

**New York State Department of Taxation and Finance  
Office of Counsel  
Advisory Opinion Unit**

TSB-A-13(25)S  
Sales Tax  
September 9, 2013

STATE OF NEW YORK  
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. S120307A

The Department of Taxation and Finance received a Petition for Advisory Opinion from [REDACTED]. Petitioner asks whether the receipts for incidental and ancillary repairs or part replacement(s) it performs while constructing a capital improvement to real property are subject to sales tax. Petitioner also asks whether it must pay sales tax to a subcontractor who has refused to accept a capital improvement certificate that Petitioner has itself accepted in good faith from its customer.

We conclude that incidental and ancillary repairs or part replacement(s) to real property that are not integral to the construction of a capital improvement constitute distinct repair or maintenance services subject to sales tax. Petitioner must collect sales tax on the receipts for these services even though its customer provided Petitioner an executed capital improvement certificate, if the Tax Department has informed Petitioner that the work does not constitute a capital improvement or Petitioner has knowledge that the service work is not integral to the capital improvement work. In all other circumstances, if Petitioner has accepted a capital improvement certificate from a customer in good faith, it is not obligated to collect sales tax.

**Facts**

Petitioner is a general contractor that performs capital improvement projects, such as new construction, alterations, and tenant fit-outs for commercial, retail and other non-residential property owners.

A Certificate of Capital Improvement executed by Petitioner's customer is provided to every subcontractor on the project regardless of the size of the subcontract. Sales tax is collected by the vendor on the purchase of all materials. In general, the plans and specifications for alterations and tenant fit-outs (including those in previously occupied spaces) dictate that Petitioner reuse certain existing equipment (e.g., fans, air conditioners, plumbing fixtures), and make certain that this equipment is in "like new condition" upon completion. Additionally, the plans and specifications may direct Petitioner to repair existing building components, such as masonry, flooring, plaster, or steel, that are to remain and/or act as a substrate for new building components.

Petitioner issues contracts to air-conditioning subcontractors to provide for all heating, ventilation and air-conditioning work in accordance with the plans and specifications. In addition to providing for new equipment and sheet metal ductwork, the plans may call for the reuse of a rooftop air conditioner, which, upon completion, is to be put into "like new condition."

After beginning work, the subcontractor may find that certain miscellaneous parts have to be replaced, the cost of which is insignificant to the overall cost of the capital improvement project. When

this happens, Petitioner will issue a change order to the subcontractor to make these repairs and replace some parts on the air-conditioning unit. The subcontractor will bill a distinct charge for these repairs.

Petitioner contends that when the contractor performing the HVAC work on a capital improvement project needs to replace a fan motor and make repairs to an existing air conditioner in order to make it work "like new", the cost of these repairs are part of the capital improvement project and should not be taxed as ordinary repairs. Petitioner also contends that repairs to masonry to ensure that a new glass facade is attached to a structurally sound building, repairs to a subfloor so that the new floor will be properly installed, or the preparation of existing walls to make certain finishes have a suitable substrate, are part of and included in the capital improvement project, and are not deemed to be ordinary repairs.

### **Analysis**

Section 1105(c)(5) of the Tax Law imposes sales tax upon the receipts from every sale, except for resale, of the service of "maintaining, servicing or repairing real property, property or land, . . . as distinguished from adding to or improving such real property, property or land, by a capital improvement."

The term "capital improvement" is defined as:

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.

Tax Law § 1101(b)(9)(i). "Maintaining, servicing and repairing" covers "all activities that relate to keeping real property in a condition of fitness, efficiency, readiness or safety or restoring it to such condition," including painting, and services to the grounds, such as lawn services, tree removal and spraying, trash removal, sewerage service, and snow removal. *See* 20 NYCRR § 527.7(a). Whether a service to real property is subject to sales tax depends on the "end result" of the service. "If the end result of the services is the repair or maintenance of real property, such services are taxable. If the end result of the same service is a capital improvement to the real property, such services are not taxable." 20 NYCRR § 527.7(b)(4).

A contractor can perform both capital improvement work and taxable services to real property for a customer. *See* TSB-A-09(10)S; TSB-A-05(7)S; TSB-A-87(30)S, TSB-A-85(5)S. However, services that by themselves would constitute taxable services become a component of capital improvement work if the services are integral to capital improvement work. For example, corrective work necessary to repair damage to real property caused by capital improvement work is itself a component of capital improvement work. *See* 20 NYCRR § 541.1(f). Another example is cleaning that occurs during the completion of the building and prior to the occupancy. This type of cleaning is known in the construction industry as "cleaning-up after the trades." The purpose of the cleaning is to

remove all construction residue including packaging and protective materials, plaster, paint, compound and dust. These cleaning services will qualify as part of the capital improvement. *See* TSB-A-02(60)S. Similarly, if an interior doorway is removed and the resultant opening in the wall is closed, the repainting of that wall will qualify as a capital improvement. *See* TSB-A-07(1)S.

If servicing of real property is not integral to the completion of capital improvement work, the service is distinct from the capital improvement work, and the receipts for the service are subject to sales and use tax. Service work is not integral to capital improvement work when the servicing is not necessitated by the capital improvement work and a clear physical separation exists between the property being serviced and the capital improvement.

Repairs to masonry to ensure that a new glass facade is attached to a structurally sound building, repairs to a subfloor so that the new floor will be properly installed, and the preparation of existing walls to make certain finishes have a suitable substrate are all integral parts of a capital improvement project. Consequently, Petitioner's receipts for these components of capital improvement work are not subject to sales tax.

The replacement of a fan motor, microprocessor control board, refrigerant or similar components of an air conditioning unit to restore the unit to a condition of fitness and efficiency if the component being replaced has failed or is near the end of its useful life, do not constitute a capital improvement. This type of service is routinely performed by itself. Further, the replacement of components of the air conditioning unit in question by Petitioner's subcontractor is not necessitated by the capital improvement work that Petitioner is performing based on the facts outlined above. The air conditioning unit containing the components is not itself being replaced and is clearly distinct from the duct work and other components of the HVAC system that Petitioner is renovating as part of its capital improvement work. Because the service work is not integral to the capital improvement work, receipts for the service are subject to sales tax.

Petitioner's timely receipt of a capital improvement certificate in good faith releases it from the obligation to collect sales tax from its customer. *See* Tax Law § 1132(c). That is, if Petitioner has accepted in good faith a certificate of capital improvement within 90 days after the completion of the capital improvement, it is not under a duty to investigate or police its customers, and has no duty to debate with its customers as to what constitutes a capital improvement. *See Saf-Tee Plumbing v State Tax Commission*, 77 AD2d 1 (3<sup>rd</sup> Dept 1980). An exemption document is accepted in good faith when a vendor "has no knowledge that the exemption certificate or other document issued by the purchaser is false or is fraudulently presented. If reasonable ordinary due care is exercised, knowledge will not be imputed to the seller required to collect the tax." 20 NYCRR § 532.4(a)(2)(i). Thus, Petitioner is not required to collect sales tax from a customer who has issued a capital improvement certificate pertaining to construction so long as Petitioner has no knowledge that the project does not qualify as a capital improvement.

If a contractor has been put on notice directly by the Tax Department that specific work does not qualify as a capital improvement, the contractor cannot accept in good faith a capital improvement certificate from a customer for such work and must collect sales tax from the customer on the receipts for the work. *See Matter of Hydronic Fabrications, Inc.*, Tax Appeals Tribunal, December 1, 1988, TSB-D-88(44)S. Because Petitioner is now on notice that the repair work on the air conditioning unit

described in this Advisory Opinion does not qualify as a capital improvement, it can no longer accept in good faith a capital improvement certificate for work that is identical in all relevant aspects to the HVAC repair described in the fact section of this Advisory Opinion. This requirement extends to any such work for which Petitioner has not received payment from its customer as of the date of its receipt of this Advisory Opinion.

If a contractor accepts in good faith a capital improvement certificate from a customer, any subcontractor that receives a copy of the certificate may rely on the general contractor's good faith acceptance of the capital improvement certificate from its customer and is not obligated to collect sales tax from the general contractor. *See* 20 NYCRR § 541.5(d)(1)(iii). However, a subcontractor has the right to demand sales tax from the general contractor if the subcontractor believes that the work it performs is taxable. That is, a subcontractor is not obligated to accept the general contractor's assertion that the work performed by the subcontractor is part of a capital improvement project. If a subcontractor demands sales tax from Petitioner, Petitioner must pay the tax. Petitioner, however, may apply for a refund of the sales tax paid to the subcontractor, and should be granted a refund unless the Tax Department can establish that Petitioner did not accept the capital improvement certificate in good faith. In this case, Petitioner may be entitled to a refund of tax it paid to a subcontractor for the HVAC repairs prior to the issuance of this Advisory Opinion. However, Petitioner would not be entitled to a refund of tax on that type of service after this AO is issued.

DATED: September 9, 2013

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NOTE: An Advisory Opinion is issued at the request of a person or entity. It is limited to the facts set forth therein and is binding on the Department only with respect to the person or entity to whom it is issued and only if the person or entity fully and accurately describes all relevant facts. An Advisory Opinion is based on the law, regulations, and Department policies in effect as of the date the Opinion is issued or for the specific time period at issue in the Opinion. The information provided in this document does not cover every situation and is not intended to replace the law or change its meaning.