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Texas Comptroller of Public Accounts STAR System

200805096R

STATE OF TEXAS
COMPTROLLER OF PUBLIC ACCOUNTS
STATE SALES AND USE TAX

Section 3.291 [Contractors](#) ►

(a) Definitions. The following words and terms, when used in this section, shall have the following meanings, unless the context clearly indicates otherwise.

(1) Agreed contract price of materials incorporated into the realty--The price specified in the contract for the incorporated materials, i.e., tangible personal property that becomes a part of the real property, plus any additional charges directly attributable to the incorporated materials. For example, profit that is calculated as a percentage of the cost of materials, cost of transportation of the materials, and markup or handling charges that relate directly to the materials charge are included in the agreed contract price. A charge that is calculated as a percentage of the total contract cost is not considered a part of the agreed contract price of materials incorporated into realty. The agreed contract price of incorporated materials cannot be less than the price that the [contractor](#) ► paid for the materials.

(2) Consumable item--Nondurable tangible personal property that is used to improve realty and, after being used once for its intended purpose, is completely used up or destroyed. Examples of consumable items are nonreusable concrete forms, nonreusable drop cloths, barricade tape, natural gas, and electricity. The term "consumable item" does not include machinery, equipment, accessories to machinery or equipment, repair or replacement parts for machinery or equipment, or any rented or leased item.

(3) [Contractor](#) ►--Any person who builds new improvements to residential or nonresidential real property, completes any part of an uncompleted new structure that is an improvement to residential or nonresidential real property, makes improvements to real property as part of periodic and scheduled maintenance of nonresidential real property, or repairs, restores, maintains, or remodels residential real property, and who, in making the improvement, incorporates tangible personal property into the real property that is

improved. The term includes subcontractors but does not include material men, suppliers, or persons who provide taxable real property services. Persons who provide real property services should refer to sec. 3.356 of this title (relating to Real Property Service). Persons who repair, restore, or remodel nonresidential real property are providing taxable services and should refer to sec. 3.357 of this title (relating to Nonresidential Real Property Repair, Remodeling, and Restoration; Real Property Maintenance). Persons who repair, restore, or remodel chemical plants or petrochemical refineries should refer to sec. 3.362 of this title (relating to Labor Relating to Increasing Capacity in a Production Unit in a Petrochemical Refinery or Chemical Plant).

(4) Equipment--Tangible personal property that a [contractor](#) uses that is not a consumable item or an incorporated material. Examples include tools, machinery, implements, and accessories and repair or replacement parts for the equipment.

(5) Exempt contract--A contract for the improvement of real property with an entity that is exempted under Tax Code, sec. 151.309 or sec. 151.310. An example of an exempt contract is a contract with a nonexempt entity to improve real property for the primary use and benefit of an organization exempted under Tax Code, sec. 151.309 or sec. 151.310, provided that the improvements relate to the exempt purpose of an organization that is exempted under Tax Code, sec. 151.310(a)(1) or (a)(2). Another example is a contract for development work covered under subsection (d) of this section. See sec. 3.322 of this title (relating to Exempt Organizations).

(6) Improvements to realty--See sec. 3.347 of this title (relating to Improvements to Realty).

(7) Incorporated materials--Tangible personal property that becomes a part of any building or other structure, project, development, or other permanent improvement on or to such real property including tangible personal property that, after installation, becomes real property by virtue of being embedded in or permanently affixed to the land or structure constituting realty and which property after installation is necessary to the intended usefulness of the building or other structure.

(8) 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. For example, guaranteed-maximum contracts are considered lump-sum contracts when the charges for incorporated materials and the charges for skill and all labor are not separately stated. Contracts to improve realty that do not break out all charges for labor, including fabrication labor, are considered lump-sum contracts. For example, a [contractor](#) who fabricates and incorporates cabinets into realty under a contract that includes the fabrication labor in the agreed contract price of materials is a lump-sum [contractor](#). Contracts to improve realty that have a zero charge for materials or for labor are considered lump-sum contracts. Separated invoices issued to the customer will not change a lump-sum contract into a separated contract unless the terms of the contract require separated invoices.

(9) New construction--All new improvements to real property, including initial finish-out work to the interior or exterior of the improvement. An example is a multiple story building that has had only its first floor finished and

occupied. The initial finish-out of each additional floor before initial occupancy or use is new construction. New construction also includes the addition of new usable square footage to an existing building. Examples include the addition of a new wing onto an existing building. Reallocation of existing square footage inside a building is remodeling and does not constitute the addition of new square footage. For example, the removal or relocation of interior walls to expand the size of a room or the finish out of an office space that was previously used for storage is remodeling. Raising the ceiling of a room or the roof of a building is not new construction if new usable square footage is not created.

(10) Ready mix concrete ◀**contractor**▶--A ◀**contractor**▶ who manufactures or produces concrete for construction purposes and incorporates the concrete into the property improved.

(11) Sale and installation of tangible personal property--Includes a contract to furnish and install machinery, equipment, or other tangible property that is not essential to the building or structure, nor adapted or intended to become a part of the realty, but which incidentally may, on account of its nature, be temporarily attached to the realty without loss of its identity as a particular piece of machinery, equipment, or property and, if attached, is readily removable without substantial damage to the unit or realty or without destruction of the intended usefulness of the realty.

(12) Residence or residential property--Property that is used as a family dwelling, a multifamily apartment or housing complex, nursing home, condominium, or retirement home. The term includes homeowners association-owned and apartment-owned swimming pools that are for the use of the homeowners or tenants, laundry rooms for tenants' use, and other common areas for tenants' use. The term does not include hotels or any other facilities that are subject to the hotel occupancy tax.

(13) 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 amount for all 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. For example, a contract that requires separated invoices is a separated contract. Cost-plus contracts are considered separated contracts if the cost of labor is separately stated from the cost for incorporated materials.

(b) Tax responsibilities of ◀**contractors**▶ who improve real property of nonexempt customers.

(1) Equipment. A ◀**contractor**▶ must pay sales tax at the time of purchase, lease, or rental on the sales price of equipment used to perform a contract. A ◀**contractor**▶ must accrue and remit use tax on the sales price of equipment purchased, leased, or rented for use in Texas from an out-of-state seller unless the out-of-state seller collected Texas use tax. See sec. 3.346 of this title (relating to Use Tax). Texas allows a credit against Texas use tax when the same property is subject to a legally imposed sales or use tax of another state. See sec. 3.338 of this title (relating to Multistate Tax Credits and

Allowance of Credit for Tax Paid to Suppliers).

(2) Consumable item. Except as provided by subparagraph (B) of this paragraph, a ◀contractor▶ must pay tax at the time of purchase on consumable items that are not physically incorporated into the customer's property.

(A) A ◀contractor▶ may not collect tax from the customer on a charge for consumable items except as provided by subparagraph (B) of this paragraph.

(B) A ◀contractor▶ who has a separated contract may issue a properly completed resale certificate to a supplier in lieu of tax for consumable items if title to the consumable items transfers to the ◀contractor▶'s customer at or before the time that the ◀contractor▶ takes possession of the consumable items, and further if the consumable items are immediately marked, labeled, or otherwise physically identified as the customer's property, when practicable. The ◀contractor▶ must separately state the charge for these consumable items to the customer and must collect sales tax from the customer, unless the customer qualifies for exemption under Tax Code, sec. 151.309 or sec. 151.310, or under other provisions that grant the customer exemption from sales tax on its purchases. See sec. 3.322 of this title (relating to Exempt Organizations).

(3) Lump-sum contracts.

(A) A ◀contractor▶ who performs lump-sum contracts owes tax on all materials, consumable items, equipment, taxable services, and other taxable items that are used by the ◀contractor▶ or incorporated into a customer's property. The ◀contractor▶ must pay tax to suppliers when the ◀contractor▶ purchases, leases, or rents the taxable items. The ◀contractor▶ must accrue and remit use tax on taxable items that are purchased, leased, or rented from an out-of-state seller unless the out-of-state seller collected and gave the ◀contractor▶ a receipt for Texas use tax. The ◀contractor▶ shall not collect from a customer any amount represented to be tax on a lump-sum charge or on any portion of the charge except as provided under subparagraph (E) of this paragraph. A lump-sum ◀contractor▶ must refund to the customer any tax that is collected in error or the ◀contractor▶ must remit the tax to the state. The ◀contractor▶ may not retain such tax.

(B) A ◀contractor▶ who, in addition to performing lump-sum contracts, sells, leases, or rents taxable items at retail or performs separated contracts may maintain a tax-free inventory of items that are held for resale. A ◀contractor▶ who, in addition to performing lump-sum contracts, performs nonresidential real property repair, restoration, and remodeling services and resells taxable items as part of those taxable services may also maintain a tax-free inventory of items that are held for resale. See sec. 3.357 of this title (relating to Nonresidential Real Property Repair, Remodeling, and Restoration; Real Property Maintenance). A ◀contractor▶ may issue a properly completed resale certificate instead of paying tax on items that are purchased for a tax-free inventory when the ◀contractor▶ does not know at the time of purchase whether the item will be resold or used in the performance of a lump-sum contract. A ◀contractor▶ must hold a sales tax permit to issue a resale certificate, and must collect, report, and remit tax to the comptroller as required by sec. 3.286 of this title (relating to Seller's and Purchaser's Responsibilities) when the ◀contractor▶ sells, leases, or rents taxable items. A ◀contractor▶ who separately states a charge for equipment that the ◀contractor▶ uses is not renting that equipment to the customer.

(C) A [contractor](#) who purchases taxable items under a valid resale certificate and uses the items in a taxable manner owes sales or use tax on the items. For example, a [contractor](#) who incorporates materials from a tax-free resale inventory into realty under a lump-sum contract must accrue and remit tax based on the purchase price of the materials. The [contractor](#) must remit the tax to the comptroller for the reporting period in which the materials were used. A [contractor](#) who purchases items that are specifically intended for use in a lump-sum contract may not issue resale certificates in lieu of tax for such items. See sec. 3.285 of this title (relating to Resale Certificates; Sales for Resale).

(D) A [contractor](#) may not accept a direct payment exemption certificate when the [contractor](#) performs a lump-sum contract for a person who holds a direct payment permit. The lump-sum [contractor](#) owes tax on all taxable items that are used on the job or that are incorporated into the direct payment permit holder's realty. A direct payment permit holder may not authorize a [contractor](#) or any other person to purchase tax free any taxable item through use of the direct payment permit holder's permit. See sec. 3.288 of this title (relating to Direct Payment Procedures and Qualifications).

(E) A ready mix concrete [contractor](#) must separate the charge for the concrete from other charges associated with the contract, and invoice the customer for each yard of concrete produced and consumed for the improvement of real property. The ready mix concrete [contractor](#) may issue a resale certificate in lieu of paying sales tax on taxable items (e.g., processed materials) incorporated into the concrete. The ready mix concrete [contractor](#) must collect and remit the tax due on the concrete produced and consumed. The tax rate in effect at the job site location is applied to the greater of the actual invoice price of the component materials or the fair market value of the concrete incorporated into the project. For the purposes of this subparagraph, fair market value is the amount that a purchaser would pay on the open market for concrete. The fair market value will be determined on a case by case basis, taking into consideration relevant factors such as cost of component materials, location of job site, volume, and prices charged by other concrete [contractors](#) in the area. Contracts entered into prior to September 1, 2007, are excluded from the requirements of this subparagraph provided the contract terms do not allow for the pass-through of taxes by the ready mix concrete [contractor](#) to the purchaser for the duration of the contract period. This subparagraph does not apply to ready mix concrete [contractors](#) providing concrete for a public works project.

(4) Separated contracts.

(A) Except as otherwise provided in this section, a [contractor](#) who performs a separated contract is a retailer of all materials that are physically incorporated into the realty that is being improved. As a retailer, the [contractor](#) must collect tax from the customer based upon the agreed contract price of the incorporated materials. The tax rate must be applied to the agreed contract price of materials, or to the price of the materials to the [contractor](#), whichever is greater. A [contractor](#) who performs a separated contract is also a retailer of taxable services that are sold under the provisions of subparagraph (D) of this paragraph, and of consumable items that are sold under the provisions of paragraph (2)(B) of this subsection. The [contractor](#) may accept a properly completed resale or exemption certificate from

a customer who claims an exemption.

(B) A [contractor](#) who performs a separated contract must hold a sales tax permit and collect, report, and remit the tax as required by sec. 3.286 of this title (relating to Seller's and Purchaser's Responsibilities). A [contractor](#) who purchases taxable items for resale as part of a separated contract may issue resale certificates to suppliers in lieu of tax. See sec. 3.285 of this title (relating to Resale Certificate; Sales for Resale). A [contractor](#) may not issue a resale certificate and must pay tax on the purchase, rental, or lease of equipment that is intended for use in the performance of a contract.

(C) A [contractor](#) may maintain a tax-paid inventory of materials. If the [contractor](#) incorporates tax-paid materials into realty under a separated contract or sells them at retail or transfers the materials to a customer as part of a taxable service, then the [contractor](#) must collect tax from the customer based upon the agreed contract price of the materials or upon the sales price of the taxable service. The [contractor](#) may claim a credit for tax paid on materials resold to customers. The [contractor](#) must remit tax to the comptroller on any difference that exists between the price that the customer paid and the price that the [contractor](#) paid.

(D) A [contractor](#) who performs separated contracts may issue properly completed resale certificates in lieu of tax on taxable services that the [contractor](#) resells to its customers. Examples include landscaping, surveying, security services (alarm systems), that are incorporated into the customer's realty, and the final clean-up (janitorial services) of the construction site. The charges for taxable services that are resold to the customer must be separated from the charges for incorporated materials and other charges, and the [contractor](#) must collect tax from the customer on charges for the taxable services and incorporated materials. A [contractor](#) who performs a separated contract may not issue a resale certificate for a taxable service that the [contractor](#) uses or consumes, such as a security service to secure the job site, telecommunication service, and daily clean-up (janitorial service or garbage collection and removal) of the construction site. A [contractor](#) who performs residential new construction should refer to paragraph (7) of this subsection.

(E) A [contractor](#) who improves realty for a direct payment permit holder may accept a properly completed direct payment exemption certificate in lieu of tax on all tangible personal property that is incorporated into the direct payment permit holder's realty. The [contractor](#) owes tax on equipment the [contractor](#) purchases, rents, or leases for use in the performance of the contract with a direct payment permit holder. See sec. 3.288 of this title (relating to Direct Payment Procedures and Qualifications). A [contractor](#) who performs a separated contract may not accept a direct payment exemption certificate in lieu of tax on consumable items unless paragraph (2)(B) of this subsection applies. A [contractor](#) who performs a separated contract may accept a direct payment exemption certificate in lieu of tax on taxable services only under the circumstances set out in paragraph (4)(D) of this subsection.

(5) Contracts versus bids and change orders. For tax purposes, the terms of a contract control over the terms of a bid. For example, if the bid is lump-sum but the written contract is separated, then the contract determines the tax responsibilities of the parties, and the customer is liable for tax on incorporated materials. The terms of a contract also control change orders. If the contract is lump-sum, then change orders will be treated as lump-sum even

if the change orders show charges for incorporated materials separate from other charges. If the contract is separated and change orders are for lump-sum amounts, then the lump-sum amounts will be treated as charges for incorporated materials unless the [contractor](#) can reasonably demonstrate the portion attributable to labor.

(6) Different types of contracts between [contractors](#) and subcontractors. For tax purposes, subcontractors are not required to use the same type of contract as the general [contractor](#). For example, a general or prime contract may be lump-sum, while some or all subcontracts may be separated. Each subcontractor's individual contract governs the subcontractor's tax responsibilities. In the example given, the subcontractors with separated contracts must collect sales tax from the general [contractor](#). The general [contractor](#) must not collect any tax from the general [contractor](#)'s customer. When the general or prime contract separately states labor and incorporated materials but some of the subcontracts are lump-sum, the prime or general [contractor](#) should treat the lump-sum charges as part of its separately stated labor charge and should not collect tax from the prime [contractor](#)'s customer on those charges from lump-sum subcontractors.

(7) Real property services. A [contractor](#) is not required to pay tax on real property services that are purchased as part of the construction of a new residential structure or as part of an improvement that is located immediately adjacent to the new structure and that is used in the residential occupancy of the structure. The [contractor](#) must issue a properly completed exemption certificate or other acceptable documentation to the service provider. If the comptroller subsequently determines that the work is taxable, then the [contractor](#) will be liable for all taxes, penalties, and interest that accrue upon such purchases. For the purposes of this paragraph, "[contractor](#)" includes a builder, developer, speculative builder, or other person who acts as a builder to improve residential real property.

(8) Materials that customers provide. A contract may specify that a customer will provide materials and that the person who performs improvements will provide the skill and labor that are necessary to incorporate the materials into realty. Under this type of contract, the person who provides the skill and labor will not incur tax liability on the materials. The customer is liable for the tax on the materials and must pay tax at the time of purchase of the materials.

(9) Noninstalled items. A person who manufactures an item for sale but who is not responsible for the incorporation of the item into realty is a manufacturer who is subject to the provisions of sec. 3.300 of this title (relating to Manufacturing; Custom Manufacturing; Fabricating; Processing). For example, cabinet makers who do not affix the cabinets to realty are manufacturers and not [contractors](#).

(10) Local tax. A [contractor](#)'s responsibility for local sales and use taxes depends on the type of contract entered into with the customer.

(A) A [contractor](#) who has entered into a separated contract with the customer must collect local taxes on the charge for materials based on the location of the job site.

(B) A [contractor](#) who has entered into a lump-sum contract with the customer is the consumer of all materials used to perform a lump-sum contract.

(i) The lump-sum ◀contractor▶ should pay tax to suppliers on all materials at the time of purchase, unless the ◀contractor▶ maintains a valid tax-free inventory or holds a direct pay permit.

(ii) When the local sales taxes collected by the supplier are less than the 2.0% local tax cap, additional local use taxes are due based on the location where the goods are first stored or used. Local use tax is not due if the supplier collected a local sales tax for the same type of taxing jurisdiction.

(iii) When a lump-sum ◀contractor▶ has items shipped to the jobsite from outside of Texas, the ◀contractor▶ is responsible for accruing local taxes based on the location of the jobsite.

(iv) The lump-sum ◀contractor▶ must accrue local use tax based on the purchase price of the taxable item. The local use tax is due in the reporting period in which the item was first stored, used, or otherwise consumed in a local taxing entity.

(11) Enterprise projects and defense readjustment projects. In order for an enterprise project or a defense readjustment project to avail itself of certain sales tax refunds, the project must enter into a separated contract, and the charges for items that qualify for enterprise project or defense readjustment project refunds must be separately stated. A ◀contractor▶ who performs a separated contract must collect sales tax from the project on the sales price of the incorporated materials. See sec. 3.329 of this title (relating to Enterprise Projects, Enterprise Zones, and Defense Readjustment Zones).

(12) Manufacturing facilities. For a manufacturer to qualify for sales tax exemptions on manufacturing equipment that is installed under a contract to improve real property, the manufacturer must enter into a separated contract. Additionally, the contract must separately state the charge for the qualifying manufacturing equipment. See sec. 3.300 of this title (relating to Manufacturing; Custom Manufacturing; Fabricating; Processing).

(c) Tax responsibilities of ◀contractors▶ who perform lump-sum and separated contracts for exempt organizations.

(1) Exemption certificates and other required proof of exemption. A ◀contractor▶ must obtain properly completed exemption certificates to document exempt contracts. Written contracts or written purchase orders that are issued by governmental entities exempted under Tax Code, sec. 151.309, are acceptable documentation of exempt contracts.

(2) ◀Contractor▶ liability.

(A) A ◀contractor▶ may claim an exemption under Tax Code, sec. 151.311, on a purchase of a taxable item for use under a contract to improve realty for an organization that is exempt under Tax Code, sec. 151.309 or sec. 151.310. If the comptroller subsequently determines that the organization is not exempt, then the ◀contractor▶ is liable for all taxes, penalties, and interest that accrue upon such purchase. If the validity of a claimed exemption or the exempt status of the customer is unclear, then the ◀contractor▶ may not accept the exemption certificate in good faith and should request additional evidence of the exempt status of the contract. If the customer claims to be an exempt

organization, then a letter of sales and use tax exemption from the comptroller that is addressed to the customer relieves the [contractor](#) from further inquiry regarding the exempt status of the customer. See sec. 3.287 of this title (relating to Exemption Certificates).

(B) A contract with a private party to improve real property owned by an exempt entity, other than a governmental entity described in Tax Code, sec. 151.309, is not an exempt contract if the improvement to real property is for the primary use and benefit of the private party. However, a [contractor](#) in a non-exempt contract may purchase tax free tangible personal property that is used to improve real property owned by a governmental entity described in Tax Code, sec. 151.309, if that tangible personal property is donated to the governmental entity and if the following conditions are satisfied:

(i) the contract between the [contractor](#) and the private party is a separated contract. See subsection (b) of this section for a discussion of lump-sum and separated contracts;

(ii) the contract provides that title to the materials used to perform the contract passes to the private party when the materials are delivered to the job site but before they are incorporated into the realty or used by either the [contractor](#) or the private party; and

(iii) the contract provides that the private party intends to donate the materials to the governmental entity before the materials are incorporated into the realty or used by the [contractor](#). The private party must provide the [contractor](#) with a letter of intent or other document from the governmental entity that states its intent to accept the property.

(3) Materials that exempt customers provide. A contract may specify that the exempt customer will provide the materials and the [contractor](#) will provide the skill and labor that are necessary to perform the contract. Under this type of contract, the [contractor](#) will not incur tax liability on the materials. The exempt customer may issue exemption certificates to suppliers in lieu of tax when purchasing the materials. Materials that are incorporated into real property improvements that are not related to the exempt purpose of the customer exempt under Tax Code, sec. 151.310(a)(1) or (2), are taxable. In this situation, the exempt customer must pay tax to suppliers when purchasing the materials. See also sec. 3.322 of this title (relating to Exempt Organizations).

(4) Exempt items. The following items are exempt from sales and use tax when purchased for use in the performance of an exempt contract:

(A) tangible personal property that is incorporated into the realty;

(B) consumable items that are necessary and essential to the contract and are completely consumed at the job site; and

(C) taxable services that are performed at the job site and are:

(i) expressly required by the exempt contract to be provided or purchased by the [contractor](#); or

(ii) integral to the performance of the exempt contract.

(5) ◀Contractor▶'s exemption or resale certificate. A ◀contractor▶ who performs a lump-sum or separated contract may issue a properly completed exemption certificate to a supplier for the purchase of exempt items that are identified in paragraph (4) of this subsection. The certificate must be properly completed and identify the ◀contractor▶ as the purchaser, the exempt entity for whom the improvements are made, and the project for which the items are being purchased. See sec. 3.287 of this title (relating to Exemption Certificates). A ◀contractor▶ may choose to issue a properly completed resale certificate when purchasing materials that will be incorporated into the customer's realty under a separated contract.

(6) Equipment. All machinery and equipment, including repair and replacement parts and accessories, that a ◀contractor▶ uses to perform contracts for any exempt entity are taxable. A ◀contractor▶ who purchases, rents, or leases equipment for use on a contract to improve realty for an exempt entity must pay tax on that purchase, rental, or lease.

(d) Development work. For the purposes of this subsection, development work means a contract with a private party to improve real property by building public infrastructure, such as roads or sewer lines, provided that the improvements are dedicated to and will be accepted by a governmental entity. To qualify as an exempt contract, the private party must dedicate the realty and the improvements to the governmental entity before the work begins, and the governmental entity must accept or conditionally accept the realty and the improvements.

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