**Private Letter Ruling**

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| **Ruling Number:** | **P-2008-009** |

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| **Tax Type:** | **Kansas Retailers' Sales Tax** |
| **Brief Description:** | **Installation, services and inspections of fire sprinkler systems.** |
| **Keywords:** |  |
| **Approval Date:** | **11/12/2008** |

**Body:**

Office of Policy & Research

November 12, 2008

XXXXXXXXXXXXXX
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XXXXXXXXXXX

Dear XXXXXXXXXX:

We wish to acknowledge receipt of your inquiry of November 6, 2008 regarding the application of Kansas Retailers’ Sales tax. You inquired regarding questions on sales tax on materials and services for your construction company which installs, services and inspects fire sprinkler systems.

Your inquiry asked about the sales tax on labor and materials for a variety of different scenarios. A response is listed by the question from your inquiry. However the general comments provided below relating to contractors may provide an explanation which relates to the overall nature of your inquiry.

Kansas looks at construction jobs as consisting of two components, materials and the labor to install or apply those materials. There are two basic rules that contractors follow regarding Kansas sales tax:
1. Contractors**must pay sales or use tax** as consumers when they buy materials and supplies used on their construction projects.
2. Contractors **must collect sales tax** as retailers when they bill their customers for the taxable labor services they perform in Kansas on their construction projects.

It is important to understand why contractors pay sales tax when they buy materials instead of buying materials tax exempt and charging sales tax to their customers. Contractors pay sales tax on their material purchases because sales tax is imposed on the retail sales of tangible personal property to the final user. For example, a contractor who agrees to construct a building is not contracting to sell lumber, cement, siding, roofing, and other building materials. The contractor is agreeing to apply his or her skill and labor to transform the construction materials into a completed building. When the building is accepted by the property owner, the nails, lumber, and other materials have become part of real property. These materials are no longer tangible personal property whose transfer is taxed under the Kansas sales tax act.

Listed below are the responses to the specific questions asked in your inquiry.

**New Construction – is labor taxable to our customer? Is the material that will be used in the project taxable to our customer?**

For sales tax purposes construction projects are differentiated between residential and commercial.

For residential property all construction labor services are exempt. This applies whether it is original construction, or any repair or remodeling type of construction labor service. Residential property is considered as an enclosure where an individual customarily lives. Residential property does not include transient accommodations such as hotels.

For commercial property only construction labor services performed in conjunction with the “original construction” of a building or facility are exempt from sales tax. There are five categories of construction project that are considered to be within the definition of “original construction”. If the construction falls within one of the following categories the labor services would not be taxable.

1) First or initial construction of a building or facility.

2) The addition of an entire room or floor to an existing building or facility.

3) Completion of any unfinished portion of an existing building or facility for the first owner.

4) Restoration, reconstruction, or replacement of a building or facility damaged or destroyed by fire, flood (natural flood only does not include things such as broken pipes), lightning, explosion, windstorm (means straight line winds of at least 80 mph), ice loading and attendant winds, terrorism or earthquake.

5) Construction, reconstruction, restoration, replacement, or repair of a bridge or highway.

Therefore the labor would not be taxable on a new construction project that falls within the definition of “original construction”.

Contractorsmust pay sales or use tax as consumers when they buy materials and supplies used on their construction projects, whether the project is for either residential or commercial.

**Remodel Labor – What is this?**
Remodel labor is any labor which is not included in the definition of “original construction” provided in the prior answer. However any remodel labor done in conjunction with a residential property is not taxable. Only commercial remodel labor is taxable.

**Service work – (anything that we either relocate or repair) is the labor taxable to our customer? Are the materials used taxable to our customer?**
Service work is defined in your inquiry as anything either relocated or repaired. This would be similar to the previous answer in that any labor which is included in conjunction with the definition of “original construction” would not be taxable. Any service work labor done in conjunction with a residential property would not be taxable. Only commercial service work labor would be taxable if it is not done within the definition of “original construction”.

Contractorsmust pay sales or use tax as consumers when they buy materials and supplies used on their construction projects, whether the project is for either residential or commercial.

**Time and materials contract – Labor and material will be listed separately on the invoice. Is the labor taxable to our customer? Are the materials used taxable to our customer?**
You recover your expenses on a construction job from the person who pays you. Your expenses include the materials you purchased along with the sales tax that you paid on those materials. If you list material on your customer billing, the material cost should be shown as one total that includes the materials and tax paid. Your customer invoice should not separately state the price that you paid for materials and the sales tax paid for the materials. If you list the sales taxes that you paid as a separate line item, your customer may think that it is sales tax that you are collecting and reporting, which it is not.

Information on the taxability of labor services has been explained in the first two questions.

Contractorsmust pay sales or use tax as consumers when they buy materials and supplies used on their construction projects, whether the project is for either residential or commercial.

**Inspections – Basically we will walk through an existing building/dwelling and let them know yes you can pass or no you have failed. No repair will be done in conjunction with inspections. If repair is needed we will set up another job as a Service Job.**
Inspection work is taxable when done in connection with taxable service or sales. When inspection work is performed by someone who does not service or repair the equipment or structure being inspected, the inspection work is not subject to tax. Any inspection work done that results in maintenance or servicing of the system by the same party that performed the inspection should be taxed since it is an integral part of the charge for maintenance and service.

**Residential – Either new residential work, and we also will do service/repair work on a residential home/dwelling. Is the labor taxable to our customer? Are the materials used taxable to our customer?**
For residential property all construction labor services are exempt. This applies whether it is original construction, or any repair or remodeling type of construction labor service. Residential property is considered as an enclosure where an individual customarily lives. Residential property does not include transient accommodations such as hotels.

Contractorsmust pay sales or use tax as consumers when they buy materials and supplies used on their construction projects, whether the project is for either residential or commercial.

**Is there a difference if we are the prime contractor or the sub-contractor in your state when it comes to taxing issues?**
Each contractor or subcontractor is responsible for collecting and remitting sales tax on taxable labor services including labor services performed for other contractors. A general contractor may not assume the sales tax for subcontractors. Subcontractors should follow the guidelines for sales tax on labor services for residential property or commercial property based on the type of job they are completing.

**What is the difference in bidding the taxes into our contract and stating “all applicable sales taxes included” and listing items out on an invoice and taxing them separately on the invoice? Is there a difference in the way we should report them on the monthly sales/use tax return?**
Your customer invoice should not separately state the price that you paid for materials and the sales tax paid for the materials. The sales taxes you pay for materials are part of your expenses. If you list the sales taxes that you paid as a separate line item, your customer may think it is sales tax that you are collecting and reporting, which it is not.

As stated, when you perform a construction contract, you are not selling construction materials. You should have paid the correct amount of sales tax as a consumer when you bought the materials. You only charge sales tax on any taxable labor services that would apply. That is why the billing to your customers should include the statement that “all applicable sales taxes are included”.

The monthly sales tax return should include the gross receipts. The formatting of the invoice is not a factor in the reporting of these gross receipts.

**Additional information:**
There is a provision of Kansas law which is important to any contractor work performed in Kansas. Kansas law does provide for a Project Exemption Certificate (PEC). This exemption certificate is issued to certain exempt entities and exempts the entire project, both materials and labor, from sales tax. PECs apply only to a specific project and expire when that project is completed. An exempt entity must furnish a PEC to all contractors and subcontractors working on the project. The contractors and subcontractors can use this certificate to purchase materials and labor without tax. However a PEC cannot be used to buy tools or other machinery or equipment used in the job. A sample copy of a PEC is enclosed.

This private letter ruling is based solely on the facts provided in your request. If it is determined that undisclosed facts were material or necessary to make an accurate determination by the department, this ruling is null and void. This private letter ruling will be revoked in the future by operation of law without further department action if there is a change in the statutes, administrative regulations, or case law, or a published revenue ruling, that materially affects this private letter ruling.

Sincerely,

Jack Smith
Policy and Research

**Date Composed: 11/19/2008 Date Modified: 11/19/2008**