

**Presented to Austin Bar Association  
Construction Law Section**

**February 21, 2008**

**TEXAS SALES AND  
REAL PROPERTY TAX  
CONSTRUCTION PROJECT ISSUES**

**By**

Ira A. Lipstet  
DuBois, Bryant & Campbell, LLP  
700 Lavaca, Suite 1300  
Austin, Texas 78701  
(512) 381-8040  
[ilipstet@dbcllp.com](mailto:ilipstet@dbcllp.com)

# TEXAS SALES TAX AND REAL PROPERTY

## CONSTRUCTION PROJECT ISSUES

### TWO MAIN CATEGORIES OF CONSTRUCTION WORK

In determining the proper sales and use tax treatment in Texas for construction work, a distinction between two broad categories of work frequently done by a company in the construction industry must first be made. The two categories are:

- (1) Non-residential real property repair and remodeling services (emphasis added), and
- (2) Improvements to real property performed by Contractors (which, by definition, include both new construction and residential repair/remodeling services).

The sales and use tax treatment for each category is different and is discussed below.

### TAXABILITY OF NON-RESIDENTIAL REAL PROPERTY REPAIR AND REMODELING SERVICES VERSUS IMPROVEMENTS TO REAL PROPERTY BY CONTRACTORS<sup>1</sup>

Non-residential real property repair and remodeling services are taxable to the purchaser (i.e., the service recipient) and subject the purchaser to Texas sales and use tax liability. The entire selling price for those services is subject to sales tax without a reduction for any expenses incurred. This would be the case for nonresidential repair/remodeling work done. The entire contract amount of the repair/remodeling work performed by a service provider would be subject to sales tax to the service recipient at the appropriate combined state and local rate.

The construction company providing the services may also be subject to tax liability if proper amounts of sales tax have not been collected and remitted. The provider of real property repair and remodeling services is required to collect sales tax on the sales of these services, and remit the tax amounts so collected to the Texas Comptroller of Public Accounts ("Comptroller"). The tax on real property repair and remodeling services does not apply to contractors as that term is defined for Texas sales tax purposes (i.e., a person who improves real property, discussed in some detail below, and hereafter referred to as "Contractor"). (As indicated, however, the construction company can be liable for unpaid sales tax if those amounts are not properly collected and remitted.) Note, however, that a single company can be (and sometimes is) both a provider of non-residential real property repair and remodeling services (a "Repairer") and a Contractor for improvements to real property. In such a case, the tax obligations would depend upon the nature of the work and the manner in which the billing is done.

The key to the distinction between (i) non-residential real property repair services and (ii) an improvement to real property is in the type of work that is being done by the construction

---

<sup>1</sup> See Texas Tax Code §§ 151.0047, 151.0101(a)(13) and 34 Tex. Admin. Code (TAC) § 3.357.

company. Work done to repair or remodel an existing structure or repair or remodel another improvement to other real property (other than residential real property) is considered a real property repair service, and, by definition, is not that which is done by a Contractor. By contrast, that type of work is, by definition, done by a Repairer. A Contractor (as that term is used for sales and use tax purposes) builds or completes new structures (whether non-residential or residential) or makes improvements (including repairs and remodeling) to residential property. In some cases, the distinction between repair/remodeling and new construction activity is not clear. (see the attached definitions for more specificity as to what is meant by these terms.) If there is any question as to the proper categorization of the work as between those categories, it would be advisable to obtain further guidance based upon the relevant facts.

### **NON-RESIDENTIAL REAL PROPERTY REPAIR AND REMODELING SERVICES<sup>2</sup>**

A provider of a non-residential real property repair or remodeling service (i.e., a Repairer) is required to collect sales tax on the total sales price to customers, less any separately stated charges for unrelated services. (An unrelated service is some type of service not subject to sales tax, commonly performed on a stand alone basis that is distinct and identifiable. Examples of unrelated services would include engineering plans or architectural design.) A Repairer need not collect sales tax, however, if it received a valid resale, exemption or direct payment certificate in lieu of the tax from the service recipient. The Repairer might get such a certificate if it was doing repair work for another Repairer or (in certain cases) an exempt organization.

Repairers of non-residential real property are considered to be the consumers of supplies, machinery and equipment not incorporated into the realty and used in performing such repairs. Consequently, the Repairer must pay sales tax on the purchase by the Repairer of these types of items (except for some work done for tax exempt entities), and is not entitled to a credit for such tax. This treatment is distinguished from that afforded for purchases by Repairers of materials incorporated into the non-residential real property as part of the repair. All tangible personal property purchased by the Repairer and incorporated into the non-residential real property can either (i) be purchased tax free (by giving the supplier a resale certificate), or (ii) give rise to a situation whereby the Repairer may pay the tax on the purchase and take a credit against the sales tax later collected or remitted on the total sales price. Following are some examples illustrating how these purchases would be treated:

Example 1: The Repairer buys materials (such as lumber, sheetrock, etc.) for \$1000 that are to be incorporated into non-residential realty as part of a job. The Repairer buys other materials and supplies at the same time for \$150 that will be used in the repair job but that won't be incorporated in to the realty (such as, for example, buckets, ladders, paintbrushes, dropcloths, etc.) The total charge to the customer for the job is \$1500. Assume the sales tax rate is 8%.

As to the \$1000 purchase of materials incorporated into the realty, the Repairer may either give a resale certificate to the seller and pay no sales tax at the time of the purchase, or, alternatively, the Repairer may pay sales tax on the \$1000. In

---

<sup>2</sup> 34 TAC § 3.357(b)

either event, the Repairer charges and collects sales tax on \$1500, or \$120, from the customer for the repair/remodeling work. If the Repairer gave a resale certificate to the supplier and paid no tax on the \$1,000 purchase, the entire \$120 of sales tax collected from the buyer/service recipient is then remitted to the Comptroller. If the Repairer paid sales tax at the time he bought the materials subsequently incorporated into the realty, the Repairer is entitled to offset the \$120 of sales tax collected from the purchaser by the \$80 paid by the Repairer at the time of the original purchase, and only remit \$40 to the Comptroller.

The Repairer is required to pay \$12 ( $\$150 \times 8\%$ ) in sales tax on the supplies and equipment used by the Repairer that was not incorporated into the realty. This sales tax amount cannot be passed through to the ultimate customer (other than indirectly as part of an overall increase in the price of the contract).

To the extent that all work done is for nonresidential repair/remodeling of existing real property projects, sales tax should be added to the total contract price at the appropriate rate. That amount would then be collected and remitted to the Texas Comptroller by the 20<sup>th</sup> day of the month following the month for which the work was done.

#### Contracts for Both Repair/Remodeling and New Construction<sup>3</sup>

A contract which involves both non-residential repair/remodeling and new construction work (discussed below) will be subject to tax on the total amount as though it was solely a non-residential repair job, unless the charge for new construction labor is separately stated and documented. Labor charges for new construction work performed by Contractor are not subject to sales tax if a separated contract format is used. This benefit is lost if there is both remodeling/repair and new construction done pursuant to the same contract, and the new construction labor is not separately stated.

#### Resale Certificates

A Repairer/restorer or remodeler of non-residential realty using tangible personal property may only issue resale certificates to suppliers in place of paying sales tax if the tangible personal property is incorporated into a customer's real property (with the exception of certain items acquired for use in connection for repairs for exempt entities). By way of example (and consistent with above noted discussion), if a Repairer purchases paint to stripe a newly repaired blacktop, the paint is transferred to the customer as part of the job. The Repairer can purchase the paint tax free by giving a resale certificate. Tax is due on the total amount charged the customer, including amounts for the paint and service. However, a resale certificate cannot be given for materials and supplies used or consumed by the Repairer which are not incorporated into the realty. Therefore, consumable materials and supplies which are not incorporated into the realty are taxable to the Repairer/remodeler.

---

<sup>3</sup> 34 TAC § 3.357(b)(7).

## NEW CONSTRUCTION<sup>4</sup>

As noted, work done on non-residential repair remodeling projects is subject to sales tax based upon the entire contract amount. By contrast, new construction work (both for non-residential and residential projects), as well as repair/remodeling work done for residential (as opposed to non-residential) projects, are treated differently. As discussed in more detail below, the taxability of work other than repair/remodeling work for non-residential projects is dependent (in large part) on whether the contracts are structured as lump sum or separated (as between labor and materials incorporated into the property). To the extent a project entails both non-residential repair/remodeling and new construction work, a different result may occur.

By contrast, a resale certificate may be issued for a service if the Repairer/remodeler buyer intends to transfer the service as a part of the taxable services which are resold. An example of this would be the issuance of a resale certificate for an otherwise taxable landscaping service if the landscaping is part of the service provided by the buyer. If (by way of example) part of the remodeling work done by a Contractor on its jobs was landscaping, it could give a resale certificate to a subcontractor doing that work. Sales tax would then be collected by the Contractor on the entire project cost, including the services purchased.

Example 2: Assume the same facts as Example 1 above, except that (i) the Repairer also pays a subcontractor \$300 to perform landscaping services as part of the remodeling, and (ii) the total charge to the customer for the job is \$2,000. The landscaping service is integral to the overall repair/remodeling work being done by the Repairer. The same treatment as set out in Example 1 pertains to the purchase of materials purchased for incorporation into the realty, as well as to the purchase of consumable materials and supplies. Landscaping is taxable as a real property service. A service will be considered an integral part of another 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. In this case, the Repairer is performing a taxable repair/remodeling service, and the landscaping work is integral to the overall service. The Repairer may issue a resale certificate to the landscaping subcontractor, and pay no sales tax at the time of the purchase of the landscaping service. The Repairer then charges and collects sales tax on \$2,000, or \$160 from the customer for the repair/remodeling work.

### Blanket Resale Certificates

A "blanket" resale certificate describing the general nature of the taxable items purchased for resale may be issued to a seller by a purchaser who purchases only items for resale from a particular vendor. Consequently, a blanket resale certificate could not validly be given to a supplier from whom the purchaser buys items which are purchased both for resale and the purchaser's own use.

---

<sup>4</sup> 34 TAC § 3.291.

**SALES AND USE TAX LIABILITY OF CONTRACTORS –  
IMPROVEMENTS TO REAL PROPERTY –  
NEW CONSTRUCTION AND RESIDENTIAL REALTY REPAIR**

New Construction Projects – Lump Sum vs. Separated Contract Matters<sup>5</sup>

Improvements to real property (such as construction of a new building or performing repair/remodeling work for residential property) are not, if performed as a lump sum project, taxable events which subject the purchaser to Texas sales or use taxes. This results (in part) because the Contractor performing a lump sum contract job is deemed to be selling the real property to the ultimate customer, and the sale of real property is not subject to sales tax. (In contrast to the nonresidential repair/remodeling situation, and as noted previously, the person making improvements to realty by way of new construction (or by performing residential repair/remodeling), is by Texas sales tax definition, referred to as a Contractor.) However, the purchase of tangible personal property used by a Contractor in making improvements to real property is a taxable event. As will be discussed, however, a different sales tax collection and remittance result is reached depending upon whether the improvement to real property is made pursuant to a lump-sum contract or a separated contract.

Treatment of Items Used in Construction of Improvements to Real Property<sup>6</sup>

Supplies, tools and equipment as well as materials (referred to collectively as “construction items”) can be used in a number of different ways in connection with a contract for the improvement of real property, as set out below:

- A. The construction items can be of a type that are used and/or consumed by the Contractor but not incorporated into the customer’s property (for example, ladders, hammers, barricades, etc.).
- B. The construction items can consist of materials that can be of a type used by the Contractor that are incorporated into realty (such as lumber, drywall, brick, etc.), but are part of a lump sum contract for which the customer is charged, or,
- C. The construction items can consist of materials of a type that can be incorporated into the customer’s real property, but are specifically identified by way of a separated contract.

Construction Items Used or Consumed by the Contractor<sup>7</sup>

Construction items used by the Contractor in performing the job which are not incorporated into the realty are subject to sales tax, due from and payable by the Contractor. These items are considered to be consumed by the Contractor who, in this case, is the ultimate customer. No tax can be charged to the customers for these amounts. A limited exception to the

---

<sup>5</sup> Tex. Tax Code § 151.056; 34 TAC § 3.291.

<sup>6</sup> See, generally, 34 TAC § 3.291(b).

<sup>7</sup> 34 TAC § 3.291(a)(2).

rule applies for improvements made to real property by Contractors for exempt entities.<sup>8</sup>

### Lump-Sum Contract<sup>9</sup>

If the contract between two parties for the improvement of realty (i.e. new construction, or residential repair/remodeling work) is set up on a lump-sum basis so that there is no distinction made between the materials used and the labor provided, the Contractor is considered to be the consumer of the materials used in performing the work. The purchaser is essentially considered to be buying a completed piece of real property (which is not subject to sales tax). In that event, the Contractor is required to pay sales tax to his supplier on all the materials purchased for the job.

The Contractor cannot charge or collect tax from the customer for any part of the lump-sum charge. As a practical matter, however, all costs incurred by the Contractor (including out of pocket sales tax expense) would very likely be taken into account when bidding the lump sum price of the projects. (Note that this inability to directly collect sales tax from the customer is different from the treatment of items purchased for incorporation into realty when providing non-residential real property repair and remodeling services. As noted in the prior examples, those purchases can be made tax free by the Repairer, with the ultimate sales tax charge on the entire job being paid by the customer.)

### Separated Contract<sup>10</sup>

If a contract for the improvement of real property separately states the price as between labor and materials, the Contractor is considered to be a retailer of those materials so identified. The Contractor must charge his customer for sales tax on such separately stated materials. The sales tax is based upon the price of the materials agreed upon in the contract or the price of materials to the Contractor, whichever is greater. There is no sales tax charge for the labor component of the separated contract.

The Contractor may take a credit against sales tax required to be remitted to the Comptroller for any sales tax amounts paid by the Contractor to the original supplier. Thus, in a separated contract situation for new construction, the Contractor only has to remit sales tax on the difference between the sales tax paid at the time of the purchase and the sales price properly attributable to resale of those materials to the customer. Sales tax is imposed on any markup over the Contractor's cost that is included in the agreed contract price.

### Combined Lump Sum/Separated Contract Jobs

Some Contractors perform both lump-sum and separated contract work, as well as holding items for resale. In such a case, the Contractor can maintain an inventory of items for which resale certificates have been given, and for which no sales tax has been paid. If the Contractor later uses some of these materials in a lump-sum contract, he must then pay sales tax

---

<sup>8</sup> 34 TAC § 3.291(b).

<sup>9</sup> 34 TAC § 3.291(a)(8).

<sup>10</sup> 34 TAC § 3.291(a)(12).

on those items based upon selling price charged for the materials.<sup>11</sup>

### New Construction Taxability Examples

Following are several examples illustrating the Texas sales and use tax workings of lump sum and separated contracts utilized in improvements to real property (i.e. new construction and residential repair/remodeling work).

Example 3: A Contractor agrees to make new construction improvements to realty for a total, lump sum price of \$2,000 with no distinction made in the contract between labor and material charges. The cost of the materials to the Contractor (which are to be incorporated into the realty) is \$1,200. The sales tax rate is 8%. At the time the materials to be used in the job are purchased, the Contractor pays sales tax on the \$1,200 amount, or \$96. No sales tax is (or may be) charged to the customer by the Contractor, and no resale certificate may be given to the supplier for the purchase of those materials.

If the Contractor had previously acquired the \$1,200 of materials in a transaction in which he had given a resale certificate and had paid no tax at that time, the Contractor would be required to pay sales tax when those items are used in a lump-sum contract.

Example 4: Assume the same facts as in Example 3, except that the price for materials to be incorporated into the realty in the contract for the new construction improvement to real property is separately stated (a separated contract) and is agreed as being \$1,400, with \$600 being the price for labor. The Contractor's cost for the materials was \$1,200, for which he gave a resale certificate at the time of the purchase. In that case, the Contractor would charge sales tax of \$112 (8% x \$1400) on the materials considered sold, and remit that entire amount to the Comptroller. (The Contractor would remit the entire \$112 amount because he had not previously paid any sales tax as a result of giving the resale certificate.)

Any sales and use tax amounts paid by a Contractor to a supplier on previously acquired taxable items can be credited against sales tax that would otherwise be due because such items were later incorporated into the realty as part of an improvement to real property (i.e., new construction or repair/remodeling of residential property) if: (i) the contract is separately stated and (ii) a sale and use tax liability is incurred as a result of such an improvement.

Example 5: Assume the same facts as in Example 4, above, except that the Contractor had previously paid sales tax on the materials acquired. If the Contractor had paid sales tax on the materials at the time he acquired them, he would be entitled to offset the \$112 otherwise due to the Comptroller by the \$96 amount (8% x \$1,200) in sales tax that he paid at the time of the acquisition.

---

<sup>11</sup> 34 TAC § 3.291(b)(3)(c).

Contractor Acts as a Materialman - Tangible Personalty Does Not Become Part of the Realty

If the Contractor does work that does not result in the incorporation of tangible personal property into realty, or if tangible personal property retains its character as such, and does not become a part of the realty, it cannot be said that the Contractor has made an improvement to real property. This typically occurs when personal property: (1) is sold for installation in a building or a structure, but is not essential to such improvements, (2) is not intended to become a part of the structure, but is temporarily attached to the realty without losing its identity, and (3) is easily removable. In such a situation, the Contractor is treated in the same manner as a manufacturer or supplier. That means that the seller can take a resale certificate and not collect sales tax on such a transaction, just as a wholesaler or supplier would when selling an item of tangible personal property to other than the final consumer. If the sale is to a final consumer, the seller should collect and remit sales tax on the sale unless some exemption from taxability exists. Determining whether the work done and items sold were actually incorporated into realty is one of facts and circumstances, and must be determined on a case by case basis.

## ATTACHMENT

### DEFINITIONS

- 1) Real property - Land, including structures (such as buildings) and other improvements embedded in or permanently affixed to the land.<sup>12</sup>
- 2) Personal property - In general, everything that is not real property. It consists of both tangible and intangible personal property. Only the sale and/or use of tangible personal property (and taxable services) are subject to Texas sales and use tax.<sup>13</sup> Tangible personal property (for sale and use tax purposes) means personal property that can be seen, weighed, measured, felt or touched or that is perceptible to the senses in any manner.<sup>14</sup> Items that are not easily moved or permanently attached to realty are typically considered to be tangible personal property. This would include (but not be limited to) materials, equipment and supplies before they become a permanent part of real property.
- 3) Contractor - Any person (including corporations) who (or which) improves real property and who, in making the improvements, incorporates tangible personal property belonging to him (or it) into the property being improved. By definition, improving real property also includes work by: i) those making improvements to real property as part of periodic and scheduled maintenance of non-residential real property, or ii) one who repairs, restores, maintains or remodels residential real property. The definition includes subcontractors, but not suppliers, materialmen or persons who provide taxable real property services. Suppliers and materialmen include those who merely sell tangible personal property, but who do not incorporate it into real property. The definition of Contractor for sales tax purposes specifically includes persons who build new structures or make improvements (including repairs or remodeling) to residential property. (NOTE: Not included within the definition of "Contractor" for Texas sales and use tax purposes are those who perform repair/remodeling work for nonresidential real property. Thus, a company doing nothing but repair/remodeling work with respect to existing commercial (i.e., nonresidential) structures would not be considered a "Contractor" for sales and use tax purposes.)<sup>15</sup>
- 4) Improvement to realty - Generally, to erect, construct, alter or repair any building or other structure or other permanent improvement on or under the surface of real property. The definition encompasses such things as creating roads, earthen dams and stock tanks. This would also include the paving of new roads and parking lots (as opposed to the repair of existing surfaces).<sup>16</sup>
- 5) New construction - All new improvements to real property including initial finish out work to the interior or exterior of buildings.<sup>17</sup>

---

<sup>12</sup> 34 TAC § 3.357(a)(10).

<sup>13</sup> Tex. Tax Code § 151.010.

<sup>14</sup> Tex. Tax Code § 151.009.

<sup>15</sup> 34 TAC §§ 3.357(a)(2), 3.291(a)(3).

<sup>16</sup> 34 TAC § 3.347.

<sup>17</sup> 34 TAC § 3.357(a)(8).

6) Repair - To mend or bring back as near as can be to its original working order real property which was broken, damaged, or defective.<sup>18</sup>

7) 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 work when it meets the definition of scheduled and periodic maintenance.<sup>19</sup>

8) Restoration - An activity performed to bring back as near as can be to its original condition real property which is still operating and functional, but that has faded, declined, or deteriorated.<sup>20</sup>

9) Residential property - Property intended for use as a family dwelling or a multifamily apartment or housing complex, nursing homes, condominiums, or retirement homes. The term includes homeowner association-owned and apartment-owned swimming pools, apartment-owned laundry rooms for tenants, and other common areas for tenants' use. Managers' offices will only be residential if the space occupied by the office is 5.0% or less of the total space of the residence. The term does not include hotels or other facilities which are subject to the hotel occupancy tax or any other area open to nonresidents.<sup>21</sup>

10) Lump-sum contract - A contract in which the agreed price as between the Contractor and seller is one lump-sum amount and in which the charges for materials incorporated into the real property improvements are not separate from the charges for skill and labor. Separated invoices issued to the Contractor will not change a lump-sum contract into a separated contract unless the terms of the contract require separated invoices.<sup>22</sup>

11) 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 agreed contract price for 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. Cost-plus contracts are generally treated as separated contracts.<sup>23</sup>

12) Agreed contract price of materials incorporated into the realty - For materials, this includes the cost of the materials, plus profit calculated as a percentage of the cost of materials, mark up, cost of transporting the materials, or handling charges directly related to the materials. A charge calculated as a percentage of the total contract cost will not be considered a part of the

---

<sup>18</sup> 34 TAC § 3.357(a)(12).

<sup>19</sup> 34 TAC § 3.357(a)(11).

<sup>20</sup> 34 TAC § 3.357(a)(14).

<sup>21</sup> 34 TAC § 3.357(a)(13).

<sup>22</sup> 34 TAC § 3.291(a)(8).

<sup>23</sup> 34 TAC § 3.291(a)(12).

materials' selling price. The agreed contract price of materials cannot be less than the price the Contractor paid for the materials.<sup>24</sup>

13) Incorporated Materials - Tangible personal property that loses its distinct and separate identity when incorporated into real property. Examples of incorporated materials include e.g., framing lumber, bricks, concrete, doors and windows.<sup>25</sup>

14) Unrelated service - A service will be considered as unrelated if:

- (A) it is not a service involving the repair, remodeling or restoration of real property, nor a service taxed under other provisions of the sales tax chapter of the Texas Tax Code;
- (B) it is of a type which is commonly provided on a stand-alone basis; and
- (C) the performance of the stand-alone service is distinct and identifiable. Examples of an unrelated service which may be excluded from the tax base include engineering plans or architectural designs.<sup>26</sup>

---

<sup>24</sup> 34 TAC § 3.291(a)(1).

<sup>25</sup> 34 TAC § 3.291(a)(7).

<sup>26</sup> 34 TAC § 3.357(a)(15).

**Ira A. Lipstet**  
DuBois, Bryant & Campbell, LLP  
700 Lavaca, Suite 1300  
Austin, TX 78701

phone: (512) 457-8000  
[ilipstet@dbcllp.com](mailto:ilipstet@dbcllp.com)

#### BACKGROUND, EDUCATION AND PRACTICE

**Ira A. Lipstet** is a partner with the Austin law firm of DuBois, Bryant & Campbell, LLP. He engages in a broad ranging tax and business practice.

Mr. Lipstet's experience involves federal and state tax and business planning and controversy work including: ad valorem property tax issues, including transactional as well as controversy work from appraisal review board proceedings through litigation; tax litigation in State District Court, U.S. Tax Court, State and Federal Appellate Courts; representation in administrative proceedings before the Internal Revenue Service, the Texas Comptroller of Public Accounts and other government agencies; negotiations with taxing authorities; consulting regarding state and local tax incentives and abatements; federal and state tax planning and structuring activities, especially involving Texas franchise, sales and use, property tax and multi-state corporate tax issues; tax exempt organization tax issues, including planning and structuring considerations for federal income and state franchise, income, sales and property tax purposes; and qualification for and maintenance of exempt status and unrelated business taxable income issues; merger and acquisition issues including exempt entities.

Prior to joining DuBois, Bryant & Campbell, Mr. Lipstet was a Director with Ryan & Company, a shareholder with Jenkins & Gilchrist, and a Senior Tax Manager with Touche Ross in Houston. He received his B.A. and M.B.A. from the University of Texas at Austin and his J.D. from the University of Houston. Mr. Lipstet is board certified in tax law by the Texas Board of Legal Specialization. Mr. Lipstet is a certified public accountant and a member of both the Texas Society of CPAs and State Bar of Texas State Tax Committees. Mr. Lipstet is a frequent lecturer to professional groups on tax and related topics.

# Texas Sales and Real Property Tax

Presented to Austin Bar Association  
Construction Law Section  
Austin, Texas  
February 21, 2008

Ira A. Lipstet  
DuBois, Bryant & Campbell, L.L.P.  
700 Congress, Suite 1300  
Austin, Texas 78701  
ilipstet@dbcllp.com  
(512) 381-8040

© Ira A. Lipstet 2008, All Rights Reserved

## TEXAS SALES TAX AND REAL PROPERTY

## TEXAS SALES TAX

- Areas where sales tax issues arise:
  - Sales tax on various services, including
    - Real property repair/remodeling services
    - Real property services
  - New Construction/Improvements to Real Property
    - Lump sum vs. separated contract
    - New construction, or improvement to existing realty?

3

## TEXAS SALES TAX

- General sales tax background:
  - All transfers of tangible personal property (“TPP”) for consideration presumed taxable unless some exemption exists
  - No services presumed taxable unless:
    - Specifically provided for by statute, or
    - Service provided incidental to taxable transfer of TPP
  - Sales/use tax rate:
    - 6.25% - state tax component
    - Up to 2 additional percentage points for local jurisdiction - city, county, metropolitan transit authorities, etc.
    - Maximum combined rate (in almost all cases) - 8.25% of gross receipts

4

## TEXAS SALES TAX

- Transfers of real property not subject to sales tax

BUT

- Complications arise in construction contract situations
- Transactions involving repair/remodeling of existing real property are subject to sales tax

5

## TEXAS SALES TAX

Real Property Repair/  
Remodeling means -

To make over, rebuild,  
replace or upgrade  
existing real property  
(other than residential  
property)



6

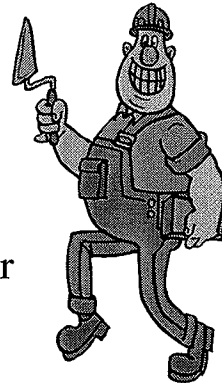
## TEXAS SALES TAX

- Real Property repair/remodeling services for commercial customers are subject to sales tax on 100% of the contract price
- Sales tax needs to be collected by seller/service provider and paid to Comptroller
- Failure to collect sales tax can result in making service provider liable for payment of tax, even though:
  - Legal incidence of sales tax is on purchaser/service recipient
  - Service provider would have right to pursue its customer/service recipient for sales tax amounts

7

## TEXAS SALES TAX

- Repair/remodeling for residential property not subject to same rules as repair/ remodeling work for commercial property
- Repair/remodeling for residential property subject to same lump sum/separated contract rules as for new construction



8

## TEXAS SALES TAX

- Definitions of Remodeling, Repair and Restoration:
- Remodeling: To make over, rebuild, replace or upgrade existing real property.
- Repair: To mend or bring back as new as can be to its original working order real property which was broken, damaged or defective.
- Restoration: To bring back as near as can be to its original condition, real property which has faded, declined or deteriorated.

9

## TEXAS SALES TAX



WHY DOES IT MATTER  
IF WORK IS NEW  
CONSTRUCTION OF  
COMMERCIAL REAL  
PROPERTY OR  
REPAIR/REMODELING  
OF REAL PROPERTY?

10

## TEXAS SALES TAX

- Repair/remodeling of commercial property is fully taxable to service recipient/purchaser
- New construction sales taxability - depends whether lump sum or separated contract (whether commercial or residential)
  - Not taxable to ultimate purchaser if construction contract is lump sum
  - Separated contract (as between material incorporated into project, and labor/overhead) different:
    - Sales tax charged to property owner on materials component
    - No sales tax on labor/overhead component

11

## TEXAS SALES TAX

### RESIDENTIAL PROPERTY CONSIDERATIONS

- RESIDENTIAL NEW CONSTRUCTION - same rules as for commercial new construction - depends on whether contract is lump sum or separated
- RESIDENTIAL REPAIR/REMODELING -
  - Follow same rules as for new construction - taxability depends upon whether contract is lump sum or separated. Can result in no tax (to customer) or tax on incorporated materials.
  - Contract with repair/remodeling for commercial properties - total charge for project taxable to purchaser

12

## **TEXAS SALES TAX**

### **NEW CONSTRUCTION OR REPAIR/REMODELING FOR SALES TAX PURPOSES?**

New construction means all improvements to real property including initial finish-out work to the interior or exterior of the improvement.

13

## **TEXAS SALES TAX**

### **Examples**

1. Multiple story building has only first floor finished and occupied. That is all new construction, as is subsequent initial finish out to the other floors. Finish out subsequent to the initial finish out would be remodeling.
2. Addition of usable footage to an existing structure is new construction. Modifying interior space to a structure without adding usable new footage is remodeling.
3. A portion of a mall gutted by mall owner and then finished by new tenants considered remodeling rather than new construction.

14

## TEXAS SALES TAX

### Mixed new construction and remodeling jobs -

- If more than 5% of project is for commercial repair/remodeling and remainder for new construction, it is all deemed taxable repair/remodeling. However:
  - Can provide documentation breaking out the two aspects of project, and reduce taxable service component
  - Burden is on taxpayer to split out repair/remodeling vs. new construction

15

## TEXAS SALES TAX

### LUMP SUM VS. SEPARATED CONTRACT: WHAT'S THE DIFFERENCE?

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.

Separated Contract - A contract in which the agreed contract price is divided into a separately stated agreed contract price for the 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.

Note: The definition of "contractor" for these purposes includes any person who builds new improvements to residential or non-residential property, or who provides real property repair/remodeling services for residential property. The term includes subcontractors (but not material men or suppliers).

16

## TEXAS SALES TAX

WHAT'S THE  
CONSEQUENCE  
OF HAVING A  
SEPARATED  
VS. LUMP SUM  
CONTRACT IN A  
NEW  
CONSTRUCTION  
PROJECT?



17

## TEXAS SALES TAX

Lump Sum - Contract contractor who performs lump sum contract owes tax on all materials, consumable items, equipment, taxable services, and other taxable items used by contractors or incorporated into a customer's property.

- The contractor must pay tax to the supplier when the contractor purchases taxable items. The contractor may not collect from a customer any amount represented to be tax on a lump sum charge.

Separated Contract - The contractor is considered a retailer of all materials that are physically incorporated into the realty being improved as well as all such taxable services resold to customers.

- The contractor must collect sales tax from the customer based upon the agreed contract price of the materials, or the price of materials to contractor, whichever is higher. Contractor must hold a sales tax permit to do this.

18

## **TEXAS SALES TAX**

**Exemption: Taxable items incorporated into or used for improvement to realty of exempt organizations**

- Purchase of TPP (other than M&E) for use in performance of contract for improvement to realty for certain exempt organizations if:
  - Necessary and essential for contract performance
  - Completely consumed at job site
- Purchase of taxable service for performance of improvement to realty for exempt organization if service performed at job site (if other requirements met)

19