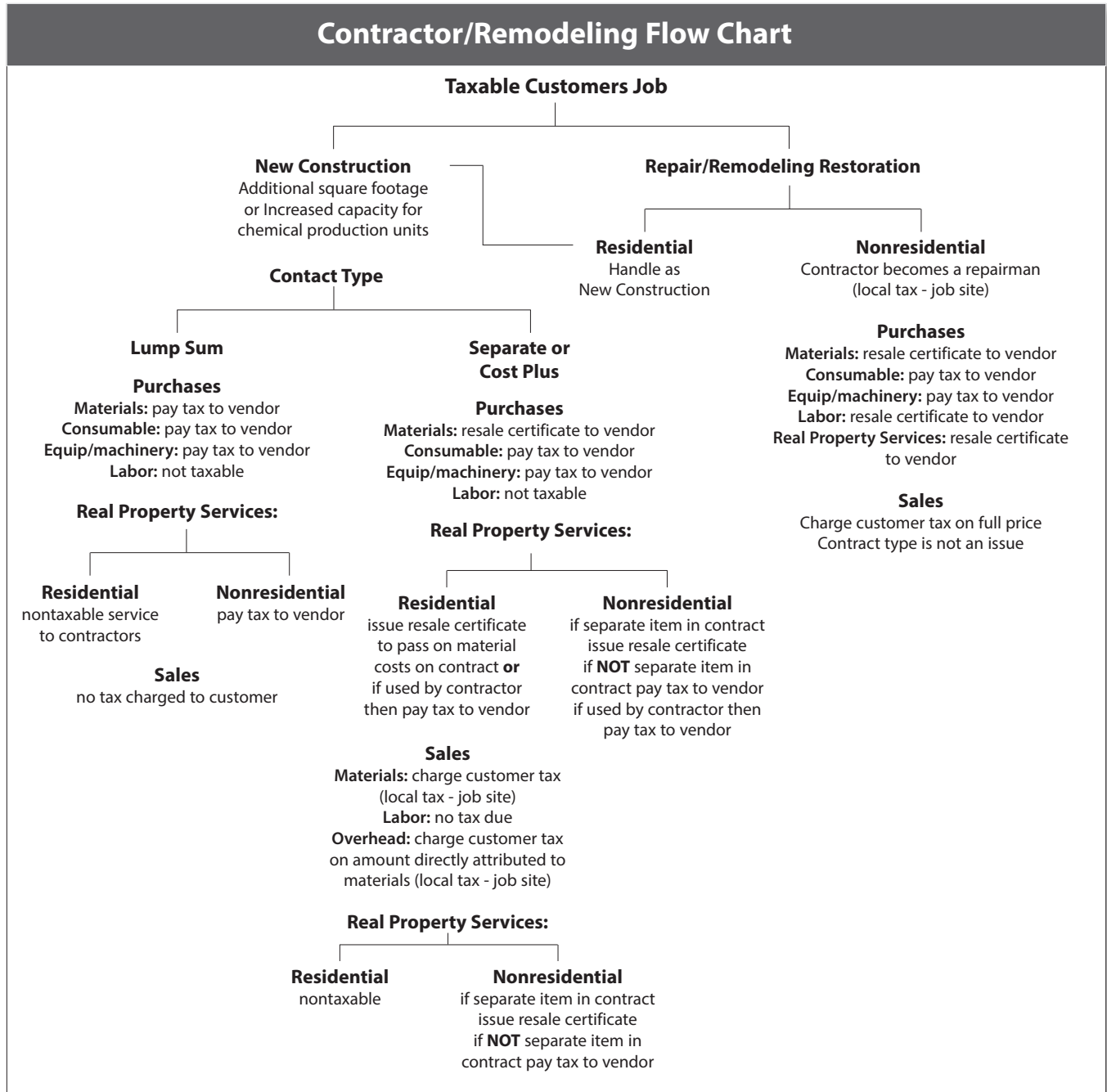
- (6) A service provider's customer must be able to substantiate by way of documentary evidence that repair, remodeling, restoration, or modification services performed on a production unit increase the unit's capacity as defined in subsection (a)(5) of this section. If the person performing the service does not have the certification set out in paragraph (5) of this subsection, the service provider must presume that the service is taxable and collect tax. If the service provider's customer has documentation to prove that the labor increases the capacity of a production unit, the customer may issue an exemption certificate in lieu of paying tax to the service provider. The certificate must state that the labor increases the production unit's capacity as defined in subsection (a)(5) of this section, and that the customer will be liable for any additional tax due in the event that it is determined that taxable services were performed. A service provider who accepts such a certificate should follow the guidelines set out in paragraph (1) of this subsection and Sec. 3.291 of this title (relating to Contractors).

Effective Date: April 3, 1996

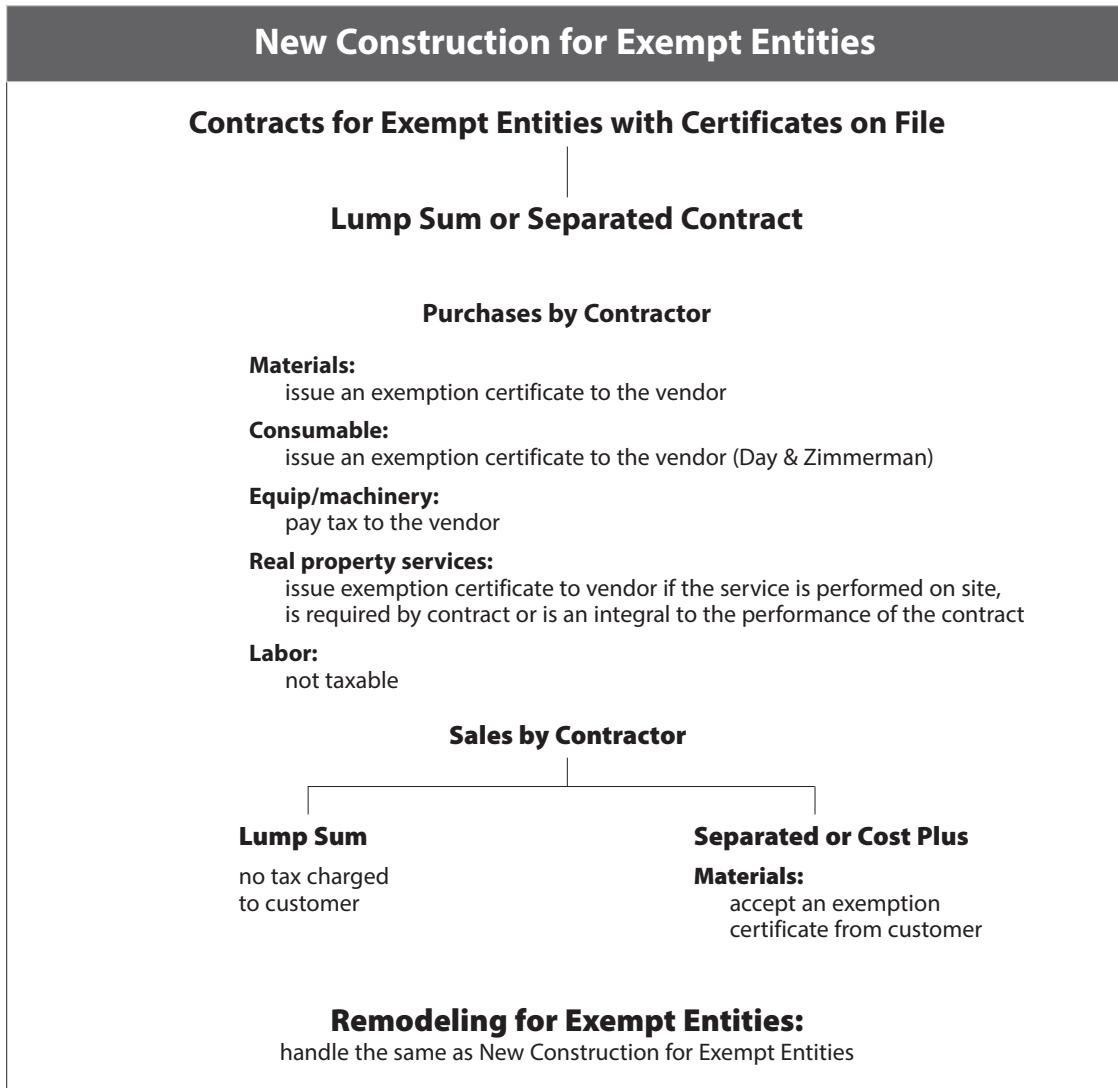
Filed with Secretary of State: March 13, 1996

# Appendix

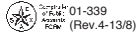
## Contractor Flowchart – Taxable Customers



## Contractor Flowchart – Exempt Customers



# Resale Certificate Form



SAVE A COPY CLEAR SIDE

## Texas Sales and Use Tax Resale Certificate

Name of purchaser, firm or agency as shown on permit	Phone (Area code and number)
Address (Street & number, P.O. Box or Route number)	
City, State, ZIP code	
Texas Sales and Use Tax Permit Number (must contain 11 digits)	
<input type="text"/>	
Out-of-state retailer's registration number or Federal Taxpayers Registry (RFC) number for retailers based in Mexico	
<input type="text"/> (Retailers based in Mexico must also provide a copy of their Mexico registration form to the seller.)	

I, the purchaser named above, claim the right to make a non-taxable purchase (for resale of the taxable items described below or on the attached order or invoice) from:

Seller: \_\_\_\_\_

Street address: \_\_\_\_\_

City, State, ZIP code: \_\_\_\_\_

Description of items to be purchased on the attached order or invoice:

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

Description of the type of business activity generally engaged in or type of items normally sold by the purchaser:

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

The taxable items described above, or on the attached order or invoice, will be resold, rented or leased by me within the geographical limits of the United States of America, its territories and possessions or within the geographical limits of the United Mexican States, in their present form or attached to other taxable items to be sold.


I understand that if I make any use of the items other than retention, demonstration or display while holding them for sale, lease or rental, I must pay sales tax on the items at the time of use based upon either the purchase price or the fair market rental value for the period of time used.

*I understand that it is a criminal offense to give a resale certificate to the seller for taxable items that I know, at the time of purchase, are purchased for use rather than for the purpose of resale, lease or rental, and depending on the amount of tax evaded, the offense may range from a Class C misdemeanor to a felony of the second degree.*

Purchaser	Title	Date
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**This certificate should be furnished to the supplier.  
Do not send the completed certificate to the Comptroller of Public Accounts.**

# Exemption Certificate Form

 01-339 (Back)  
Sales and Use Tax Exemption Certificate  
(Rev. 4-13/8)

SAVE A COPY

CLEAR SIDE

## Texas Sales and Use Tax Exemption Certification

*This certificate does not require a number to be valid.*

Name of purchaser, firm or agency	
Address (Street & number, P.O. Box or Route number)	Phone (Area code and number)
City, State, ZIP code	

I, the purchaser named above, claim an exemption from payment of sales and use taxes (for the purchase of taxable items described below or on the attached order or invoice) from:

Seller: \_\_\_\_\_

Street address: \_\_\_\_\_ City, State, ZIP code: \_\_\_\_\_

Description of items to be purchased or on the attached order or invoice:


\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

Purchaser claims this exemption for the following reason:

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

I understand that I will be liable for payment of all state and local sales or use taxes which may become due for failure to comply with the provisions of the Tax Code and/or all applicable law.

*I understand that it is a criminal offense to give an exemption certificate to the seller for taxable items that I know, at the time of purchase, will be used in a manner other than that expressed in this certificate, and depending on the amount of tax evaded, the offense may range from a Class C misdemeanor to a felony of the second degree.*

Purchaser 	Title	Date
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NOTE: This certificate cannot be issued for the purchase, lease, or rental of a motor vehicle.

**THIS CERTIFICATE DOES NOT REQUIRE A NUMBER TO BE VALID.**

Sales and Use Tax "Exemption Numbers" or "Tax Exempt" Numbers do not exist.

**This certificate should be furnished to the supplier.  
 Do not send the completed certificate to the Comptroller of Public Accounts.**