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**Capital Improvements versus Repairs: Sales Tax Info for Contractors**

When it comes to collecting sales tax, the distinction between capital improvements and repair, maintenance, and installation services to real property is a dichotomy that impacts all contractors and their customers. In New York State, a contractor is not required to charge sales tax to its customers and is relieved from liability for any sales tax due on the work performed if the work is considered a “capital improvement”. Conversely, a contractor must charge sales tax to its customers if the work performed is considered “repair, maintenance, or installation work.” While this concept may seem straightforward, failure to accurately make this distinction can result in costly penalties and unexpected costs.

To determine what qualifies as a capital improvement versus repair, maintenance, or installation services, the New York State Department of Taxation and Finance (“NYDTF”) has defined a capital improvement as any addition or alteration to real property that meets all three of the following conditions:

- A. it substantially adds to the value of the real property, or appreciably prolongs the useful life of the real property; and
- B. it 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 the item itself; and
- C. it is intended to become a permanent installation.

If the project does not meet all three requirements, it will be regarded as a repair or maintenance item and the contractor should bill sales tax. It is important to note that the dollar value that goes into a project does not transform the project into a capital improvement.

The NYDTF has defined repair and maintenance as a job where the purpose is to keep real property in good working order, readiness, safe, or restoring it to that condition. An installation service that is taxable is defined by the NYDTF as the service of installing items that do not become part of the real property. Should an item be installed and become part of the real property, that item shall be considered a capital improvement.

For example, if a contractor installs a new chimney to a home, that work is a capital improvement and the contractor does not have to collect sales tax for the service. However, if a contractor repaired or replaced a few bricks on a chimney, that work would be a repair and the contractor is required to collect sales tax. For further guidance, contractors should refer to NYDTF Publication 862: “Sales and Use Tax Classifications of Capital Improvements and Repairs to Real Property.”

If a contractor believes the work being performed is a capital improvement, the contractor should have the customer complete Form ST-124 “Certificate of Capital Improvement” and should not collect sales tax. If a contractor has collected a correctly completed Form ST-124 and is subjected to an audit, the burden will be on

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the customer to prove that the project was a capital improvement. If the contractor fails to receive this completed form, the burden shifts to the contractor to prove the project was a capital improvement.

It is important for contractors to be knowledgeable of this distinction before services are performed. Any confusion or mistake regarding this matter could result in extensive financial penalties. If there is any uncertainty regarding this issue, contractors are strongly encouraged to reach out to their attorneys and accountants for further guidance.

If you have any questions about this Legal Briefing, please contact any attorney of our Firm at 585-730-4773.

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