



Capital Improvements

Introduction

Whether or not a contractor collects sales tax from a customer depends on if the work being performed is considered a capital improvement to real property, or is installation, repair, or maintenance work. This bulletin explains what type of work is a capital improvement to real property, which is not taxable. It also includes information on purchases by contractors and property owners, billing, and the appropriate use of exemption certificates.

What is a capital improvement?

A *capital improvement* is any addition or alteration to real property that meets **all three** of the following conditions:

- It substantially adds to the value of the real property, or appreciably prolongs the useful life of the real property.
- 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 article itself.
- It is intended to become a permanent installation.

For example, building a deck, installing a hot water heater, or installing kitchen cabinets are all capital improvement projects. Repairing a broken step, replacing a thermostat on a hot water heater, or painting existing cabinets are all examples of taxable repair and maintenance work.

[Publication 862](#), *Sales and Use Tax Classifications of Capital Improvements and Repairs to Real Property*, provides detailed information on various types of work that do and do not qualify as capital improvements. Since the method of installation may affect how the work is taxed, certain work will need to be looked at on a case-by-case basis.

Purchases of materials

Building materials and other tangible personal property purchased for capital improvement work are taxable, whether purchased by a contractor, subcontractor, repairman (hereafter *contractor*), or homeowner. The sales tax paid by contractors becomes an expense that can be passed through to the customer as part of the overall charge for the capital improvement.

Contractors do not normally sell building materials to customers without installation and, therefore, cannot use [Form ST-120](#), *Resale Certificate*, to make purchases of building materials exempt from tax.

However, in certain circumstances, contractors can use [Form ST-120.1](#), *Contractor Exempt Purchase Certificate*, to make purchases exempt from sales tax. For example, a contractor is hired to build a house, and the contract requires the contractor to provide certain freestanding appliances such as a refrigerator, washer, and dryer. The installation

of these appliances does not qualify as a capital improvement, since freestanding appliances do not become part of the real property, as do building materials. The contractor can use [Form ST-120.1](#) to purchase the appliances exempt from sales tax. However, the contractor **must** collect sales tax on the charge to the customer for the appliances.

Purchases of materials in one taxing jurisdiction in New York may be subject to a different tax rate (higher or lower) if the materials are later used in a different jurisdiction in New York. For additional information see Tax Bulletins [Use Tax for Businesses \(TB-ST-910\)](#) and [Contractors - Sales Tax Credits \(TB-ST-130\)](#).

Exemption certificates

When performing capital improvement work, a contractor should get a properly completed [Form ST-124, Certificate of Capital Improvement](#), from the customer and should not collect sales tax from the customer for the project. Receiving [Form ST-124](#) relieves the contractor from liability for any tax due on the work. The contractor should keep this exemption certificate in his or her records to show why no sales tax was collected on the work. However, if no capital improvement certificate is received, the contract or other records of the project can still be used to establish that the work done constituted a capital improvement.

If a contractor hires a subcontractor to work on a capital improvement project, the contractor should give the subcontractor a copy of the capital improvement certificate issued by the customer, so that the subcontractor’s charges will be exempt from sales tax.

All records must be kept for a minimum of three years. Additional information can be found in Tax Bulletin [Recordkeeping Requirements for Sales Tax Vendors \(TB-ST-770\)](#).

Capital improvement billing

When calculating how much to charge a customer, a contractor may include the sales tax paid on building materials just like any other project expense.

Example: A contractor is hired to build a new porch for a customer, which qualifies as a capital improvement. The contractor purchases \$500 of materials, including lumber, screws, and stain. The bill to the contractor might look like this:

<i>Materials:</i>	<i>\$500</i>
<i>Sales tax (8%):</i>	<i><u>40</u></i>
<i>Total:</i>	<i>\$540</i>

The bill to the customer might look like this:

<i>Materials (including sales tax and mark up):</i>	<i>\$600</i>
<i>Labor:</i>	<i><u>1,000</u></i>
<i>Total:</i>	<i>\$1,600</i>

The sales tax that the contractor paid on the materials is an expense that the contractor builds into the price charged to the customer. However, because the work is a capital improvement, there is no sales tax due on the charge to the customer.

Leasehold improvements

Additions or alterations to real property made by or for a tenant, rather than the owner of the property, may be considered to be temporary in nature, rather than permanent. As a result, certain work that may otherwise qualify as a capital improvement may not qualify if the tenant’s lease does not transfer ownership of the improvement to the property owner. For example, some leases require the tenant to return the property to its original state

when the lease expires. In those cases, nothing that was installed over the term of the lease can be considered permanent, since it will have to be removed if the tenant moves. This fact means that the work performed cannot qualify as a capital improvement. See [TSB-M-83\(17\)S](#), *Taxable Status of Leasehold Improvements For or By Tenants*, for more information.

Example: A contractor installs sinks and related plumbing fixtures for a hair salon that is a tenant in a building. Installing a sink normally qualifies as a capital improvement. However, the hair salon's lease stipulates that the premises must be returned to their original condition when the lease ends. Because the sinks must be removed at the end of the lease, they do not qualify as a permanent installation, and their installation is not a capital improvement.

Property owners

A property owner who hires a contractor to perform work that qualifies as a capital improvement should give the contractor a completed [Form ST-124](#), *Certificate of Capital Improvement*. The contractor should keep the form in its records to show why no sales tax was collected on the work.

A contractor is not required to accept [Form ST-124](#). If a contractor charges sales tax on work that the customer believes qualifies as a capital improvement, the customer can apply for a refund directly from the Tax Department. For more information, see Tax Bulletin [How to Apply for a Refund of Sales and Use Tax \(TB-ST-350\)](#).

As stated above, there is no exemption from sales tax on the purchase of materials used in a capital improvement project. Purchases of materials are taxable, regardless of whether a property owner or a contractor buys them.

Note: A Tax Bulletin is an informational document designed to provide general guidance in simplified language on a topic of interest to taxpayers. It is accurate as of the date issued. However, taxpayers should be aware that subsequent changes in the Tax Law or its interpretation may affect the accuracy of a Tax Bulletin. The information provided in this document does not cover every situation and is not intended to replace the law or change its meaning.

References and other useful information

Tax Law: Sections 1101(b)(4), 1105(c)(3), and 1105(c)(5)

Regulations: Sections 541.1 and 541.5

Memoranda:

[TSB-M-83 \(17\)S](#), *Taxable Status of Leasehold Improvements For or By Tenants*

Publications:

[Publication 862](#), *Sales and Use Tax Classifications of Capital Improvements and Repairs to Real Property*

Bulletins:

[Use Tax for Businesses \(TB-ST-910\)](#)

[Contractors--Sales Tax Credits \(TB-ST-130\)](#)

[Recordkeeping Requirements for Sales Tax Vendors \(TB-ST-770\)](#)

[How to Apply for a Refund of Sales and Use Tax \(TB-ST-350\)](#)