

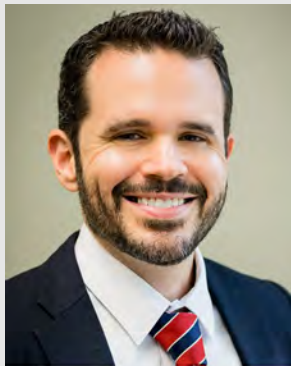
How Alarming! Taxing Security System Repairs

by Steven M. Hogan

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In this edition of Florida Tax Today, Hogan discusses the taxable status of contracts for the maintenance and monitoring of security systems in Florida.

Contracts for the maintenance and monitoring of security systems are generally taxable in Florida. That makes them a rare bird in Florida tax law, as most services are tax free in the Sunshine State.

The unique taxable status of those kinds of contracts creates a gray area for security system repair companies. The question is whether the materials they purchase for use in repairing security system components are taxable to them.

The general rule is this: if repairs are made to tangible personal property, the customer must pay tax on the materials used to accomplish the repair. However, if the repair is made to real property (for example, a fixture to real property), the person making the repair is acting as a "real property contractor." In those kinds of cases, the

"contractor" must pay tax on the materials used to accomplish the repair. The customer is not charged tax on the ultimate cost.¹

While the initial installation of a security system is easy enough to analyze under the general rule, maintenance that occurs after installation is a more difficult question. This article offers a way to think through that problem.

The Initial Installation

On the initial installation of a security system, the question to ask is whether the process is more like "installing" tangible personal property (such as a window-mounted air conditioner) or whether it is more like an improvement to real property (such as a central air conditioning unit).

Although individual cases may vary, sophisticated security systems often look like improvements to real property rather than the installation of tangible personal property. In such cases, the security system company should pay tax on the items it uses when installing the security system. The customer should not be charged tax.²

Repairs After Installation

The question of how to treat repairs after installation can be more difficult, depending on the circumstances. That is because the maintenance of security systems that have already been installed is treated as a taxable service rather than a contract for the repair of real property.

¹ See Fla. Admin. Code r. 12A-1.051 (taxation of real property repair contracts); and Fla. Admin. Code r. 12A-1.006 (taxation of tangible personal property repair contracts).

² See Fla. Admin. Code r. 12A-1.051.

The Department of Revenue has provided in rule 12A-1.0092 that dealers offering alarm system repair or monitoring services are “dealers in a taxable service and are required to charge sales tax on the total taxable sales price of the service.”³

The rule adds that both monitoring services and maintenance are taxable services. Although the initial installation of the alarm system may be a contract for improvement of real property, the maintenance of such a system is a taxable service. The term “maintenance” includes replacement of defective parts.⁴

In that way, the rule usurps the general rule of determining whether maintenance or repair services are taxed as real property contracts or tangible personal property contracts.

Ambiguity and Logical Answers

Rule 12A-1.0092 is silent about how the tangible personal property incorporated into the repair or maintenance of a security system is to be taxed. That creates ambiguity on how to determine the tax status of such property.

This analysis carries significant consequences, as both parts and labor incorporated into a real property contract are taxable to the contractor, while the same parts and labor incorporated into a tangible personal property contract are taxable to the end consumer.⁵

The ambiguity can be resolved with a close reading of the statutes and rules. Because the maintenance contracts are taxable to the end consumer, and the consumer “pays for” the full price of repairs through the maintenance contracts, security system repairs should be treated as though the tangible personal property used in the repair is taxable to the end consumer.

³ Fla. Admin. Code r. 12A-1.0092(1). The rule applies that standard to alarm system repair or monitoring services by reference to North American Industry Classification System codes, including code 561621. According to the U.S. Census Bureau, that code includes alarm system repair or monitoring services. See U.S. Census Bureau, North American Industry Classification System (search for keyword “561621”).

⁴ Fla. Admin. Code r. 12A-1.0092(2)(a)3.c. The rule provides an exception for the “expansion or upgrade” of an existing system. 12A-1.0092(2)(a)3.c. That makes sense, as the installation of an expanded or upgraded system may well qualify as a contract for improvement to real property. In such a case, the upgrade would not be taxable to the customer, as the contractor would be the ultimate consumer of the tangible personal property installed on the premises. See *id.*

⁵ See Fla. Admin. Code r. 12A-1.051 (taxation of real property repair contracts); and Fla. Admin. Code r. 12A-1.006 (taxation of tangible personal property repair contracts).

Subsection (6) of rule 12A-1.0092 states that security service providers are “considered the ultimate users or consumers of the tangible personal property sold to them and *used in connection with their service* and are required to pay the tax imposed upon such sales of tangible personal property to their dealers.”⁶ The rule does not define what the phrase “used in connection with their service” means in that context.

A “use” is defined in section 212.02(20) to mean “the exercise of any right or power over tangible personal property incident to the ownership thereof, or interest therein, except that *it does not include the sale at retail of that property in the regular course of business.*”⁷ As the statute says, a “sale” is specifically not a “use” under Florida tax law.

A “sale” is defined in the same statute to mean, in pertinent part, “*any transfer of title or possession, or both, exchange, barter, license, lease, or rental, conditional or otherwise, in any manner or by any means whatsoever, of tangible personal property for a consideration.*”⁸

One can read those statutes together to conclude that when a security system customer pays for maintenance and monitoring service, the customer has purchased the tangible personal property necessary to perform any needed maintenance. Stated differently, when a security system provider performs maintenance services under a taxable monitoring and maintenance contract and provides tangible personal property to the customers in the form of completed repairs, then the tangible personal property has been “sold to” the customer under the maintenance contract.

A similar dynamic appears in the context of taxable service warranties for the repair of tangible personal property. Like continuing contracts for the maintenance and monitoring of security systems, service warranties are taxable in full to the end consumer. Rule 12A-1.105(4)(c), Florida Administrative Code, provides that dealers who perform repair services under a taxable service warranty “may purchase repair

⁶ Fla. Admin. Code r. 12A-1.0092(6) (emphasis added).

⁷ Fla. Stat. section 212.02 (emphasis added).

⁸ *Id.* (emphasis added).

parts, materials, and labor incorporated into the repair or maintenance of the indemnified property tax-exempt for the purposes of resale.”⁹ That means that even though the end consumer is not specifically charged for the repair parts on an itemized invoice, the end consumer is treated as the purchaser of the parts for tax purposes.¹⁰

Therefore, unless the facts of a given case indicate differently, repairs made to a security system should be treated as though they are taxable to the end consumer. That would mean that the security system company making those repairs can avoid paying tax on the tangible personal property used to accomplish those repairs.

Conclusion

Though it may be an academic point to the end consumer, this analysis will dictate whether a security system repair company must pay tax on the tangible personal property used in its repairs. Companies in that position should think through their fact patterns to determine the proper tax treatment of their operations. ■

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⁹ Fla. Admin. Code r. 12A-1-105(4)(c).

¹⁰ *Id.*