

ARIZONA TRANSACTION PRIVILEGE TAX RULING

TPR 95-21

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

ISSUE:

Elements necessary to establish a valid agency agreement for purposes of the Arizona transaction privilege tax under the prime contracting classification.

APPLICABLE LAW:

A.R.S. § 42-1310.01.A provides that the transaction privilege tax imposed on the retail classification does not apply to the gross proceeds of sales or gross income from sales of tangible personal property to:

- (a) A qualifying hospital as defined in § 42-1301.
- (b) A qualifying health care organization as defined in § 42-1301 if the tangible personal property is used by the organization solely to provide health and medical related educational and charitable services.
- (c) A qualifying health care organization as defined in § 42-1301 if the organization is dedicated to providing educational, therapeutic, rehabilitative and family medical education training for blind, visually impaired and multi-handicapped children from the time of birth to age twenty-one.
- (d) A qualifying community health center as defined in § 42-1301.
- (e) a nonprofit charitable organization that has qualified under § 501(c)(3) of the internal revenue code and that regularly serves meals to the needy and indigent on a continuing basis at no cost.

A.R.S. § 42-1310.01.B provides for a deduction from the tax base of the gross proceeds of sales or gross income derived from sales of certain machinery and equipment.

A.R.S. § 42-1310.16 imposes the transaction privilege tax on the gross proceeds of sales or the gross income derived from the business of prime contracting.

A.R.S. § 42-1329 establishes a presumption that all gross proceeds of sales and gross income from business activity comprises the tax base.

A.A.C. R15-5-608.C provides that when a contract between a builder and owner contains an agency agreement authorizing the builder to purchase exempt machinery and equipment for the account of the owner, the cost of such machinery is not deemed to be contracting income, even though installed by the builder.

A.A.C. R15-5-629.B provides that when a contract between a builder and a qualified exempt hospital contains an agency agreement authorizing the builder to purchase tangible personal property for the account of the hospital, the cost of such property is not deemed to be contracting income even though installed or incorporated into the construction project.

LEGAL REFERENCES:

Owner supplied equipment purchased in the name of the utility by contractor as purchasing agent was not included in the gross receipts of contractor. *Ebasco Services Incorporated v. Arizona State Tax Commission*, 105 Ariz. 94, 459 P.2d 719 (1969).

Agency is ultimately a question of the intention of the parties as evidenced by their actions and is not dependent on what the person is called. *Arizona State Tax Commission v. Parson-Jurden Corporation*, 9 Ariz. App. 92, 449 P.2d 626 (1969).

The cost of materials, supplies and equipment purchased by a contractor who had entered into a purchasing agency agreement with a qualified hospital was not included in the contractor's tax base. *Kitchell Contractors, Inc. v. City of Phoenix*, 151 Ariz. 139, 726 P.2d 236 (1986).

The cost of machinery and equipment which qualified for an exemption from tax under the retail classification was included in the tax base of a contractor who had not entered into a purchasing agency agreement with the owner. *Brink Electric Construction Co.; Ball, Ball & Brosamer, Inc. v. Arizona Department of Revenue*, 193 Ariz. Adv. Rep. 56 (CA-1, 6-29-95).

DISCUSSION:

OVERVIEW:

The Arizona Revised Statutes at Title 42, Chapter 8, Article 1 are structured into various classifications under which a taxpayer may conduct business, each with its own exemptions

and/or exclusions.

The retail classification provides exemptions for items sold by a business which sells tangible personal property at retail. Many of these exemptions are based on the status of the purchaser. The contracting classification assesses tax on the business of prime contracting. Exemptions or exclusions under the retail classification are not available to businesses operating under the contracting classification.

An agency relationship allows a person who qualifies to make exempt purchases to take advantage of the exemption by having the agent purchase the tangible personal property. Purchases made under an agency agreement are not includable in the gross proceeds from contracting. An agency agreement may be for all purchases of materials and supplies used on the project or for items specifically designated in the agreement.

The Arizona Supreme Court in its decision in *Duhamel v. State Tax Commission*, 65 Ariz. 268, 179 P.2d 252 (1947), stated "[W]hile perhaps a contractor may be making a sale in the loose sense of the word ..., a contractor when fabricating personality into realty neither sells, resells, sells at retail, nor can he be considered a retailer."

CONTRACTUAL AGENCY RELATIONSHIP:

An agency relationship is a contractual relationship between two persons, under which one party (the agent) acts for and on behalf of the other party (the principal) subject to the principal's control. It is a legal relationship which depends upon the existence of required factual elements.

As a general rule, there is no particular form which is required to create the relationship so long as a valid contract has been entered into. While a contract is essential in creating an agency, the fact that a contract exists between the parties does not necessarily establish the relationship nor does the use of the term "agent" in a contract determine the status. Whether a particular relationship is an agency depends on the relations of the parties as they in fact exist. If contractual provisions purporting to establish an agency are merely matters of form and not of substance, the intended effect of tax exemption will be denied. The question in each instance is whether an actual agency relationship has been established.

The basic element of an agency is that the agent has the power to act on behalf of the principal with third persons and has the power to bind the principal and to alter legal relations between the principal and third persons.

Another essential element in establishing an agency is the right of the principal to control the actions of the agent. Although it is not necessary that there be actual supervision of the agent's work, a principal must generally have the right to control or direct the actions of the agent.

CONCLUSION AND RULING:

A valid agency agreement, for purposes of the exclusions provided in A.A.C. R15-5-608.C and A.A.C. R15-5-629.B, must be a written agreement which manifests the intent to create an agency relationship. If separate from the construction agreement, the agency agreement must be dated and signed by both principal and agent. The agreement must vest in the agent the authority to make purchases on behalf of the principal (i.e., to bind the principal) and must reserve to the principal the right to control or direct the manner by which such purchases are made. An agency agreement may be for all purchases of materials and supplies used on the project or for items specifically designated in the agreement. Additionally, no other provisions of the construction agreement may negate or modify the provisions of the agency agreement.

An agency agreement cannot be entered into retroactively. Therefore, only purchases made on behalf of the principal **after** the agency agreement has been entered into may be excluded from the tax base under the prime contracting classification. Purchases made prior to the date an agency agreement was entered into may not be deducted from the tax base.

For a valid agency to exist there must be an agreement which establishes the essential elements of an agency relationship and which is substantiated by conduct of the parties consistent with the agreement.

The following items are included in this ruling as examples of agency agreement language or contractual provisions which contain the essential elements to establish a valid agency relationship for purposes of the Arizona transaction privilege tax.

A contract or agreement will be deemed by the department to meet the qualifications of a valid agency agreement, if the principal uses the language in examples 1 and 2 in a contract, or a signed and dated agreement appended to a contract, and both parties to the agreement or contract act in accordance with the provisions in either example 3 or 4.

Examples of Elements of a Valid Agency Agreement:

1. Provision which manifests the intent to create an agency relationship:

Contractor, and its subcontractors, shall act as Owner's agent for the purpose of making approved purchases of machinery, equipment, materials and other tangible personal property required under the terms of the contract to which this agreement is appended (or contract in which this agreement is incorporated). No other provisions in the contract shall negate or modify the provisions of this agency agreement.

2. Provision which vests in the agent the authority to make purchases on behalf of the principal and to bind the principal:

All machinery, equipment, materials and other tangible personal property shall be purchased by the Contractor and its subcontractors on behalf of and for the account of Owner as its agent. Title to the subject property shall pass directly from the vendor to Owner. Neither the Contractor nor any of its subcontractors shall acquire any ownership interest in such property.

In making such purchases, the Contractor and any of its subcontractors shall include the following language on the purchase orders:

Purchaser. The name and address of the purchaser on all purchase order forms shall be:

"(Owner)" OR "(Contractor), as agent for (Owner)"

(Owner's address)

Signature. The signature on all purchase orders shall be:

"(Contractor), as agent for (Owner)"

To substantiate that the contractual provisions are not merely matters of form, the purchases should be made by one of the following methods:

3. The purchases are made in the name of the principal; with the principal's funds or credit, either in the form of cash advances or checks drawn on a separate bank account maintained by the principal; and, title to the items purchased passes to the principal at the time of purchase.

4. The purchases are made in the name of the principal, with the agent's funds or credit. In this case the transactions must be segregated. The agent must maintain separate, detailed accounting records for these purchases.

OTHER TYPES OF AGENCY AGREEMENTS:

The department recognizes that various approaches to the drafting and execution of an agency agreement exist. An example would be that of an undisclosed principal. If the language of the agreement and the associated conduct of the parties is other than that as presented in the examples as delineated in this ruling, the agency agreement shall be subject to review by the department as to the facts and circumstances surrounding its execution. The burden of

proof as to the validity of the agreement would lie with the taxpayer.

Harold Scott, Director

Date Signed December 20, 1995

Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law which are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement which provides interpretation, details or supplementary information concerning the application of the law. Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling. See GTP 92-1 for more detailed information regarding documents issued by the Department of Revenue.