

701—219.13(423) Tax on enumerated services. The tax on the services enumerated in 2005 Iowa Code section 423.2 is basically a tax on labor. When such services are performed on or connected with new construction, reconstruction, alteration, expansion or remodeling of real property or structures, the services are exempt from tax. Neither the repair nor the rental of machinery on the job site is exempt from tax under this rule. See rule 219.21(423) for an explanation of the exemption in favor of rented machinery used by a contractor on a job site.

The distinction between a repair (see subrule 219.13(1)) and new construction, reconstruction, alteration, expansion and remodeling activities (see subrule 219.13(2)) can, oftentimes, be difficult to grasp. Therefore, the intent of the parties and the scope of the project may become the factors which determine whether certain enumerated services are taxable. An area of particular difficulty is the distinction between repair and remodeling. Remodeling a building or other structure means much more than making repairs or minor changes to it. Remodeling is a reforming or reshaping of a structure or some substantial portion of it to the extent that the remodeled structure or portion of the structure is in large part the equivalent of a new structure or part thereof. See *Board of Commissioners of Guadalupe County v. State*, 43 N.M. 409, 94 P.2d 515 (1939) and *City of Mayville v. Rosing*, 19 N.D. 98, 123 N.W. 393 (1909).

219.13(1) Repair is synonymous with mend, restore, maintain, replace and service. A repair contemplates an existing structure or tangible personal property which has become imperfect and constitutes the restoration to a good and sound condition. A repair is not a capital improvement; that is, it does not materially add to the value or substantially prolong the useful life of the property.

2005 Iowa Code section 423.1(42) defines a person engaged in the business of performing taxable services as a retailer. Since retailers may purchase building materials, supplies and equipment for resale, persons making taxable repairs (repairpersons and servicepersons) are not considered to be contractors and are not subject to the provisions of 2005 Iowa Code subsection 423.2(1)“b.” In addition, such persons are not considered to be owners, subcontractors or builders. Repairpersons and servicepersons will normally purchase building materials and supplies free of tax for subsequent resale to their customers; contractor-retailers will also do this. However, contractors, subcontractors or builders who may make repairs are subject to 2005 Iowa Code subsection 423.2(1)“b” and must pay tax at the time building materials, supplies and equipment are purchased from vendors even though the contractors, subcontractors or builders hold a valid sales tax permit. See rules 219.2(423) and 219.3(423). In determining who is a contractor and who is a retailer of repair services, the department looks to the total business of the entity in question and not to any one portion of it. Thus, the fact that a business whose overall activity is contracting has a division engaged in taxable repair services does not transform that business into a retailer providing services rather than a contractor. When contractors do repair work, they may separately itemize labor and materials charges and collect sales tax on all charges. A contractor’s markup on a materials charge is part of any taxable sale. A contractor can take a credit for any tax paid on the purchase of materials that are sold as part of a service transaction.

When other persons making repairs sell tangible personal property at retail in connection with any taxable service enumerated in 2005 Iowa Code section 423.2, those persons shall collect and remit tax on the sales price. The person making repairs shall purchase tangible personal property for resale when the property is used in the repair job and is resold to a customer. Reference rule 701—18.31(422,423) for an explanation of when persons performing services sell the property that the persons use in performing those services to their customers. Nonexclusive examples of repair situations are as follows:

- a. Repair of broken or defective glass.
- b. Replacement of broken, defective or rotten windows.
- c. Replacing individual or damaged roof shingles.
- d. Replacing or repairing a segment of worn-out or broken kitchen cabinets.
- e. Repair or replacement of broken or damaged garage doors or garage door openers.
- f. Replacing or repairing a part of a broken or worn tub, shower, or faucets.
- g. Replacing or repairing a broken water heater, furnace or central air conditioning compressor.
- h. Restoration of original wiring in a house or building.

219.13(2) The following are examples of new construction, reconstruction, alteration, expansion and remodeling activities:

- a.* The building of a garage or adding a garage to an existing building would be considered new construction.
- b.* Adding a redwood deck to an existing structure would be considered new construction.
- c.* Replacing a complete roof on an existing structure would be considered reconstruction or alteration.
- d.* Adding a new room to an existing building would be considered new construction.
- e.* Adding a new room by building interior walls would be considered alteration.
- f.* Replacing kitchen cabinets with some modification would be considered an improvement.
- g.* Paneling existing walls would be considered an improvement.
- h.* Laying a new floor over an existing floor would be considered an improvement.
- i.* Rebuilding a structure damaged by flood, fire or other uncontrollable disaster or casualty would be considered reconstruction.
- j.* Building a new wing to an existing building would be considered an expansion.
- k.* Rearranging the interior physical structure of a building would be considered remodeling.
- l.* Installing manufactured housing or a modular or mobile home on a foundation would be considered new construction. However, reference rule 701—33.10(423) for a description of the special treatment of taxable installation charges when the taxable sale of manufactured housing as real estate occurs.
- m.* Replacing an entire water heater, water softener, furnace or central air conditioning unit.
- n.* Sign installation and well-drilling services are generally performed in connection with new construction.

In all the examples, the contractor is responsible for paying tax to any supplier on materials. However, there would be no tax on any enumerated services.

219.13(3) The term “on or connected with” is broad and should be used to convey generally accepted meaning. Therefore, in a specific situation, the facts relating thereto are controlling in determining whether the exemption is applicable. “On or connected with” does not connote that those things connected have to be primary or subsidiary to the construction, reconstruction, alteration, expansion or remodeling of the real property. An incidental relationship can qualify the activity for exemption if the relationship forms an intimate connection with the construction activity. For example, the service of excavating and grading relating to the clearing of land to begin construction of a building would qualify for the exemption; however, excavating and grading land without motive toward construction would not qualify for exemption even though at some later date plans to construct a building were created and a structure was actually erected.

The presence of a time relationship can also be a factor in determining the applicability of exemption. For example, tax would not apply to separate labor charges relating to the installation of production machinery and equipment in a building while remodeling of the real property was in progress. (Tax could apply to the sales price of the production machinery and equipment; reference rule 701—18.58(422, 423)). However, if a year after all construction activity has ended, the owner decides to install a piece of production machinery in the building, any taxable enumerated services relating thereto would be subject to tax. Further, if, following construction, the land is graded for the purpose of seeding a new lawn, the exemption would be applicable. However, if the lawn does not grow and the land is regraded the following year, the exemption would not be applicable. Reference 701—subrule 18.58(8) for the exemption regarding the installation of new industrial machinery and equipment.

Therefore, the motive behind the activity and the course of events that could reasonably be expected to occur would be a further consideration in determining if the exemption is applicable.

A physical relationship is also a factor that should be evaluated. If a building is constructed to house machinery, any enumerated services relating to the installation of that machinery would be exempt from tax. For example, piping joining two pieces of equipment housed in separate buildings would qualify for exemption if the equipment in either building was installed while such new construction, reconstruction, alteration, expansion or remodeling to the structure was also taking place to house the equipment.

On the other hand, an incidental relationship, a time relationship and close physical proximity may not be enough to support the conclusion that a taxable service is performed in connection with new construction or reconstruction. For example, a homeowner hires a general contractor to add a new room to an existing home (which is new construction; see 219.13(2)“d”). The existing home is in need of a number of the repairs described in 219.13(1); for example, it is in need of rewiring and replacement of a broken window. The general contractor rewires the home and repairs the window in addition to building the new room. The taxable services which the general contractor performs while rewiring the home and repairing the window are not performed in connection with the construction of the new room simply because those services happen to be performed at the same time and on the same home as the new construction. If the addition of the new room were the cause of the need for the taxable service (e.g., the window was broken during construction of the new room) and not just a convenient occasion for performance of the service, that performance would be exempt from tax.

The department would like to emphasize that facts and motives are important in the determination of the taxability of services relating to construction activities. However, it should also be noted that taxes on enumerated services are applicable to repair or installation work that is not a construction activity. Refer to subrule 219.13(1) relating to persons who make repairs or perform enumerated services for more information.

219.13(4) Excavating includes digging, hollowing out, scooping out, or making a hole in the earth. It also includes removal of materials or substance found beneath the surface. Grading includes a change in the earth’s structure by scraping and filling to a common level or a fixed line known as a grade. The enumerated services of excavating and grading are not subject to tax if performed on or connected with new construction. Removal of overburden which is directly related to road building, building of dikes, building of farm ponds, and creating drainage ditches would not be taxable as such activities would be considered on or connected with the creation of a structure. See *Maasdam v. Kirkpatrick*, 214 Iowa 1388 (1932). However, the mere removal of overburden, without more, would be taxable as the enumerated service of excavating or grading under 2005 Iowa Code subsection 423.2(6).

219.13(5) Services associated with new construction or reconstruction, for example, which are not taxable include, but are not limited to, brick laying, concrete finishing, tiling, siding installation, laying of linoleum and other flooring and carpet installation. No tax can be collected on the performance of these services even when they are furnished in connection with the performance of repairs.