Barley Snyder

Construction Law Update January 2012

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Practice Pointer

If you are a contractor who has a construction contract with a qualified tax-exempt entity, be sure to take advantage of the sales and use tax exemption for certain "building machinery and materials" that you incorporate into the construction, remodeling, renovation or repair of the "real estate structure" for that entity. Pursuant to Pennsylvania Act 45 of 1998, contractors who have a construction contract (whether oral or written) with a qualified tax-exempt entity, as set forth in the Act, can purchase certain "building machinery and materials" as defined in the Act without having to pay sales and use taxes. Be sure to become familiar with the definition of building machinery and materials so that you do not pay such taxes (and otherwise have to deal with obtaining a refund). Also, be sure to have a provision in the contract that requires the tax-exempt entity to provide you with an appropriate exemption certificate so that you can submit it to vendors.

If you are a tax-exempt entity (and especially if you have a contract sum that is based on the cost of the work), you will want to ensure that your contract has a provision that excludes from the contract sum any taxes that the contractor pays on any "building machinery and materials" as defined under Act 45 which qualify for tax exemption. Also, the contract should require the contractor and its subcontractors to deliver the exemption certificate to its vendors in connection with the purchase of "building machinery and materials," and further require the contractor and its subcontractors to pay taxes on all other materials and services that do not qualify for tax exemption under Act 45.

The Pennsylvania Department of Revenue has a website page that provides guidance on determining whether or not the machinery and materials incorporated into the real estate structure or the tax-exempt entity meet the requirements for tax exemption under Act 45.

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Mechanic's Lien Update: Applicability

Both owners and contractors need to evaluate carefully the applicability of mechanic's liens. Specifically, the Mechanic's Lien Law permits contractors to lien real estate for labor or materials furnished in the erection, construction, alteration or repair of any improvement. The mechanic's lien law defines improvement to be work that is

"incidental" to erection, construction, alteration or repair. Historically, the Courts have differentiated between work that is "incidental" and work that is "independent" of erection, construction, alteration or repair of any building or permanent structure on real estate.

Recent litigation handled by Barley Snyder is illustrative of this point. Specifically, Barley represented a project owner against whose property a lien was improperly attached.

The owner contracted with the contractor to repair and resurface drives and parking lots. Work began in October 2009 and a certificate of substantial completion was issued on November 16, 2009. No other construction was completed during this time frame. Previously, in June 2008, the owner contracted with a separate contractor to install sidewalks, curbing and assorted landscaping projects. The liening contractor was not a party to this contract. A certificate of substantial completion was issued to the separate contractor on January 26, 2009. In December 2009, after the contract with the liening contractor was completed, the owner contracted with the separate contractor to perform interior renovations. The liening contractor was not involved with this contract either. Testimony at a hearing confirmed that these three contracts were entered separately and were not part of a larger renovation scheme or plan for the property.

The original contractor ultimately filed a mechanic's lien. The owner filed preliminary objections asserting that the work performed by the original contractor was not incidental to the construction or erection of a permanent building or structure.

Based upon the law as described above, the Court agreed with the owner and the mechanic's lien was stricken.

Careful analysis of the "incidental" versus "independent" distinction is necessary for all parties involved in the lien process.

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Update to Pennsylvania's Mortgage Licensing Act: Three Mortgages Per Year or Less Excepted

By: Sarah Yocum Rider

As described in the July 2011 Construction Law Brief, the Pennsylvania legislature passed amendments to the Mortgage Licensing Act (the "MLA") which prohibits individuals and entities from engaging in the residential mortgage loan business (except to immediate family members) without being licensed under the MLA. The amendments to the MLA were made in response to, and to remain compliant with, the federal SAFE Mortgage Licensing Act (the "SAFE Act"). The SAFE Act establishes minimum standards for mortgage licenses that apply to all states.

Since the amendments to the MLA have been enacted, the Pennsylvania real estate community responded to the MLA with major opposition and has been working to restore seller financing in limited situations.

In August 2011, the United States Department of Housing and Urban Development ("HUD") issued a final regulation related to the SAFE Act that was inconsistent with Pennsylvania's prohibition on individuals and entities engaging in the residential mortgage loan business without a license (the "HUD Regulation"). The HUD Regulation, in part, prohibits an individual from engaging in the mortgage loan business if the individual, in a commercial context, *habitually and repeatedly* takes a residential mortgage loan application or offers or negotiates terms of a

residential mortgage loan for compensation or gain, or represents to the public that such individual can or will perform these activities. The MLA, as currently enacted, contains no similar qualification.

On October 6, 2011, the Pennsylvania Department of Banking (the "Department") issued a letter discussing the Department's position with regard to the MLA in light of the HUD Regulation. The letter states that the Department will be seeking amendment to the MLA in order to implement the HUD Regulation as soon as possible, thereby making the MLA consistent with the HUD Regulation.

The Department's letter, however, stated that "the Department will not take exception to an individual making or brokering *three (3) or less mortgage loans in a calendar year* without being licensed as a mortgagor originator." Accordingly, the Department apparently will not enforce the MLA against a residential seller who finances a portion of the purchase price and takes back a residential mortgage on property that it is selling, even if the mortgage is not from an immediate family member, provided that the seller take back three or less mortgages in a calendar year.

This is welcome news for the Pennsylvania real estate community. However, it is important to proceed with caution, since a letter from the Department of Banking is not the law. We expect amendments to the MLA implementing the Department's position in the near future.

In addition to clarifying its position regarding private residential mortgages, the Department's letter also announced that the Department reversed its original position that installment sales agreements are not a form of selling financing subject to the mortgage licensing requirements. The Department explained that installment sales agreements create an "equivalent consensual security interest on a dwelling or on residential real estate." Accordingly, sellers of residential real estate, by means of installment sales agreements, are essentially treated as mortgagees for purposes of the MLA and the same licensing requirements apply.

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