

subject to Wisconsin sales or use tax, including billings for UPS charges, travel costs, and telephone expenses.

Analysis

Section Tax 11.71(3)(b), Wis. Adm. Code, provides that the gross receipts from the sale of custom programs are not taxable. Paragraph (e) provides that consulting services, feasibility studies, and other services related to custom programs are not taxable.

Section Tax 11.71(1)(e), Wis. Adm. Code, provides that the "determination of whether a program is a custom program shall be based upon all the facts and circumstances, including the following:

1. The extent to which the vendor or independent consultant engages in significant presale consultation and analysis of the user's requirements and system.
2. Whether the program is loaded into the customer's computer by the vendor and the extent to which the installed program must be tested against the program's specifications.
3. The extent to which the use of the software requires substantial training of the customer's personnel and substantial written documentation.
4. The extent to which the enhancements and maintenance support by the vendor is needed for continued usefulness.
5. There is a rebuttable presumption that any program with a cost of \$10,000 or less is not a custom program.
6. Custom programs do not include basic operational programs.

7. If an existing program is selected for modification, there must be a significant modification of that program by the vendor so that it may be used in the customer's specific hardware and software environment."

The sale by XYZ Corporation to Company W meets the definition of custom software in sec. Tax 11.71(1)(e), Wis. Adm. Code, because:

1. Significant presale consultation (a system study taking 90 hours) was conducted to determine the needs of Company W.
2. XYZ Corporation installed and tested the program against the customer's requirements.
3. In excess of 200 hours of training has been billed to Company W.
4. The base cost of the software and subsequent modifications far exceed \$10,000.
5. Based on the time involved, the number of modifications made, and complexity of modifications, significant modifications are being made to customize the programs to meet Company W's needs.

The fact that some of the charges are being separately invoiced does not affect the status of the software. The terms of the contract provide that additional modifications will be made before the system will be acceptable to Company W and that the modifications will be made by XYZ Corporation. The base software is not taxable as it is only being used as a shell (or starting point) for the customized system.

Section Tax 11.71(2)(c), Wis. Adm. Code, provides that training services

are not taxable, although any training materials provided for a specific charge are taxable. □

✴ **W9251015**, September 28, 1992

Type Tax: Sales and Use

Issue: Construction contractors (activities) — exempt entity construction

Statutes: Section 77.54(9a), Wis. Stats. (1989-90)

This letter responds to your request for a private letter ruling regarding the Wisconsin sales and use tax implications of performing real property construction for an exempt entity.

Facts

DEF Company ("Contractor") has entered into a real property construction contract with an entity exempt from Wisconsin sales or use tax under sec. 77.54(9a), Wis. Stats. (1989-90) ("Owner"). The contract in part provides the following:

Under Wisconsin Law, the Contractor is required to pay all sales and/or use taxes on materials and equipment purchased by it for the work of construction described herein. Certain types of exempt organizations, however, may purchase materials and equipment without the payment of Wisconsin sales or use taxes, meaning that sales and use taxes can be saved with respect to the materials and equipment which the exempt entity, rather than the Contractor, purchases directly from suppliers. Because the Owner in this case has represented that it is an organization exempt from the payment of Wisconsin sales or use tax, the materials and equipment pur-

chased directly by the Owner will not be subject to Wisconsin sales and use tax.

Accordingly, the Owner shall purchase directly any equipment and materials for the work of construction where the total cost of an item or any aggregation of items to be ordered from one supplier is two thousand dollars (\$2,000) or more. At the end of this section is set forth a list of items of materials and equipment which shall be purchased directly by the Owner. Except as stated below, Contractor will under no circumstances purchase any equipment or materials set forth on the attached listing.

For purposes of submitting a contract bid, the Contract Sum shall include the cost to the Owner of the work to be performed for the work of construction and shall include all labor and services and the total cost, including applicable taxes, of only the materials and equipment to be purchased by the Contractor for the completion of the work of construction. The Contract Sum shall not include any amount for the materials and equipment to be purchased directly by the Owner and, if the Contract Sum as stated in the bid does for any reason include the cost of materials that are to be purchased by the Owner, the Construction Manager shall revise the Bid so that the Contract Sum does not include any amount for such items.

In addition to preparing its contract bid, Contractor shall separately state the total cost of all materials and equipment that will be purchased directly by Owner. Contractor shall also submit a schedule of all purchases to be made by Owner including the

recommended supplier's name, a general description of the item(s) to be purchased, and the maximum price for each item. Owner will purchase from the suppliers recommended by the Contractor, unless the Owner is able to secure more advantageous prices. Any discounts, savings and rebates belong to Owner. If the Owner is not able to obtain such or comparable materials or equipment within the maximum price, Owner may, at its option, purchase the materials at the higher price (in which case the Contract Sum shall be reduced by the difference between the higher price and the listed maximum price) or require the Contractor to purchase those items (in which case the Contract Sum shall be increased, but only by the stated maximum price of the items in question plus applicable sales or use taxes).

For those items to be purchased directly by the Owner, the Construction Manager will prepare and review the proposed purchase orders, which will be signed by the Owner. The supplier shall invoice the Owner for the items purchased and the Owner shall pay the supplier directly with the Owner's own funds.

The Owner shall receive, store and protect all materials and equipment until provided to Contractor at the job site or such place as designated by Contractor. Until such equipment and materials are delivered to the job site, Owner shall have sole and complete responsibility for such materials and equipment, including without limitation, loss or damage thereto. Upon delivery to the job site or other location designated by the Contractor, Contractor shall store, safeguard

and protect the materials; provided, however, that Contractor shall be liable for any loss or damage to the materials and equipment only if negligent in performing these duties.

Upon delivery of the directly purchased materials and equipment to the job site or such other place designated by the Contractor, Contractor shall also be responsible for inspecting or examining the materials to assure the Owner they are acceptable and in conformance with the contract documents. Any defect, shortfall or other deficiency shall be called to the attention of the Owner immediately upon delivery in order that the Owner may obtain any necessary adjustment or replacement of such materials and equipment. Upon acceptance of such equipment and materials, the Contractor is responsible for the installation and incorporation of such materials into the work of construction in accordance with its agreement with the Owner and the contract documents generally.

The Owner shall at all times have and possess all incidents of ownership with respect to the materials and equipment purchased by it. Accordingly, Contractor shall not be responsible for any defect, shortfall, or other deficiency with respect to materials and equipment purchased by the Owner, regardless of whether such defect is discovered or occurs before, during or after installation, unless Contractor is negligent in performing its duties under the contract. The Owner is solely responsible for obtaining and/or perfecting any warranties, express or implied, with regard to those materials and equipment purchased directly by it. Owner shall insure its interest in such

equipment and materials or arrange with Contractor to be added as an additional insured to any insurance policy covering equipment and materials located at the job site or such other location where the materials may be stored.

As part of the consideration received under the Contract, Contractor agrees that it will install any replacement materials provided by vendors, suppliers or manufacturers within a period of two years after the contract is completed. Such responsibility relates to installation only and, by agreeing to perform this service, Contractor in no way assumes any responsibility for defects or other deficiencies in the materials, unless such defect or deficiency is due to negligence by the Contractor in performing its duties under the contract.

Owner shall indemnify and hold the Contractor harmless from and against any and all claims asserted against the Contractor relating to the liability for sales and/or use tax (including penalties and interest and, in the event of litigation, all reasonable expenses, including attorney's fees and accountant's fees incurred by Contractor in connection therewith) on any materials or equipment purchased by Owner, provided that (1) Contractor promptly tenders to Owner the defense, negotiation, or other handling of such claim, (2) Owner shall have the right, at its own expense, to assume defense of the claim, and (3) Contractor shall cooperate fully with Owner in providing any and all information which Owner reasonably requests in connection with defense of the claim.

Request

You ask the following:

1. Is the sale of materials by suppliers to the exempt Owner subject to Wisconsin sales or use tax?
2. Is Wisconsin sales or use tax due as a result of the Contractor's use of the materials purchased by the exempt Owner?

Ruling

Based on representations provided in your request and restated in the facts above:

1. The sale of the materials by suppliers to the exempt Owner is not subject to Wisconsin sales or use tax. However, if the supplier is the person who will install the materials purchased directly by the Owner, the supplier is the consumer of the materials and is subject to Wisconsin sales or use tax on its cost of the materials.

(Note: Although not stated in the contract, it is assumed that the purchase orders which are prepared by the Contractor and signed by the Owner are purchase orders of the Owner).

2. There is no sales or use tax due as a result of the Contractor's use of materials purchased by the exempt Owner.

Analysis

Section Tax 11.04(5), Wis. Adm. Code, provides that a supplier's sales of building materials made directly to an exempt entity, as defined in sec. 77.54(9a), Wis. Stats. (1989-90), are not taxable, even though such tangi-

ble personal property is used by the contractor in the erection of a building or structure, or in the alteration, repair, or improvement of real property for the exempt entity. This exemption applies provided the exempt entity gives its own purchase order to the supplier for the tangible personal property and pays for the tangible personal property with its own funds.

Section Tax 11.04(4), Wis. Adm. Code, provides that a supplier who is also the contractor who uses the building materials in the construction of buildings or structures, or the alteration, repair, or improvement of real property for an exempt entity, is the consumer of such building materials, not the seller of tangible personal property to the exempt entity. The sale of building materials to the consumer is subject to tax.

Since the Owner is purchasing the materials and equipment, listed as part of the contract, with its own purchase orders and paying for the materials and equipment with its own funds, the sales of the building materials by suppliers to the Owner are exempt from Wisconsin sales or use tax. However, if the Owner purchases any of the materials and equipment from a supplier who will install those materials and equipment, the supplier is the consumer of the equipment and must pay sales or use tax on its purchase of the materials and equipment. The supplier may pass the sales or use tax on to the exempt entity as a cost of doing business.

In the tax release titled "Purchases of Building Materials by Exempt Entities for Use By Contractor in Real Property Construction," which was published in *Wisconsin Tax Bulletin* 74 (October 1991), it is provided that

if the following conditions are met, there is no taxable sale of materials and equipment transferred by the exempt entity to the contractor:

1. The contract between the exempt entity and contractor states that the contractor is to provide only those materials and equipment not purchased directly by the exempt entity, and
2. There is no reduction in the contract price for any materials and equipment purchased directly from suppliers by the exempt entity.

Since the contract does not provide that the Contractor is to furnish those materials and equipment that will be purchased directly by the Owner from suppliers and the contract price will not include the price of materials and equipment the Owner will purchase directly from suppliers, the transfer of materials and equipment from the Owner to the Contractor is not subject to Wisconsin sales or use tax.

If the Owner is unable to obtain materials and equipment within the maximum price and purchases such materials and equipment at a higher

price resulting in the contract sum being reduced by the difference between the higher price and the maximum price, the sales and use tax treatment of the transaction shall not be affected. Such reduction in the contract price is considered to be a penalty imposed on the Contractor because of the Owner's failure to obtain materials and equipment at the maximum price, rather than consideration for the transfer of materials and equipment from the Owner to the Contractor. □