**Private Letter Ruling**

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| **Ruling Number:** | **P-2007-003** |

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| **Tax Type:** | **Kansas Retailers' Sales Tax** |
| **Brief Description:** | **Labor services related to original construction.** |
| **Keywords:** |  |
| **Approval Date:** | **04/05/2007** |

**Body:**

Office of Policy & Research

April 5, 2007

XXXXX
XXXXX
XXXXX

RE: Your letter dated March 29, 2007

Dear XXXXX:

Thank you for your recent letter. You work for a general contractor that is finishing a 50,000 square foot space in a building that was built about fifteen years ago. The building has been used as a warehouse. The new owner will transform the building for a different use by installing new walls, flooring, and a ceiling in what was warehouse space. You ask if this work qualifies as the original construction of a building. This would allow the construction services to go untaxed pursuant to K.S.A. 2006 Supp. 79-3603(p). Sales of materials purchased by the general contractor, subcontractors, building owner, and others would continue to be subject to sales tax. *See EDU-26, Sales Tax Guidelines for Contractors and Contractor-Retailer.*

The answer to your question is no. The labor services that you describe do not qualify as original construction. Therefore, the general contractor you work for should charge sales tax on its labor services when it bills the building owner for the work being done. In addition, the general contractor should pay sales tax to its subcontractors as explained in EDU-26.

The question of whether the construction services that you describe should be taxed or not was answered by the Kansas Supreme Court in the following discussion found in *J.G. Masonry, Inc. v. Department of Revenue,*235 Kan. 497, 680 P.2d 291 (1984):

**I. THE "ORIGINAL CONSTRUCTION" and "BUILDING" EXEMPTIONS IN K.S.A. 1978 Supp. 79-3603**

The taxpayer first contends that two of its construction projects upon which sales taxes were levied come within the "original construction" exemption of the statute and thus should not have been taxed. The pertinent portions of the statute read:

"79-3603. Tax imposed; rate. From and after the effective date of this act, for the privilege of engaging in the business of selling tangible personal property at retail in this state or rendering or furnishing any of the services taxable under this act, there is hereby levied and there shall be collected and paid a tax as follows:

. . . .

"(*p*) a tax at the rate of three percent (3%) upon the gross receipts for the service of installing or applying tangible personal property which when installed or applied is not being held for sale in the regular course of business, and whether or not such tangible personal property when installed or applied remains tangible personal property or becomes a part of real estate, except that no tax shall be imposed upon the service of installing or applying tangible personal property in connection with the original construction of a building or facility or the construction,reconstruction, restoration, replacement or repair of a bridge or highway. The tax imposed pursuant to this subsection shall not be applicable to said services which were rendered on and after the effective date of this act pursuant to a written contract for a fixed price and not subject to negotiation or alteration entered into prior to May 15, 1977.

"For the purposes of this subsection:

"(1) `Original construction' shall mean the first or initial construction of a new building or facility. The term `original construction' shall include the addition of an entire room or floor to any existing building or facility, the completion of any unfinished portion of any existing building or facility and the restoration, reconstruction or replacement of a building or facility damaged or destroyed by fire, flood, windstorm, hailstorm, snowstorm, lightning, explosion or earthquake, but said term shall not include replacement, remodeling, restoration, renovation or reconstruction under any other circumstances;

"(2) `Building' shall mean only those enclosures within which individuals customarily live or are employed, or which are customarily used to house machinery, equipment or other property, and including the land improvements immediately surrounding such building . . . ."

In April or early May 1979, J.G. Masonry, Inc. (J.G.), built an office at the Perk Foods Plant. The office is described as having four freestanding walls and a roof. It is wholly within the plant building and is "a building within a building." Similarly, in June 1979, J.G. built an office inside the Midwest Conveyor plant. Again, it consists of four freestanding walls and a roof. It is "a building inside a building." Taxpayer contends that these rooms were "original construction," as that term is used in 79-3603( *p*)(1), because each is "the addition of an entire room . . . to [an] existing building . . . ." J.G. argues that it added a new room to each plant. The State claims that the statute exempts only rooms added to the *exterior* of buildings, and in support of its argument it cites K.A.R. 1983 Supp. 92-19-31. That regulation as originally adopted by the secretary of revenue was submitted to the 1979 session of the Kansas Legislature and was modified by Senate Concurrent Resolution No. 1627. The modified regulation, set forth in 1979 Session Laws, chapter 349, reads in part as follows:

"92-19-31. *Installation or application of tangible personal property.* (a) *General rule.* Kansas sales tax must be collected by the retailer on total gross receipts received for the service of installing or applying tangible personal property. A retailer of the service of installing or applying tangible personal property is *the* person who *performs such service.*

"(*b*) *Original construction.* No tax is imposed upon the service of installing or applying tangible personal property in connection with the original construction of a building or facility. (1) The addition of a room or floor inside an existing building is not considered to be original construction. The addition of an entire room or floor to the exterior of an existing building or facility is considered to be original construction." (Emphasis in original.)

The administrative regulation makes it clear that a building inside a building or a room within a room is not original construction. Administrative regulations, when adopted, have the force and effect of statutes. *Jones v. The Grain Club,* 227 Kan. 148, Syl. ¶1,605 P.2d 142 (1980); *Harder v. Kansas Comm'n on Civil Rights,* 225 Kan. 556, Syl. ¶1,592 P.2d 456 (1979). This resolution became effective on May 1, 1979, and thus was in full force at the time of the Midwest Conveyor construction. Whether it is applicable to the Perk Foods job depends upon the time that work was done, and the record shows only that the work was done in "April or early May."

Nevertheless, this issue may be decided on the basis of K.S.A. 1978 Supp. 79-3603(*p*)(1) alone, without resort to the regulation. That portion of 79-3603(*p*)(1) here applicable speaks of "the *addition*" of a room. "Addition" is defined in Webster's Third New International Dictionary (1964) as "a part added to or joined with a building to increase available space." To add is to enlarge. Neither the Perk Foods nor the Midwest Conveyor projects resulted in any increased available space in either plant; rather, the available space inside the plant was subdivided in order to make it usable for a particular purpose. The original structure was not enlarged. The interior of the plant was merely remodeled.

The sales tax statutes are penal, and thus must be strictly construed in favor of the taxpayer. *State v. Zimmerman & Schmidt,* 233 Kan. 151, 155, 660 P.2d 960 (1983). The rule of strict construction, however, does not permit a disregard of manifest legislative intention appearing from plain and unambiguous language. *State v. Howard,* 221 Kan. 51, 54, 557 P.2d 1280 (1976). The legislative language speaks of "the addition of an entire room." The plain and ordinary meaning of that language is not the dividing of one room into two or more rooms; it connotes an addition to the building. We conclude that the statute does not exempt from the sales tax the construction of a building within a building or a room within a room. The Board of Tax Appeals and the district court did not err in finding the construction at the Perk Foods and Midwest Conveyor plants subject to the Kansas sales tax.

For purposes of answering your question, the decision in *J.G. Masonry* still controls. The various statutory changes that have been enacted since the decision was handed down do not effect the Supreme Court's conclusion, which continues to answer your question. That answer is that the labor services you describe are taxable and do not qualify for exemption as original construction.

This is a private letter ruling pursuant to Kansas Administrative Regulation 92-19-59. It is based solely on the facts provided in your request. If it is determined that undisclosed facts were material or necessary to an accurate determination by the department, this ruling is null and void. This private letter ruling will be revoked in the future by operation of law without further department action if there is a change in the statutes, administrative regulations, or case law, or a published revenue ruling, that materially affects this ruling. Please call me if you need to discuss anything further.

Sincerely,

Thomas E. Hatten
Attorney/Policy & Research

**Date Composed: 04/16/2007 Date Modified: 04/16/2007**