

## PRIVATE TAXPAYER RULING LR96-004

February 22, 1996

The following private taxpayer ruling is in response to your letter dated January 30, 1996. You have requested a ruling regarding the application of transaction privilege tax to design and engineering services and purchases of certain machinery and equipment in conjunction with the construction of a manufacturing facility for ....

The following is a restatement of the facts presented in your letter.

### Statement of Facts:

... has entered into an agreement with ... and ... jointly for construction of a manufacturing facility. Under the agreement, ... will act as contractor on the project to build the facilities.

... will purchase, as agent for ..., certain pipe and certain manufacturing machinery and equipment to be used in the manufacturing facility. Additionally, all engineering and design services will be separately accounted for and separately billed.

The agency agreement entered into between ... and ... basically provides that the agents and their designated subcontractors shall act as the owner's agent for the purpose of making approved purchases of exempt machinery and equipment. All exempt property shall be purchased by the agents and their subcontractors on behalf of, and for the account of, the owner as its agents. Title to the property shall pass directly from the vendor to the owner. Neither the agents nor any or their subcontractors shall acquire any ownership interest in such property.

... has developed procedures which are intended to insure that neither ... nor ... will be subject to transaction privilege tax on the purchase of any manufacturing equipment nor on the purchase of certain pipe used to carry oil, gas or water. ... will maintain separate and detailed accounting records for the purpose of billing .... Monthly billing to ... will include a statement and supporting schedules which list the items acquired by ... as agent for ... separately from other components of the bill.

... also intends that its procedures will ensure that the engineering and design services will not be subject to transaction privilege tax. ... will maintain separate detailed accounting records for the purpose of billing .... Monthly billing will include a separate statement and supporting schedules for nontaxable services provided by ... or other professionals hired by ....

### Your Position:

If ... and ... follow the agency purchases procedure, as outlined in your request, ... will not be subject to transaction privilege tax on the cost of manufacturing machinery and equipment, and pipe four inches in diameter or larger.

Furthermore, if ... and ... follow the procedures for non-contracting services, as outlined in your request, neither ... nor ... will be subject to tax on the cost of services rendered relative to engineering and design of the facility.

### Applicable Statutory Provisions:

Arizona Revised Statutes (A.R.S.) § 42-1310.01 levies the transaction privilege tax on the business of selling tangible personal property at retail.

A.R.S. § 42-1310.01.A.1 provides that the tax imposed on the retail classification does not apply to the gross proceeds of sales or gross income from professional or person service occupations or businesses which involve sales or transfer of tangible personal property only as inconsequential elements.

A.R.S. § 42-1310.01.B.1 provides a deduction from the tax base for income derived from sales of machinery or equipment used directly in manufacturing or processing.

A.R.S. § 42-1310.01.B.6 provides a deduction from the tax base for income derived from sales of pipes or valves four inches in diameter or larger used to transport oil, natural gas, artificial gas, water or coal slurry.

A.R.S. § 42-1310.16 levies the transaction privilege tax on the business of prime contracting. Contracting includes constructing, altering, repairing, improving, adding to or subtracting from real property.

A.R.S. § 42-1310.16.F.6 defines a "prime contractor" as a contractor who supervises, performs or coordinates the construction, alteration, repair, addition, subtraction, improvement, movement, wreckage or demolition of any building, highway, road, railroad, excavation or other structure, project, development or improvement including the contracting, if any, with any subcontractors or specialty contractors and is responsible for the completion of the contract.

Arizona Administrative Code (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 equipment is not deemed to be contracting income, even though it is installed by the builder.

### Discussion:

## The Agency Agreement:

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.

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.

A valid agency agreement, for purposes of the exclusion provided in A.A.C. R15-5-608, 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. Additionally, no other provisions of the construction agreement may negate or modify the provisions of the agency agreement. These essential elements must be substantiated by conduct of the parties consistent with the agreement.

The agency agreement submitted with your request appears to contain the essential elements to establish a valid agency relationship. The agreement manifests an intent to create an agency relationship by providing that ... is appointed as agent for the purpose of making approved purchases of materials and equipment required under the terms of the contract.

The agreement vests in ... the authority to bind the principal by providing that purchases are to be made in the name of the principal or by ... as agent for the principal. The agreement also provides that title to the materials shall pass directly from the vendors to the principal.

Additionally, ... will maintain separate and detailed accounting records for the purpose of billing .... Monthly billings to ... will include a statement and supporting schedules which list the items acquired by ... as agent for ... separately from other components of the bill.

However, the agency agreement is entered into under the terms of the contract to which the agency agreement is appended. The information provided by the private taxpayer ruling request is not sufficient to determine whether any provisions of the construction contract may negate or modify the provisions of the agency agreement.

## Non-Contracting Services:

The transaction privilege tax is imposed on the income derived from the business of prime contracting. In a case involving a corporation which performed engineering and design services as well as contracting under separate contracts, the Supreme Court of Arizona stated that the tax is on the contracting business, not on all activities of a corporation based on the fact that one of the activities engaged in is contracting. The Court went on to hold that gross receipts from engineering services were not taxable under the contracting classification. *Ebasco Services Inc. v. Arizona State Tax Commission*, 105 Ariz. 94, 459 P.2d 719 (1969).

The information provided by the private taxpayer ruling request does not establish that the contract which provides for the engineering and design services at issue is in a contract which is separate from the construction contract. In a case involving a single contract to design and construct a facility, the Supreme Court of Arizona held that the gross receipts from design and engineering services were not subject to transaction privilege tax under the contracting classification. *State Tax Commission v. Holmes & Narver, Inc.*, 113 Ariz. 165, 548 P.2d 1162 (1976). However, in that case the facts established that the receipts for design and engineering services were of a substantial nature and not incidental to the contracting business.

### Conclusion and Ruling:

The following ruling is given based on the facts presented in your request.

The department rules that the agreement between ... and ... is sufficient to establish an agency relationship enabling ... to make tax exempt purchases of tangible personal property under the exemption for machinery and equipment used directly in manufacturing provided by A.R.S. § 42-1310.01.B.1 and the exemption for pipes and valves four inches in diameter or larger used to transport oil, natural gas, artificial gas, water or coal slurry provided by A.R.S. § 42-1310.01.B.6. However, the construction contract may not contain any provisions which negate or modify the provisions of the agency agreement.

The department further rules that services rendered by ..., or professionals hired by ..., relative to engineering and design of the facility, for which a separate detailed accounting will be made, are not subject to transaction privilege tax provided that those services are of a substantial nature and are not incidental to the contracting business.

The conclusion in this private taxpayer ruling does not extend beyond the facts as presented in the request for a private taxpayer ruling dated January 30, 1996, and related documents.

This response is a private taxpayer ruling and the determination herein is based solely on the facts provided in your request. The determination in this taxpayer ruling is the present position of the department and is valid for a period of four years from the date of issuance except as set out herein. This determination is subject to change should the facts prove to be different on

audit. If it is determined that undisclosed facts were substantial or material to the department's making of an accurate determination, this taxpayer ruling shall be null and void. Further, the determination is subject to future change depending on changes in statutes, administrative rules, case law or notification of a different department position.