

STATE OF ARIZONA

Department of Revenue
Office of the Director
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Janet Napolitano
Governor

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Director

CERTIFIED MAIL [redacted]

**The Director's Review of the Decision
of the Administrative Law Judge Regarding:**)
)
[redacted])
)
License No. [redacted])
_____)

O R D E R

Case No. 200700085-S

On July 16, 2007 the Administrative Law Judge issued a decision regarding the protest of [redacted] ("Taxpayer"). The Taxpayer timely appealed this decision on August 15, 2007. The appeal being timely, the Director of the Department of Revenue ("Director") issued a notice of intent to review the decision.

In accordance with the notice given the parties, the Director has reviewed the Administrative Law Judge's decision and now issues this order.

STATEMENT OF CASE

The Transaction Privilege and Use Tax Section of the Audit Division ("Division") of the Department audited Taxpayer for the period July 1998 through May 2003. In the audit, the Division determined that Taxpayer owed transaction privilege tax on four projects and use tax on some of the purchases for another project. Taxpayer argues that he was a construction manager on three projects and that income is not taxable. With regard to the fourth job he claims he did no construction work and had no income. Finally, Taxpayer argues no use tax is due by him because the house for which the property was purchased was owned by his stepdaughter and the retailers should have paid transaction privilege tax.

FINDINGS OF FACT

The Director adopts from the findings of fact in the decision of the Administrative Law Judge and makes additional findings of fact based on the record below and the Affidavit of Taxpayer ("Affidavit") submitted on appeal:

1. Taxpayer, a sole proprietor, is a licensed general residential contractor.
2. Taxpayer and the property owners of the jobs at issue did not have written contracts. Affidavit, ¶ 15.
3. Taxpayer provided no evidence from any of the property owners regarding the terms of their agreement(s) with Taxpayer.
4. With respect to three properties, identified in Taxpayer's Opening Memorandum as the P[redacted], H[redacted] and B[redacted] Houses, Taxpayer asserts that he was hired as a contractor for some work and a "construction manager" for the projects. Affidavit, ¶ 8. As "construction manager", Taxpayer hired the subcontractors and "oversaw" their work. Affidavit, ¶¶ 17-18. Taxpayer asserts he received one fixed fee for each of these projects. Affidavit, ¶ 13.
5. Taxpayer claims that he was not responsible to pay the subcontractors and that the moneys he received from the owners to pay the subcontractors went into a separate account in the owners and his name. In paying the subcontractors he claims he was acting on behalf of the owners. Affidavit, ¶¶ 20, 22, 23, 27.
6. Taxpayer asserts that he did no contracting work and was not a construction managers with respect to the property identified in the Opening Memorandum as the H[redacted] House. Affidavit, ¶¶ 31, 38.
7. Taxpayer signed the residential building permit application for the H[redacted] House. Department's Exhibit submitted to the Office of Administrative Hearings ("OAH Exhibit") H, page 140. He was also listed on the building/grade permit application as the contactor for the project. OAH Exhibit H, page 141. These documents were completed in identical fashion for the other properties for which Taxpayer was the prime contractor. See, e.g., OAH Exhibit D, pages 40-41; Exhibit E, pages 65-66. Also, he ordered soil tests for the project and contacted the mason for the foundation work. OAH Exhibit H, page 142; Affidavit, ¶ 32.
8. Taxpayer and the Division agree that Taxpayer was not the prime contractor with

respect to the F[redacted] House.

9. While Taxpayer asserts that [redacted] F[redacted], his stepdaughter, owned the property, Taxpayer was also a partial owner of the property. OAH Exhibit I, pages 173-181 and Affidavit, ¶¶ 36, 37. Further, he signed the Owner-Builder Declaration with the City of [redacted] as the property owner and contacted the mason for the foundation work. OAH Exhibit I, pages 183-184 and Affidavit, ¶ 32.
10. For the F[redacted] House Taxpayer purchased materials from a number of retailers. To the extent that the invoice indicated that transaction privilege tax was added to the invoice, the auditor did not assess use tax.
11. When purchasing materials for the F[redacted] House, Taxpayer knew some of the retailers were not charging tax and he did not clarify that he was using the material for his personal use.
12. The Division audited Taxpayer and in making its review the Division used [redacted] County records as well as information supplied by Taxpayer.
13. In his protest of the assessment issued by the Division, Taxpayer indicated (apparently for one project) that he was an employee with a weekly salary from “Mr. B[redacted]” and further indicated (for the other projects) that he was “simply an advisor.”
14. In April 2005, the parties participated in an informal conference and Taxpayer agreed to provide additional information (copies of escrow statements and contracting licenses) by May 13, 2005.
15. Taxpayer provided some information in August 2005. See Exhibit K.
16. The only documentation Taxpayer submitted regarding tax paid by vendors consists of a list of vendors and amounts; he did not produced actual invoices.
17. In August 2005, the Division subsequently proposed to amend the Assessment, with which Taxpayer disagreed. See Exhibit L.

CONCLUSIONS OF LAW

The Director adopts from the conclusions of law in the decision of the Administrative Law Judge and makes additional conclusions of law as follows:

1. A.R.S. § 42-5075 imposes the transaction privilege tax on persons engaging in the business of prime contracting.
2. The transaction privilege tax is measured by the amount or volume of business transacted, and the tax base for prime contracting is the 65% of the gross proceeds of sales or gross income derived from the business. A.R.S. § 42-5008; A.R.S. § 42-5075.
3. A.R.S. § 42-5075(N) defines “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, manufactured building or other structure, project, development or improvement, including the contracting, if any, with any subcontractors or specialty contractors and who is responsible for the completion of the contract.
4. A person hired as a “construction manager” is a prime contractor for tax purposes if he is hired to use his contracting knowledge to supervise or coordinate the construction project. *Ariz. Dep’t of Revenue v. Ormond Builders, Inc.*, 216 Ariz. 379, 385, 166 P.3d 934, 940 (App. 2007).
5. With respect to the four projects for which the Department assessed transaction privilege tax, Taxpayer’s activities fell within the statutory definition of prime contractor.
6. The transaction privilege tax is measured by all of the business activity of the taxpayer and not merely a part if it. *Duhamé v. State Tax Commission*, 65 Ariz. 268, 276, 179 P.2d 252 (1947).
7. All gross proceeds of sales and gross income derived by a person from business

activity classified under a taxable business classification is presumed to comprise the tax base for the business until the contrary is established. A.R.S. § 42-5023.

8. Because there is insufficient evidence that Taxpayer was not liable for payments to the subcontractors, he must pay tax on all amounts that he received, including the amounts that he paid to the subcontractors. *Cf. Ormond Builders*, 216 Ariz. at 387-88, 166 P.3d at 942-43 (finding that the agreements, bid specifications, and warranties established that the taxpayer was not liable to the trade contractors for payments).
9. Arizona imposes a tax on the storage, use or consumption in this state of tangible personal property purchased from a retailer. A.R.S. § 42-5155(A).
10. The use tax does not apply to the storage, use or consumption of tangible personal property sold in this state, the gross receipts from the sale of which are included in the measure of the tax imposed by articles 1 and 2 of chapter 5 of Title 42. A.R.S. § 42-5159(A)(1).
11. “[T]he measure of the tax imposed by article 1 of this chapter” within A.R.S. § 42-1409.A.1 [now A.R.S. § 42-5159(A)(1)] means all gross receipts on which seller is obligated to pay retail transaction privilege tax, whether or not actually paid, except where seller reasonably concludes from some action of the buyer at or around sale that sale is tax-exempt” [quoting from *People of Faith v. Arizona Dep’t of Revenue*, 161 Ariz. 514, 520, 779 P.2d 829, 835 (Tax Ct.1989)]. *Arizona Dept. of Revenue v. O’Connor, Cavanaugh, Anderson, Killingsworth & Beshears, P.A.*, 192 Ariz. 200, 204, 963 P.2d 279, 283, (App., 1997).
12. A purchaser is relieved from use tax obligation if he obtains a receipt from a retailer that maintains a place of business in this state showing that a charge for tax has been passed on to the purchaser. A.R.S. § 42-5155(F).
13. Taxpayer has not produced sufficient evidence to show that he should be allowed additional exclusions under A.R.S. § 42-5155(F).

14. There is no authority to allow a credit against transaction privilege tax for amounts Taxpayer may have paid to trade contractors or vendors as reimbursement for the contractors' or vendors' tax liability.

DISCUSSION

This case concerns gross income for contracting work on four houses on which the Division assessed transaction privilege tax and use tax assessed for materials used in a fifth house. Taxpayer and the property owners of the jobs at issue did not have written contracts and Taxpayer provided no evidence from any of the property owners regarding the terms of their agreements.

P[redacted], H[redacted] and B[redacted] Houses

Arizona imposes tax on a taxpayer's gross income from the business of prime contracting. "Prime contractor" means a contractor who supervises, performs or coordinates the construction of any building, other project, development or improvement, including the contracting, if any, with any subcontractors or specialty contractors and who is responsible for the completion of the contract. A person hired as a "construction manager" is a prime contractor for tax purposes if he is hired to use his contracting knowledge to supervise or coordinate the construction project. *Ariz. Dep't of Revenue v. Ormond Builders, Inc.*, 216 Ariz. 379, 385, 166 P.3d 934, 940 (App. 2007). Taxpayer admits in his affidavit that he is a general residential contractor.

With respect to three properties, identified in the Opening Memorandum as the P[redacted], H[redacted], and B[redacted] Houses, Taxpayer asserts that he was hired as a contractor for some work and a "construction manager" for the projects. As "construction manager", Taxpayer hired the subcontractors and supervised their work. These facts demonstrate that Taxpayer was the prime contractor for these projects.

Taxpayer claims that he was not responsible to pay the subcontractors and that the moneys he received from the owners to pay the subcontractors went into a separate account in the owners and his name. In paying the subcontractors he claims he was acting on behalf of the owners. In his protest Taxpayer indicated (apparently for one project) that

he was an employee with a weekly salary and further indicated (for the other projects) that he was “simply an advisor.” Even if a contractor is acting as an agent for the owner, that does not change whether or not he is a prime contractor. *Ormond Builders*, 216 Ariz. at 385- 386. Taxpayer was hired for his expertise in construction of homes and supervised the construction; Taxpayer was the prime contractor for these houses.

H[redacted] House

Taxpayer asserts that he did no contracting work with respect to the property identified in the Opening Memorandum as the H[redacted] House. Taxpayer, however, signed the residential building permit application for the H[redacted] House. He was also listed on the building/grade permit application as the contact for the project. These documents were completed in identical fashion for the other properties for which Taxpayer was the prime contractor. He also ordered soil tests for the project.

Taxpayer did not appear at the hearing before the Office of Administrative Hearings. Taxpayer’s statements in an affidavit, without an opportunity for examination or documentary support, do not outweigh the contradictory documentary evidence. See, *White v. All Am. Cable & Radio, Inc.*, 642 F. Supp. 69, 72 (D. P.R. 1986) (noting that a party’s own self-serving statements should be subject to judicial skepticism). The documentation created at the time of the construction project better evinces Taxpayer’s participation in the construction. Taxpayer was a prime contractor on the H[redacted] House.

Gross Income from the Business

A prime contractor’s gross income includes all amounts that he receives. Arizona law defines gross income as “the gross receipts of a taxpayer derived from trade, business commerce or sales and the value proceeding or accruing from the sale of tangible personal property or service, or both, and without any deduction on account of losses.” A.R.S. § 42-5001(4). The transaction privilege tax is measured by all of the business activity of the taxpayer and not merely a part if it. *Duhamel v. State Tax Commission*, 65 Ariz. 268, 276, 179 P.2d 252 (1947). All gross proceeds of sales and gross income derived by a person

from business activity classified under a taxable business classification is presumed to comprise the tax base for the business until the contrary is established. A.R.S. § 42-5023.

Included in the proposed assessment are amounts Taxpayer paid to subcontractors. Taxpayer hired the subcontractors and paid them. Taxpayer states that the payments from the owners for the subcontractors went into a separate account in the name of the owner and Taxpayer.

This financial arrangement does not, by itself, demonstrate whether Taxpayer was receiving and paying the subcontractors as the owners' agent. While Taxpayer's Affidavit states he was not liable for payments to the subcontractors, no testimony has been received from the subcontractors or owners. Given the self-serving nature of the only evidence to support Taxpayer's claim and the apparent potential for additional evidence from others, Taxpayer has not established he was not liable for payments to the subcontractors. This being the case, Taxpayer must pay tax on all amounts that he received, including the amounts that he paid to the subcontractors. *Cf. Ormond Builders*, 216 Ariz. at 387-88, 166 P.3d at 942-43 (finding that the agreements, bid specifications, and warranties established that Ormond Builders was not liable to the trade contractors for payments).

Use Tax on Materials Purchased for F[redacted] House

The Division assessed use tax on some of the purchases of tangible personal property used in a project Taxpayer refers to as the F[redacted] House. The Division determined Taxpayer was a part owner, therefore, the materials he bought to use in the house were subject to use tax. Arizona imposes a tax on the storage, use or consumption in this state of tangible personal property purchased from a retailer. A.R.S. § 42-5155(A). A purchaser is relieved from use tax obligation if he obtains a receipt from a retailer that maintains a place of business in this state showing that a charge for tax has been on the purchase. A.R.S. § 42-5155(F). To the extent that the invoice indicated that transaction privilege tax was added to the invoice, the auditor did not assess use tax.

Taxpayer asserts that the F[redacted] House was owned by [redacted] F[redacted], his stepdaughter. However, according to the [redacted] County records Taxpayer was one

of the joint owners of the property. In addition he signed the Owner-Builder Declaration with the City of [redacted] as the property owner and contacted the mason for the foundation work. Taxpayer had an opportunity to file a Reply Memorandum in which he could have explained and refuted the evidence of his ownership but failed to do so. Taxpayer is found to have been a part owner of the F[redacted] House.

Taxpayer purchased materials for this project from a number of Arizona retailers and on some of the purchases no tax was passed on by the retailer. Taxpayer argues that these Arizona retailers were subject to transaction privilege tax, therefore, they should have paid the tax and he is exempt under A.R.S. § 42-5159(A)(1). The latter provides that the use tax does not apply to the storage, use or consumption of,

Tangible personal property sold in this state, the gross receipts from the sale of which are *included in the measure of the tax imposed by articles 1 and 2 of this chapter* [5 of Title 42] [emphasis added].

In its Response Memorandum the Division argued that Taxpayer regularly purchased materials from the same retailers in his capacity as a general contractor and that the retailers had no reason to know that the materials in this case were for property that Taxpayer owned himself. There is no evidence that Taxpayer clarified to the retailers that the materials were for his own use, even though he knew that the retailers sometimes did not charge tax on those sales. Taxpayer had the opportunity to reply to the Division's assertions, but did not do so. It can be deduced that Taxpayer knew some of the retailers were not charging tax and that he did not clarify that he was not buying the materials as a contractor.

"[T]he measure of the tax imposed by article 1 of this chapter" within A.R.S. § 42-1409.A.1 [now A.R.S. § 42-5159(A)(1)] means all gross receipts on which seller is obligated to pay retail transaction privilege tax, whether or not actually paid, except where seller reasonably concludes from some action of the buyer at or around sale that sale is tax-exempt" [quoting from *People of Faith v. Arizona Dep't of Revenue*, 161 Ariz. 514, 520, 779 P.2d 829, 835 (Tax Ct.1989)]. *Arizona Dept. of Revenue v. O'Connor, Cavanaugh, Anderson, Killingsworth & Beshears, P.A.*, 192 Ariz. 200, 204, 963 P.2d 279, 283, (App., 1997). In this case, Taxpayer was a contractor who routinely bought construction material

exempt from transaction privilege tax because he was incorporating it into real property or improvements on real property. A.R.S. § 42-5061(A)(27). Taxpayer's failure to clarify to the retailer that the material would be used in a house in which he was part owner was "some action of the buyer at or around the sale" that caused the retailers to "reasonably conclude" that the "sale was tax-exempt." The gross receipts to these retailers were not includible in the measure of their tax; therefore, Taxpayer is not exempt from use tax under A.R.S. § 42-5159(A)(1).

Credit against Transaction Privilege Tax for Tax Paid to Vendors

Taxpayer argues that he is entitled to a credit for amounts he paid to retailers and trade contractors ("Vendors") to reimburse the Vendors for their transaction privilege tax liability arising from the proceeds of the transaction with Taxpayer. With regard to the F[redacted] House, Taxpayer was not assessed use tax if the vendor showed transaction privilege tax on the invoices. With regard to the other four houses, the vendors would not have added a charge for tax if Taxpayer had given them an exemption certificate. A taxpayer's failure to take advantage of an exemption or structure a transaction in the most tax advantageous manner does not require the Department to relieve him of his tax liability. See *Brink Elec. Const. Co. v. Ariz. Dep't of Revenue*, 184 Ariz. 354, 362, 909 P.2d 421, 429 (App. 1995) (refusing to apply the retail exemptions to a contractor who failed to enter into purchasing agent agreements).

There is no statutory authority to grant Taxpayer a credit for taxes paid to a Vendor. Taxpayer asks that he be granted the relief granted to Ormond Builders. The relief to which Taxpayer refers is found in the Arizona Tax Court's unpublished minute entry in *Arizona Department of Revenue v. Ormond Builders, Inc.* In that case the court stated "the Court believes that Defendant acted in good faith and should not have to pay taxes that it can prove, within a reasonable period of time, were paid by the trade contractors." Minute Entry at 1. Thus, the court required Ormond Builders to prove that the trade contractors actually paid the tax to the State. Moreover, the agreements and bid instructions in the Ormond case indicated that the trade contractors were to pay all applicable taxes. That

was the type of evidence that court found demonstrated Ormond's good faith belief that it was not subject to tax. In this case, Taxpayer had no good reason to believe that he was not subject to tax on the four houses at issue.

Secondly, Taxpayer did not submit documentation to substantiate tax allegedly charged by the Vendors. He submitted a list of Vendors and amounts and said he would provide actual invoices. He did not do so and provided no explanation of why he did not.

Finally, there is no legal authority for the Department to give a taxpayer credit for tax paid to reimburse Vendors. The *Ormond Builders* Court's equitable relief cannot be granted by the Department.

ORDER

The Administrative Law Judge's decision is affirmed.

This decision is the final order of the Department of Revenue. The Taxpayer may contest the final order of the Department in one of two manners. The Taxpayer may file an appeal to the State Board of Tax Appeals, 100 North 15th Avenue, Suite 140, Phoenix, AZ 85007 or may bring an action in Tax Court (125 West Washington, Phoenix, Arizona 85003) within sixty (60) days of the receipt of this order. For appeal forms and other information from the Board of Tax Appeals, call (602) 364-1102. For information from the Tax Court, call (602) 506-3763.

Dated this 8th day of October, 2008.

ARIZONA DEPARTMENT OF REVENUE

Gale Garriott
Director

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