

# Chapter 16

## Construction Contractors

### A. General Information

A construction contractor is the user or consumer of everything he buys. A “construction contractor” is a person or business making repairs, alterations, or additions to real property.<sup>1</sup>

In general, all purchases by construction contractors, including building materials,<sup>2</sup> are retail purchases and are subject to South Carolina sales or use tax. A contractor who buys building materials in another state and brings them into South Carolina for use on a construction contract in South Carolina is liable for South Carolina use tax.<sup>3</sup> A credit is allowed against South Carolina use tax for the total taxes (state and local) due and paid in another state.<sup>4</sup>

The following are examples of transactions where the contractor is not subject to South Carolina sales and use tax:

- (1) The contractor buys property from a South Carolina supplier and the supplier delivers the property to the contractor (or to an agent or donee of the contractor) outside South Carolina.<sup>5</sup>
- (2) The contractor purchases tangible personal property in South Carolina for use on contracts outside South Carolina. To come within this exclusion, the contractor must perform some work on the property in South Carolina and the property must not be brought back into South Carolina.<sup>6</sup>

### B. Construction Contracts with Manufacturers

Unlike most purchases by construction contractors, the purchase of materials that are components of machines which are used in manufacturing tangible personal property for

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<sup>1</sup> SC Regulation 117-314.2.

<sup>2</sup> SC Regulation 117-314.2 defines “building materials” to mean any material used in making repairs, alterations or additions to real property, including “such tangible personal property as lumber, timber, nails, screws, bolts, structural steel, elevators, reinforcing steel, cement, lime, sand, gravel, slag, stone, telephone poles, fencing, wire, electric cable, brick, tile, glass, plumbing supplies, plumbing fixtures, pipe, pipe fittings, prefabricated buildings, electrical fixtures, built-in cabinets and furniture, sheet metal, paint, roofing materials, road building materials, sprinkler systems, air conditioning systems, built-in-fans, heating systems, floorings, floor furnaces, crane ways, crossties, railroad rails, railroad track accessories, tanks, builders hardware, doors, door frames, window frames, water meters, gas meters, well pumps, and any and all other tangible personal property which becomes a part of real property.”

<sup>3</sup> South Carolina Code §12-36-1310(A) and SC Revenue Ruling #89-16.

<sup>4</sup> South Carolina Code §12-36-1310(C).

<sup>5</sup> South Carolina Code §12-36-120(36).

<sup>6</sup> South Carolina Code §12-36-110(2).

sale may be purchased tax free.<sup>7</sup> Often, a construction contractor will have a contract with a manufacturer, processor or compounder that has an exemption certificate and is entitled to the exemption for machines, parts and attachments.

Since construction contractors usually cannot make tax free purchases, the Department has developed several methods by which a contractor may purchase tax free all items to be used in building machines, parts and attachments for manufacturers that are exempt from tax. These methods are:

Manufacturer Letter to Contractor's Suppliers – The manufacturer furnishes documentation, in the form of a letter, to the contractor's suppliers establishing that the item is not subject to the tax. The manufacturer agrees to reimburse the party liable for the tax if a transaction is later determined to be subject to the tax. The contractor does not use the manufacturer's exemption certificate.

Agency Agreement – The contractor enters into a limited agency agreement with the manufacturer, and the contractor is allowed to use the manufacturer's exemption certificate. As an agent, the contractor is legally acting for the principal. The manufacturer is liable for any taxes due, so it is important for the agreement to be in writing and clearly state what the contractor can and cannot buy with the certificate. This is usually used for large projects.

Department Special Agreement – The Department executes a special agreement with the manufacturer whereby the manufacturer will accept liability and responsibility for payment of all the sales and use tax due on the project. This is only available for large projects and the use of this method is at the sole discretion of the Department. This is referred to as a "Special 19 Agreement."

Single Sale Exemption Certificate – The contractor completes Form ST-8 and extends it to the supplier indicating the purchase is exempt under the "machine exemption."<sup>8</sup> A certificate must be extended for each purchase. The contractor assumes full liability for the tax if it is determined that the purchase was used for a non-exempt purpose.

### **C. Light Construction Equipment**

The law provides a maximum tax of \$300 on purchases of light construction equipment used for construction purposes, *i.e.*, building or making additions to real property.<sup>9</sup> The equipment must be self-propelled with a maximum of 160 net engine horsepower. Form ST-405 may be completed by the purchaser and given to the retailer in order to limit the tax to \$300. The local option sales and use taxes collected by the Department do not apply to sales subject to the \$300 maximum tax.

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<sup>7</sup> See Regulation 117-302.5.

<sup>8</sup> South Carolina Code §12-36-2120(17).

<sup>9</sup> South Carolina Code §12-36-2110(A)(7).

If light construction equipment is leased, it is subject to the \$300 maximum tax if the lease is in writing and has a stated term of, and remains in force for, a period in excess of 90 continuous days. The taxpayer may pay the total tax due at the time the lease is executed or with each lease payment until the \$300 is paid.

The Department has concluded that the \$300 maximum tax does not apply to equipment used to maintain or repair property, such as tractors, loaders and other self-propelled equipment used to maintain golf courses, parks and campgrounds.<sup>10</sup>

#### **D. Construction Material Used to Construct a Single Manufacturing or Distribution Facility**

South Carolina exempts from sales and use tax construction materials used in the construction of a single manufacturing or distribution facility, or one that serves both purposes, with a capital investment of at least \$100 million in real and personal property at a single site in the State over an 18 month period.<sup>11</sup>

This exemption will be phased in by reducing the tax rate as follows:

4% for sales from July 1, 2007 - June 30, 2008

3% for sales from July 1, 2008 - June 30, 2009

2% for sales from July 1, 2009 - June 30, 2010 and

1% for sales from July 1, 2010 - June 30, 2011.

The taxpayer must notify the Department in writing before the first month it uses the exemption and must notify the Department in writing that it has met the investment requirement or, after the expiration of the 18 month period, that it has not met the investment requirement. This notification must also include the beginning date of the investment period.

#### **E. Contracts with the Federal Government<sup>12</sup>**

South Carolina exempts from sales and use tax tangible personal property purchased by a person under written contract with the federal government that

- becomes part of real or personal property owned by the federal government or
- transfers to the federal government, pursuant to a written contract.<sup>13</sup>

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<sup>10</sup> SC Technical Advice Memorandum #89-13.

<sup>11</sup> South Carolina Code §12-36-2120(67).

<sup>12</sup> SC Revenue Ruling #04-9.

<sup>13</sup> South Carolina Code §12-36-2120(29).

The exemption does not apply to purchases of items that do not transfer to the federal government, such as tools. Purchases made by contractors under contracts with state, county and municipal governments are not exempt from sales and use tax.

Further, South Carolina Revenue Ruling #04-9 provides that purchases by a construction subcontractor for use in a federal government construction project in South Carolina are exempt if (a) the subcontractor has a written contract with the general construction contractor that in turn has a written contract for the project with the federal government and (b) the subcontractor is an agent for the general contractor. In addition, purchases by a subcontractor of the subcontractor for use in a federal government construction project in South Carolina are not subject to the sales and use tax if the general contractor that has the written contract with the federal government has specifically granted his agent the authority to appoint a subagent that can bind the general contractor. The agency agreements with the subcontractors (as agents or subagents) must be in writing to meet the exemption requirement.<sup>14</sup>

## **F. Contracts with State, County and Municipal Governments**

Sales to, or purchases by, contractors under contracts with state, county and municipal governments generally are **not** exempt from the sales and use taxes.

## **G. Contractors that Manufacture or Fabricate Items that They Will Use in Constructing Real Property<sup>15</sup>**

The state sales and use tax applies to businesses that manufacture or fabricate items, that they will use in constructing real property, as follows:

### Standard Finished Products:

If the taxpayer produces “standard finished products” that it sells at wholesale or at retail on a regular and continuous basis; creates “a new and substantially different article having a distinctive name and substantially different character or use” than that of the raw materials from which it was made; and, is commonly thought of as a manufacturer, then the taxpayer is a “manufacturer” of “building materials.” As a manufacturer, if the taxpayer uses such building materials in the performance of a construction contract, then the taxpayer is a “manufacturer/contractor,” and is liable for the sales tax based on the fair market value of the building materials at the time and place where used or consumed - the job site. However, if the job site is located outside of South Carolina, then no tax is due.

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<sup>14</sup> See South Carolina Revenue Ruling #04-9 for the conditions that must be met for a subcontractor to be an agent for a general contractor.

<sup>15</sup> SC Revenue Ruling #94-2. See also *Metromont Materials Corp. v. South Carolina Tax Commission*, Spartanburg County Court of Common Pleas, No. 84-CP-42-14 (1985).

In addition, as a “manufacturer/contractor,” the taxpayer is entitled, to the extent applicable, to the exemptions and exclusions provided in South Carolina Code §§12-36-2120(9),<sup>16</sup> 12-36-2120(17),<sup>17</sup> 12-36-2120(19)<sup>18</sup> and 12-36-120.<sup>19</sup> Also, the credit provisions of South Carolina Code §12-36-1310(C)<sup>20</sup> may be applicable.

“Standard finished products” are items that are not specifically designed for use on a particular construction project. Such items are standard or interchangeable and have a resale value and a fair market value. These items are generally mass-produced and are suitable for use on many construction projects.

#### Unique Products:

If the taxpayer produces “unique products” that it uses in the performance of a construction contract, then the taxpayer is a contractor. As such, sales to, and purchases by, the taxpayer of the raw materials used to fabricate (within South Carolina) the unique product are subject to the sales and use tax. However, if the fabricated item will be used, and become a part of realty, at a job site located outside of South Carolina, then the sales to, and purchases by, the taxpayer of the raw materials used in the fabrication of that unique product are not subject to the sales and use tax.

If the unique product is fabricated out-of-state, sales to or purchases by, the contractor of the materials used to fabricate the unique product are not subject to the sales and use tax, provided the materials were not sold and delivered to the contractor within South Carolina.

In addition, as a contractor, the taxpayer is not entitled to the exemptions and exclusions provided in South Carolina Code §§12-36-2120(9),<sup>21</sup> 12-362120(17),<sup>22</sup>

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<sup>16</sup> This code section provides exemptions for coal, or coke or other fuel sold to manufacturers for (a) use or consumption in the production of by-products, (b) the generation of heat or power used in manufacturing tangible personal property for sale and (c) the generation of electric power or energy for use in manufacturing tangible personal property for sale.

<sup>17</sup> This code section provides an exemption for machines used in manufacturing tangible personal property for sale.

<sup>18</sup> This code section provides an exemption for electricity used by manufacturers to manufacture tangible personal property for sale.

<sup>19</sup> This code section provides exclusions for the sale of (a) tangible personal property to a manufacturer as an ingredient or component part of the tangible personal property or products manufactured for sale, (b) tangible personal property used directly in manufacturing tangible personal property into products for sale and (c) materials, containers, cores, labels, sacks, or bags used incident to the sale and delivery of tangible personal property, or used by manufacturers in shipping tangible personal property.

<sup>20</sup> This code section allows with respect to each purchase a credit against the South Carolina state and local use tax for sales or use taxes paid in another state.

<sup>21</sup> This code section provides exemptions for coal, or coke or other fuel sold to manufacturers for (a) use or consumption in the production of by-products, (b) the generation of heat or power used in manufacturing tangible personal property for sale and (c) the generation of electric power or energy for use in manufacturing tangible personal property for sale.

<sup>22</sup> This code section provides an exemption for machines used in manufacturing tangible personal property for sale.

12-36-2120(19)<sup>23</sup> and 12-36-120<sup>24</sup>, unless a substantial portion of its business also includes the fabrication of “unique products” (and/or standard finished products) that it sells to contractors and other consumers. However, the credit provisions of South Carolina Code §12-36-1310(C)<sup>25</sup> may be applicable.

“Unique products” are items that are specifically designed for use on a particular construction project. Such items are not standard or interchangeable in any sense and have no resale value and no reasonable fair market value.

Note: Sales of “standard finished products” or “unique products” to contractors and other consumers who use them in the performance of a construction contract, or to otherwise make improvements to realty, are subject to the sales and use tax based upon gross proceeds of sales or sales price, unless otherwise excluded or exempted from the tax.

## **H. Transient Construction Property<sup>26</sup>**

When a contractor is hired to build an office complex somewhere in South Carolina, the contractor may purchase various machinery, tools and equipment from out-of-state vendors for use at the South Carolina job site. These purchases are subject to the South Carolina sales tax or the use tax.

In addition, the contractor may import or bring into this State other machinery, tools and equipment, owned by the contractor and previously and substantially used on other jobs outside of South Carolina. Such machinery, tools and equipment is known as “transient construction property.”<sup>27</sup>

“Transient construction property” is subject to a special imposition of the South Carolina use tax. This special imposition prorates the use tax to reflect the equipment's duration of use in South Carolina, provided the other state's statute has similar provisions for proration of the tax or depreciation of the tax base.<sup>28</sup>

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<sup>23</sup> This code section provides an exemption for electricity used by manufacturers to manufacture tangible personal property for sale.

<sup>24</sup> This code section provides exclusions for the sale of (a) tangible personal property to a manufacturer as an ingredient or component part of the tangible personal property or products manufactured for sale, (b) tangible personal property used directly in manufacturing tangible personal property into products for sale and (c) materials, containers, cores, labels, sacks, or bags used incident to the sale and delivery of tangible personal property, or used by manufacturers in shipping tangible personal property.

<sup>25</sup> This code section allows with respect to each purchase a credit against the South Carolina state and local use tax for sales or use taxes paid in another state.

<sup>26</sup> South Carolina Code §12-36-1320 and SC Revenue Ruling #89-11. Note: SC Revenue Ruling #89-11 references the sales and use tax code sections prior to recodification in 1990; however, the taxation of transient construction property remained the same in Code Section 12-36-1320 after recodification.

<sup>27</sup> South Carolina Code §12-36-150 defines “transient construction property” to mean “motor vehicles, machines, machinery, tools, or other equipment, other tangible personal property brought, imported, or caused to be brought into this State for use, or stored for use, in constructing, building, or repairing any building, highway, street, sidewalk, bridge, culvert, sewer or water system, drainage or dredging system, railway system, reservoir or dam, power plant, pipeline, transmission line, tower, dock, wharf, excavation, grading or other improvement or structure, or any part of it.”

<sup>28</sup> South Carolina Code §12-36-1320.

In summary, the use tax imposed on the use of transient construction property is computed as follows:

Step #1: Multiply the Original Purchase Price by the State Tax Rate.<sup>29</sup>

Step #2: Divide the Duration of Time the Property is Used in South Carolina by the Property's Total Useful Life.<sup>30</sup>

Step #3: Multiply the Result of Step #1 by the Result of Step #2.

Step #4: The Result of Step #3 is the State Use Tax due South Carolina on the transient construction property.

South Carolina will also allow a credit (prorated to reflect the equipment's duration of use in South Carolina) for sales tax paid another state, against the South Carolina use tax, on equipment previously used in another state if the out-of-state contractor's state will allow a similar credit.

Note: Machinery, tools and equipment purchased for first use in South Carolina is not "transient construction property" and is subject to the full amount of use tax,<sup>31</sup> however, such purchases qualify for the credit for sales and use taxes, if any, legally due and paid in another state on the purchase of such machinery, tools and equipment.<sup>32</sup>

## **I. Local Sales and Use Taxes**

The local sales tax is reportable by the contractor's supplier in the county and municipality where the tangible personal property is delivered.

The local use tax is reportable by county and/or municipality where the property is first stored, used or consumed. Form ST-389 provides information as to which type of local sales and use tax must be reported by county and municipality and which type of local sales and use tax must only be reported by county.

The liability for the local use tax, as with the state use tax, is on the contractor. The supplier may, however, be required to collect the tax from the contractor and remit it to the Department if the supplier has nexus with the county of delivery.

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<sup>29</sup> The State tax rate is 6% on all transient construction property except items that qualify for the maximum tax under South Carolina Code §12-36-2110. Items that qualify for the maximum tax under South Carolina Code §12-36-2110 are taxed at a State rate of 5%. Items subject to the State rate of 6% are also subject to any applicable local taxes administered and collected by the Department of Revenue on behalf of local jurisdictions. Items that qualify for the maximum tax under South Carolina Code §12-36-2110 are not subject to local taxes administered and collected by the Department of Revenue on behalf of local jurisdictions.

<sup>30</sup> The same unit of time (*e.g.*, days, weeks, months) used for both the duration of time the property is used in South Carolina and the total useful life of the property.

<sup>31</sup> South Carolina Code §12-36-1310(A).

<sup>32</sup> South Carolina Code §12-36-1310(C).

If the contractor takes delivery in one local tax county and pays that county's local sales tax to the supplier, he is not liable for the local use tax if he takes the property to another local tax county and stores, uses or consumes the property in that county, provided the local sales tax he paid is equal to or greater than the local use tax that would otherwise be due. If the local sales tax he paid is less than the local use tax, then the contractor owes the difference. Also, the contractor is relieved of the liability for the local use tax if he has a receipt from a retailer showing the retailer has collected the local use tax.

Construction contracts executed before the imposition date of the local option tax are exempt from the local option sales and use taxes. The exemption from the local tax also applies to written bids that are submitted before the imposition date, and that culminate in a contract executed before or after the imposition date. To come within the exemption, contractors must apply to the Department of Revenue, using Form ST-10-C. If the application is approved, an exemption certificate will be issued (ST-35). An application form must be filed for each contract, accompanied by a copy of each contract. A separate exemption certificate will be issued for each contract.