

New York State Department of Taxation and Finance
Office of Tax Policy Analysis
Technical Services Division

TSB-A-04(15)S
Sales Tax
June 16, 2004

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S030603A

On June 3, 2003, the Department of Taxation and Finance received a Petition for Advisory Opinion from The Claridge Furniture Company, Inc., 3240 Chili Avenue, Rochester, NY 14624. Petitioner, The Claridge Furniture Company, Inc., furnished additional information with respect to the Petition on August 11, 2003.

The issues raised by Petitioner are:

1. Whether the purchases of materials for upgrades from Petitioner, as described below, for a new home under contract to be built are subject to sales tax.
2. If such purchases are not taxable, whether Petitioner may accept a *Certificate of Capital Improvement* (Form ST-124) from the home purchaser.

Petitioner submitted the following facts as the basis for this Advisory Opinion.

A customer enters into a construction contract with a builder for the construction of a house on a designated lot. The construction contract allows the customer (home buyer) to choose certain standard materials, colors and styles. The home buyer is referred by the builder to a related company, Petitioner, for the selection of materials, colors and/or styles. When choosing the materials the home buyer may decide on an upgrade, the cost of which is not covered by the contract with the builder. Petitioner completes a form entitled "Work Order Change Sheet/Upgrade Sheet" which shows the change requested and the additional cost to provide a requested upgrade. The home buyer is required by the builder to provide payment to Petitioner for the additional cost amount with the completion of this form.

The Work Order Change Sheet/Upgrade Sheet states, "This sheet is to be used for alterations and additions to the present contract. Additions and alterations to be paid when ordered, or Builder may proceed with the terms of the present contract." The form also provides the lot and development where the house is to be built. The home buyer signs as buyer, the form is dated and the signatures are witnessed. The contract referred to in this Work Order Change Sheet/Upgrade Sheet is the construction contract between the home buyer and the builder.

Petitioner currently does not collect tax on the payments received from the home buyer for the additional cost of the upgrade, and the home buyer completes a *Certificate of Capital*

Improvement (Form ST-124) for Petitioner to retain on file. The amount paid by the home buyer is applied to the builder's account, for that contract, as partial payment for the builder's materials.

The builder purchases the building materials from Petitioner, including materials for upgrades. Petitioner currently collects tax from the builder on the total cost of all materials. In the case of an upgrade, Petitioner collects tax from the builder based on the total cost of materials for the upgrade. The total cost of materials is the total amount paid to Petitioner for materials which includes monies received from the builder and the home buyer.

Petitioner requests that it be assumed that the construction projects in question, including any upgrades, constitute a capital improvement for the purpose of this Advisory Opinion.

Applicable law and regulations

Section 1101(b) of the Tax Law provides, in part:

When used in this article for the purposes of the taxes imposed by subdivisions (a), (b), (c) and (d) of section eleven hundred five and by section eleven hundred ten, the following terms shall mean:

(1) Purchase at retail. A purchase by any person for any purpose other than those set forth in clauses (A) and (B) of subparagraph (i) of paragraph (4) of this subdivision.

* * *

(4) Retail sale. (i) A sale of tangible personal property to any person for any purpose, other than (A) for resale as such or as a physical component part of tangible personal property, or (B) for use by that person in performing the services subject to tax under paragraphs (1), (2), (3), (5), (7) and (8) of subdivision (c) of section eleven hundred five where the property so sold becomes a physical component part of the property upon which the services are performed or where the property so sold is later actually transferred to the purchaser of the service in conjunction with the performance of the service subject to tax. Notwithstanding the preceding provisions of this subparagraph, a sale of any tangible personal property to a contractor, subcontractor or repairman for use or consumption in erecting structures or buildings, or building on, or otherwise adding to, altering, improving, maintaining, servicing or repairing real property, property or land, as the terms real property, property or land are defined in the real property tax law, is deemed to be a retail sale regardless of whether the tangible personal property is to be resold as such before it is so used or consumed, except that a sale of a new mobile home to a contractor, subcontractor or repairman who, in such capacity, installs such property is not a retail sale. . . .

* * *

(5) Sale, selling or purchase. Any transfer of title or possession or both, exchange or barter, rental, lease or license to use or consume (including, with respect to computer software, merely the right to reproduce), conditional or otherwise, in any manner or by any means whatsoever for a consideration, or any agreement therefor, including the rendering of any service, taxable under this article, for a consideration or any agreement therefor.

* * *

(9) Capital improvement. (i) An addition or alteration to real property which:

(A) Substantially adds to the value of the real property, or appreciably prolongs the useful life of the real property; and

(B) Becomes part of the real property or is permanently affixed to the real property so that removal would cause material damage to the property or article itself; and

(C) Is intended to become a permanent installation.

Section 1105 of the Tax Law provides, in part:

Imposition of sales tax On and after June first, nineteen hundred seventy-one, there is hereby imposed and there shall be paid a tax . . . upon:

* * *

(c) The receipts from every sale, except for resale, of the following services:

* * *

(3) Installing tangible personal property . . . whether or not the services are performed directly or by means of coin-operated equipment or by any other means, and whether or not any tangible personal property is transferred in conjunction therewith, except:

* * *

(iii) for installing property which, when installed, will constitute an addition or capital improvement to real property, property or land, as the terms real property, property or land are defined in the real property tax law as such term capital improvement is defined in paragraph nine of subdivision (b) of section eleven hundred one of this chapter; . . .

Section 1110(a) of the Tax Law provides, in part, as follows:

Except to the extent that property or services have already been or will be subject to the sales tax under this article, there is hereby imposed on every person a use tax for the use within this state on and after June first, nineteen hundred seventy-one except as otherwise exempted under this article, (A) of any tangible personal property purchased at retail, (B) of any tangible personal property (other than computer software used by the author or other creator) manufactured, processed or assembled by the user, (i) if items of the same kind of tangible personal property are offered for sale by him in the regular course of business or (ii) if items are used as such or incorporated into a structure, building or real property by a contractor, subcontractor or repairman in erecting structures or buildings, or building on, or otherwise adding to, altering, improving, maintaining, servicing or repairing real property, property or land, as the terms real property, property or land are defined in the real property tax law, if items of the same kind are not offered for sale as such by such contractor, subcontractor or repairman or other user in the regular course of business, . . .

Section 1115(a) of the Tax Law provides, in part:

Receipts from the following shall be exempt from the tax on retail sales imposed under subdivision (a) of section eleven hundred five and the compensating use tax imposed under section eleven hundred ten:

* * *

(17) Tangible personal property sold by a contractor, subcontractor or repairman to a person other than an organization described in subdivision (a) of section eleven hundred sixteen, for whom he is adding to, or improving real property, property or land by a capital improvement, or for whom he is about to do any of the foregoing, if such tangible personal property is to become an integral component part of such structure, building or real property; provided, however, that if such sale is made pursuant to a contract irrevocably entered into before September first, nineteen hundred sixty-nine, no exemption shall exist under this paragraph.

Section 526.6(d)(8) of the Sales and Use Tax Regulations provides, in part:

Other inter-corporate transactions. (i) The sale of property by one related corporation to another related corporation is a retail sale, and taxable to the extent of the consideration paid, or the fair market value, if the consideration paid is not an adequate indication of the true value of the property transferred.

Section 541.1(b) of the Sales and Use Tax Regulations provides, in part:

The principal distinguishing feature of a sale to a contractor, as compared to a sale to other vendors who purchase tangible personal property for resale, is that the sale of tangible personal property to a contractor for use or consumption in construction is a retail sale and subject to sales and use tax, regardless of whether tangible personal property is to be resold as such or incorporated into real property as a capital improvement or repair. . . .

Section 541.5 of the Sales and use Tax Regulations provides, in part:

(a) The term customers in this classification includes, but is not limited to:

(1) residential customers; and

(2) business customers.

(b) Capital improvements contracts. (1) Purchases. All purchases of tangible personal property (excluding qualifying production machinery and equipment exempt under section 1115(a)(12) of the Tax Law) which are incorporated into and become part of the realty or are used or consumed in performing the contract are subject to tax at the time of purchase by the contractor or any other purchaser. A certificate of capital improvement may not be validly given by any person or accepted by a supplier to exempt the purchase of these materials.

(2) Labor and material charges. All charges by a contractor to the customer for adding to or improving real property by a capital improvement are not subject to tax provided the customer supplies the contractor with a properly completed certificate of capital improvement.

* * *

(4) Documents; capital improvement contracts.

(i) When a properly completed certificate of capital improvement has been furnished to the contractor, the burden of proving the job or transaction is not taxable and the liability for the tax rests solely upon the customer.

(a) The prime contractor should obtain a certificate of capital improvement from the customer and retain it as part of his records. Copies of such certificate must be furnished to all subcontractors on the job and retained as part of their records.

(b) A certificate of capital improvement may not be issued by a contractor, subcontractor or any other person to a supplier on the purchase of tangible personal property.

Opinion

The builder in this case refers its customers (home buyers) to a related company, Petitioner, to make selections of colors and styles of certain materials to be used as part of the construction contract to build a house. When choosing these materials the home buyer may decide to change a standard material or choose an upgraded material. For such changes and upgrades, Petitioner completes a "Work Order Change Sheet/Upgrade Sheet" which lists the change or upgrade requested with any additional cost. This form provides that it represents alterations and/or additions to the present construction contract between the home buyer and the builder, and is signed by the home buyer.

The Work Order Change Sheet/Upgrade Sheet provides that without payment the builder will proceed according to the terms of the original construction contract. Upon receipt of payment the change order/upgrade form becomes an addendum to the construction contract. This addendum is an agreement between the home buyer and the builder, pursuant to which the builder directs the home buyer to make the payment to Petitioner when selecting the upgrade.

The builder purchases materials from Petitioner, which are installed into the house pursuant to a construction contract. When an upgrade is requested by the home buyer, the builder purchases the upgraded materials from Petitioner and installs them into the house pursuant to the Work Order Change Sheet/Upgrade Sheet, as agreed to by and paid for by the home buyer. The builder directs the home buyer to pay to Petitioner the additional cost attributable to the upgrade materials, which the builder owes to Petitioner. Petitioner is selling the building materials, including upgrades, to the builder and the home buyer is providing partial payment to Petitioner on behalf of the builder.

Petitioner states that its payment from the builder for standard materials includes sales tax. Further, Petitioner states that payments from the builder for upgraded materials includes sales tax based on the total cost of the materials. Payment for the costs of the upgraded materials is partially

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paid by the home buyer to Petitioner when the upgrade is requested and the remainder of the payment is provided by the builder. For the purpose of this Advisory Opinion the upgraded materials are presumed to be used in capital improvements.

Under these circumstances Petitioner has made a sale of materials to the builder. Pursuant to section 1101(b)(4) of the Tax Law, the sale of any tangible personal property to a contractor for use or consumption in erecting structures is deemed to be a retail sale subject to sales tax. Therefore, the materials consumed in the upgrade are subject to tax when purchased by the builder, though part payment for such materials may be made to Petitioner by the home buyer.

Petitioner's customer with regard to the materials to be used in the upgrade is the builder. The home buyer is not the customer of Petitioner. The upgrade contract signed by the home buyer is an addendum to the contract between the home buyer and the builder pursuant to which the builder becomes bound to provide the contracted improvement, together with the contractual upgrades, to the realty. Thus, Petitioner must collect sales tax from the builder on the charges for the upgrade materials, including any portion of the charges for the upgrade materials remitted directly to Petitioner by the home buyer. Since Petitioner's sales to the builder are retail sales to a related company, such sales are taxable to the extent of the consideration paid, or the fair market value if the consideration paid is not an adequate indication of the true value of the property transferred. See section 526.6(d)(8)(i) of the Sales and Use Tax Regulations.

Petitioner is not currently imposing sales tax on the home buyer (as the home buyer is not the purchaser of the upgrade materials). However, the builder's expense for the materials consumed in the upgrade, including the sales tax imposed on the builder's purchase of such materials, may be factored into the payments that the home buyer makes to the builder or for the builder's account.

Since Petitioner does not contract to perform any services for the builder or the home buyer, Petitioner may not rely on a *Certificate of Capital Improvement* (Form ST-124) obtained from the home buyer to be relieved of tax liability on its sales of materials. See section 541.5(b)(1) of the Sales and Use Tax Regulations. Petitioner is selling tangible property which will be incorporated into an improvement to realty. The *Certificate of Capital Improvement* can never be accepted to exempt purchases of materials.

However, it should be noted that if instead of simply selling the builder the materials Petitioner were to provide these materials to the builder on an installed basis, Petitioner would then be considered a subcontractor. A subcontractor may accept a Certificate of Capital Improvement from a contractor for work performed on a capital improvement project. See section 541.5(b)(4)(i)(a) of the Sales and Use Tax Regulations. As a subcontractor Petitioner would not be required to collect tax from the builder on the installed materials, which are presumed in this case

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to qualify as a capital improvement. In such instances, Petitioner would be required to pay sales and use tax on the material which it uses in making such installations. See section 541.13 of the Sales and Use Tax Regulations. In order to purchase installation services and materials as part of the installation service without payment of sales tax the builder would provide Petitioner with a copy of the *Certificate of Capital Improvement* (Form ST-124) which was completed by the home buyer. As the prime contractor, the builder should obtain a *Certificate of Capital Improvement* from its customer and retain it as part of its records. See section 541.5(b)(4) of the Sales and Use Tax Regulations.

DATED: June 16, 2004

/s/
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NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.