



PRIVATE TAXPAYER RULING LR05-007

Janet Napolitano
Governor

Gale Garritt
Director

September 1, 2005

. . . .

The Department issues this private taxpayer ruling in response to your letter of August 10, 2004, in which you request a ruling on behalf of your client . . . ("Client") . . . on the applicability of Arizona transaction privilege tax to specific business activities engaged in by Client as well as . . . ("Contractor"), a contractor hired by Client. The ruling is based on facts as provided in your original request, as well as additional information submitted on August 20, 2004, October 13, 2004, March 1, 2005, April 1, 2005, and June 8, 2005.

Statement of Facts:

The following facts are excerpted from your August 10 letter:

[Client] is an owner/developer of office properties. During the period of June 2002 through March 2003, [Client] hired and contracted with [Contractor] to build four shell buildings on [Client]'s real property located at [Street Address], [City], Arizona. [Client] was passed-on Arizona State prime contracting transaction privilege tax and City . . . contracting privilege tax by [Contractor] for the construction of the shell buildings.

Both during and after substantial completion of the shell buildings, [Client] entered into contracts for sale for various units of the buildings in seven separate contracts. Two of the contracts were executed during the construction of the shells, one at the end of construction after substantial completion, and four after the shell COs [certificates of occupancy] ha[d] been issued by the City

All contracts for sale state that [Client] "shall cause [Contractor] to substantially complete" the construction . . . and provide that [Client] "shall cause Seller's Contractor . . . to guarantee to Purchaser the Unit and the Tenant Improvements against defective workmanship and/or materials." . . . Five of the sold units included tenant improvements ("TIs") and two did not. Thus, [Client], through [Contractor], constructed TIs for five of the seven sales, and was again passed-on Arizona State prime contracting transaction privilege tax and City . . . contracting privilege tax by [Contractor] for the construction of the tenant improvements.

The contracts for sale (that include tenant improvements) separately state the gross sales price for the shell. . . . The additional gross sales price for tenant improvements is to be added to the shell sale price, is set forth in amendments to the contracts, and is limited to [Client]'s cost of the tenant improvements. . . . In addition, the gross income from the unit shells is approximately 60% of the total sales price

All purchases of shell and TI materials incorporated into the various sold units were purchased by and incorporated by [Contractor].

During the periods of March 2003 through April 2004, the sales of the seven units were concluded. See attached timeline.

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You provided the following supplemental facts on August 20 in response to the Department's request for information:

[Client] hereby clarifies that the Purchase and Sale Agreement and Second Amendment to the Purchase and Sale Agreement were originally submitted as an example of a contract for sale where tenant improvements are included in the subject sale. This sample is substantially similar to other past contracts for sale with TIs, and will be substantially similar to future contracts for sale with TIs. If a sale does not include TIs, the contract for sale is similarly worded, but the contract property and the contract price relate to the shell of the unit(s) only.

In additional facts you provided in your June 8 letter, you asserted that:

1. Client utilized Contractor to actually perform all contracting activities and "in no way acted itself, or through others, as a construction manager."
2. Client does not hold a performance or payment bond for third-party purchasers in the type of projects at issue.
3. Client holds general liability and property insurance, but does not specifically insure against its nonfulfillment of any duties and obligations to a third-party purchaser or to Contractor.

Your Issues:

1. Whether Client is liable for tax under the owner builder classification.
2. Whether Client is properly considered a prime contractor for any or all of the transactions in question.
3. Whether any or all of Client's proceeds related to the shell component of the sales are subject to prime contracting transaction privilege tax to Client.
4. Whether Contractor is an exempt subcontractor for any or all of the proceeds received from Client.

Your Positions:

1. Client is not liable for tax under the owner builder classification.
2. Client is not a prime contractor for the transactions in question.
3. If the Department rejects Position Two and finds that Client is a prime contractor, Client's alternative position is that Client's proceeds related to the shell component of the sales should be deemed subject to prime contracting transaction privilege tax

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to Client only for those proceeds not previously subject to transaction privilege tax when paid to Contractor (*i.e.*, where the shell was not substantially completed before the contract for sale).

4. Contractor is an exempt subcontractor for any or all of the proceeds received from Client where Client is the prime contractor.

Conclusion and Ruling:

In accordance with Arizona Revised Statutes (“A.R.S.”) § 42-2101(G), the Department issues this private taxpayer ruling addressing Client’s future transactions and tax liabilities accruing from the date the taxpayer receives this ruling, to provide guidance on prospective actions Client may choose to undertake in substantially similar transactions.

As provided in A.R.S. § 42-5075, the tax base for the prime contracting classification is sixty-five percent of the gross proceeds of sales or gross income derived from the business of prime contracting and dealership of manufactured buildings. A “contractor,” as provided for generally under A.R.S. § 42-5075(K)(2), is:

synonymous with the term “builder” and means any person, firm, partnership, corporation, association or other organization, or a combination of any of them, that undertakes to or offers to undertake to, or purports to have the capacity to undertake to, or submits a bid to, or does personally or by or through others, construct . . . [or] improve . . . any building . . . or improvement, or to do any part of such a project, . . . in connection with such a project, and includes subcontractors and specialty contractors. For all purposes of taxation or deduction, this definition shall govern without regard to whether or not such contractor is acting in fulfillment of a contract.

Compare this definition with that for a *prime* contractor under A.R.S. § 42-5075(K)(6), which in relevant part provides that it means “a contractor who supervises, performs or coordinates the construction . . . [or] improvement . . . of any building . . . or improvement including the contracting, if any, with any subcontractors or specialty contractors and who is responsible for the completion of the contract.”

By definition, then, *all* prime contractors are contractors, but a contractor is not necessarily a *prime* contractor subject to tax under A.R.S. § 42-5075. The prime contractor must be the party “responsible for the completion of the contract.” Contrastingly, a contractor need not even act “in fulfillment of a contract”—A.R.S. § 42-5075(K)(2) provides that the “definition shall govern” regardless.

A prime contractor may present to other contractors an executed Arizona Form 5005, *Prime Contractor’s Certificate* (“Form 5005”) stating that it is the prime contractor and, consequently, liable for transaction privilege tax under A.R.S. § 42-5075. If the prime contractor presents a Form 5005, it is subject to transaction privilege tax on its gross receipts, while the gross receipts of the other contractors are exempted from tax.

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A.R.S. § 42-5075(E) further provides that even if a person who provides a prime contractor's certificate is *not* liable for the tax under the classification (*i.e.*, because the person does not qualify as a prime contractor by definition), "that person is nevertheless deemed to be the prime contractor in lieu of the contractor and is subject to the tax under this section on the gross receipts or gross proceeds received by the contractor."

Based upon the facts provided, the Department rules:

1. Under a substantially similar set of transactions, Client is not subject to tax under the owner builder classification except for sales of improvements incorporated into the real property within twenty-four months after substantial completion. A.R.S. § 42-5076(A).
2. The treatment of liability for transaction privilege tax under A.R.S. § 42-5075 under a substantially similar set of transactions is as follows:
 - a. During the periods in which Client has hired Contractor to engage in contracting activities that are not in furtherance of a sales agreement between a purchaser and Client, the Contractor is the prime contractor under A.R.S. § 42-5075 and is liable for transaction privilege tax due on gross receipts received during the periods that are related to the contracting activities.
 - b. During the periods in which Contractor is performing contracting activities in fulfillment of a contract between Client and a purchaser (*e.g.*, for completion of a shell or a TI), as determined by the date of execution of the Client-purchaser agreement, Client is the prime contractor under A.R.S. § 42-5075 and may issue a Form 5005 to Contractor that is effective from that date. Client is liable for transaction privilege tax due on the gross receipts received during the periods that are related to contracting activities that Client is performing through Contractor for the purchaser and other contractors on the shell or TI.
 - c. Regardless of the general tax treatment of Client and Contractor as described above in subsections 2(a) and 2(b), Client is deemed to be a prime contractor upon the date it assumes liability for transaction privilege tax through issuance of a Form 5005 pursuant to A.R.S. § 42-5075(E). Client's liability would consist of gross receipts received by Contractor from Client.
3. In circumstances under which Client is the prime contractor as described above in subsection 2(b), Client's gross proceeds of sales or gross income relating to sales of the shell components are subject to transaction privilege tax under the prime contracting classification. Contrastingly, in circumstances under which Client is

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deemed to be the prime contractor as described above in subsection 2(c), Client's liability would consist of gross receipts received by Contractor from Client.

4. Contractor is an exempt subcontractor on gross proceeds of sales or gross income received from Client under the circumstances described above in subsections 2(b) and 2(c).

The conclusions in this private taxpayer ruling do not extend beyond the facts presented in your communications of August 10, 2004, August 20, 2004, October 13, 2004, March 1, 2005, April 1, 2005, and June 8, 2005.

This response is a private taxpayer ruling and the determination herein is based solely on the facts provided in your request. The determinations are 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.

The determinations in this private taxpayer ruling are only applicable to the taxpayer requesting the ruling and may not be relied upon, cited, nor introduced into evidence in any proceeding by a taxpayer other than the taxpayer who has received the private taxpayer ruling.