



**July 2, 2003 (Reissued July 3, 2008)
Pennsylvania Sales and Use Tax
No. SUT-03-035**

Governmental Entity Contracting with Suppliers for Property Used by Construction Contractor

ISSUES/CONCLUSIONS:

1. Will a Contractor have any sales or use tax liability related to the Major Materials the Contractor includes in the construction bid when the items are purchased from the Contractor and paid for by the County?

Yes. If a contractor uses property that it has sold to the County, the contractor will be liable for use tax for the property other than 'building machinery and equipment' that it sold and then used for the Project.

2. Are non-building machinery and equipment material purchases subject to sales or use tax when the County contracts with the various vendors for the purchase of items included in the Contractor's bid?

Yes. The Major Materials are subject to sales and use tax because they are obtained by the Contractor pursuant to the County's acceptance of the Contractor's bid specifying the Major Materials required for the Project, the procedures outlined in the bid, and Contractor's resulting construction contract.

FACTS:

The County, a political subdivision of the Commonwealth, is planning to build a correctional facility (the Project). The new facility will be approximately 106,000 square feet and contain 108 cells. An alternative plan is for 114,000 square feet and 136 cells. The County will operate the facility and have legal and beneficial title to the prison.

The County has a construction management agreement with the Construction Management, Inc., (the Construction Manager). The Construction Manager is contractually responsible for the management of the project but will not hold contracts for trade construction services. In addition to being a purchasing agent for the County, the Construction Manager will assist the County in publicly bidding approximately 14 trade contracts. Each contractor submitting a bid is required to provide the customary single bid for labor and materials. The two lowest bidders, however, are required to submit the quantity of material needed, the applicable pricing for each item, and the vendor from whom the Major Materials can be purchased. The lowest responsible bidder (the Contractor) will be determined based on the base bid for labor and materials.

The Contractor is required to guarantee that the cost of the Major Materials listed when purchased from Contractor's vendor will not exceed the cost submitted by the Contractor. The Contractor also must assist in coordinating the purchasing for the County and provide the Construction Manager the County purchase order for signature. Using these purchase

orders, the County will contract directly with the Contractor's vendors for the Major Materials.

Since the County will be issuing the purchase orders, the selected bidder's contract amount will be reduced by its cost for the Major Materials and the applicable tax. The County will contract with the selected bidders for the construction services required for the Project, building machinery and equipment, and other items that are not listed as Major Materials. In the event a Contractor proposes to supply the items on the Major Materials list, the Contractor will enter into one contract with the County for all construction services, items qualifying as building machinery and equipment and other materials required for the Project except for the purchase of the listed Major Materials, and a separate contract with the County for Major Materials. The Contractor is required to purchase those items that qualify as building machinery and equipment.

Vendors will be responsible for delivering the Major Materials to the project site and will bill the County. Despite the County's purchase of these items, the Contract provides that the issuance of the purchase orders in this manner does not relieve the Contractor of any responsibility for the material quality and quantity, or the timeliness of its delivery. Additionally, the Contractor remains responsible for coordination, submittals, protection, storage, scheduling, security, shipping, receiving, unloading, inspection, installation, cleaning, and all applicable warranties. Finally, if the County does not want the excess material when the Project is complete, the Contractor is required to remove the property from the site.

The trade contractors will purchase materials other than Major Materials. The Contractor's base bid will be reduced by the net amount of the County's purchase orders and all applicable sales taxes. It is understood that materials purchased by the contractors will be taxable to the contractors, unless the materials constitute 'building, machinery and equipment' pursuant to Section 201(pp) of the Tax Reform Code of 1971. 72 P.S. § 7201(pp).

DISCUSSION:

The County has solicited lump sum bids from various contractors for the Project. Those bids are required to list the Major Materials and the vendors and costs associated with them. The Major Materials will be purchased with County purchase orders that the Contractor will give to the Construction Manager for signature, as purchasing agent for the County.

The County Code provides that Contracts for the construction of a county prison by the county commissioners must be made in accordance with its provisions. 16 P.S. § 2315. The Code also specifies that contracts for purchases in excess of \$10,000 "shall not be made except with and from the lowest responsible and responsive bidder" 16 P.S. § 1802(b). Additionally, the Code also provides that "[t]he board of commissioners shall receive separate bids upon each of said branches of work and award the contract for the same to the lowest responsible bidder for each of said branches" 16 P.S. § 2317 (emphasis added). This provision clearly does not envision the creation of a myriad of contracts as would be required with the proposed procedure, i.e. one for services and numerous others for the Major Material purchases.

The Tax Reform Code of 1971, as amended, provides that the obtaining of property by a construction contractor for use in a construction contract is a taxable use. 72 P.S. §§ 7201(o)(17); 7202(b). A Contractor submitting a bid that includes a listing of materials to be purchased by the County will be liable for use tax for the items that do not qualify as 'building machinery and equipment' whether or not the Contractor purchases them directly from a supplier or allows them to be purchased by the exempt entity with the Contractor's assistance as outlined in the bid package. The Contractor is responsible for identifying the materials to be purchased and the preparation of the purchase order for signature. Except for the procedures relating to the preparation of the purchase order which incidentally requires the Contractor's participation, Contractor remains responsible for the materials as if the contract were the standard construction contract.

The County's acceptance of a bid from the lowest responsible and responsive bidder for construction activities using materials that the bidder is required to delineate for purchase by the County, guarantee its pricing and remain responsible for the items' quality, etc., creates the basis for the contractor's obtaining of the materials. The Legislature clearly could have provided that all building materials for public buildings are exempt from tax when it created the exemption for building machinery and equipment. They did not. Clearly, a County does not have to pay sales tax when it purchases materials from a supplier. However, when a procedure in a County contract requires a Contractor to do everything related to the acquisition and installation of the materials used in the Project except sign the purchase order, the signature on the purchase order and the County's payment to the supplier rather than the contractor does not change the applicability of use tax as it relates to the construction contractor.

'Use' is defined in the Code to include "the obtaining by a construction contractor of tangible personal property or services provided to tangible personal property which will be used pursuant to a construction contract whether or not the tangible personal property or services are transferred."

72 P.S. § 7201(o)(17). Thus, a construction contractor whose bid includes the materials and labor is responsible for use tax when those materials are used for the construction of the Project whether or not the materials are purchased by the Contractor or separately delineated for purchase by the exempt entity.