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SHEETZ TEST REJECTED FOR SALES AND USE TAX

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In two consolidated cases, the Pennsylvania Supreme Court held that the applicable test to distinguish between real estate and tangible personal property for Sales and Use Tax purposes is the test announced by the Supreme Court in Commonwealth v. Beck Electric Construction Inc., 403 A.2d 553 (Pa. 1979), not the test applied by the Commonwealth Court below based on In re: Appeal of Sheetz, 657 A.2d 1011 (Pa. Commw. 1995). Northeastern Pennsylvania Imaging Center v. Commonwealth, No. 93 MAP 2009 (Pa Dec. 21, 2011). Using the Beck test, the court reversed the Commonwealth Court and held that contracts for the sale and installation of MRIs and CT/PET scanners were sales of tangible personal property taxable to the purchaser, not items used in a construction contract. The Supreme Court and the Commonwealth Court below discussed at some length the elaborate changes needed to the buildings in order to install the medical equipment. The equipment was very large, weighed several tons, and required structural reinforcing and extensive rewiring. However, it is not clear why any of those facts were material, as the changes to the buildings do not appear to have been made by the sellers of the MRI and CT/PET scanner equipment. In both cases, the court stated that the purchaser of the equipment – in one case the building owner and in the other the building lessee – made the "extensive structural changes to the building" needed for the installation of the equipment. In order for the changes made to the building to be relevant to whether the MRI and CT/PET scanner equipment were installed as part of a construction contract, the changes would need to have been made by the seller of the equipment. However, the contract with the seller of the equipment called for installation of the equipment after the building was modified by the owner. Thus no construction contractor used the medical equipment in a construction contract for improvements to the building. The only possible user was the seller-installer. In any event, there does not appear to be a great deal of difference between the two tests set forth in Beck and Sheetz. Beck emphasized the ease with which the property could be moved from the real estate without damage either to the real estate or to the equipment. Sheetz was a real estate tax case. It focused on the following three factors: (1) the degree of physical attachment of the systems; (2) whether the systems were essential to the use of the building; and (3) whether the parties intended that the medical equipment be part of the real estate. The Pennsylvania Supreme Court criticized the third factor – the intention of the parties – on the grounds that it was too vague to be a useful guideline. Otherwise, there does not appear to be a sharp distinction between the two. Evidently, the key reason for reversal was regulatory. In Beck, the Supreme Court focused on then Sales and Use Tax Regulation Section 150, now found at 61 Pa. Code § 31.11. The regulation contains a number of examples of items presumed to constitute other real estate or tangible property. The Supreme Court reaffirmed the importance of following regulatory guidelines in making the distinction for Sales and Use Tax and purposes. The Supreme Court remanded for consideration of one taxpayer's claim that refunds were constitutionally required for tax paid during the short time-period that the Department of Revenue took the position that the transaction constituted a construction contract because other similarly situated taxpayers were granted refunds.

To discuss any questions you may have regarding the opinion discussed in this Alert, or how it may apply to your particular circumstances, please contact:
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