

## PRIVATE TAXPAYER RULING LR94-012

September 29, 1994

The following private taxpayer ruling is in response to your request that the department rule that ... are not taxable prime contractors on the construction of infrastructure.

### **Statement of Facts:**

The following is a restatement of the facts as presented in your letter. ... holds 600 acres of land purchased from the State Land Department. As a condition of its purchase of the land, ... is required to construct the infrastructure for the future development of the land. If ... defaults on its obligations, the ownership of the land will revert to the state. ... has a pending sale of a portion of this land to four homebuilders. The sale price of the land to the homebuilders reflects the value of improved parcels rather than raw land. Of the \$28 million sale price, \$23 million will be placed in an escrow account to be used to fund the construction of the infrastructure within a fixed period of time.

As a condition of the sale, the sale of the property to the homebuilders will not be completed if the infrastructure is not constructed as required. In order to complete the infrastructure on a timely basis, a new partnership, ... is being formed. ... is an Arizona general partnership consisting of ... and ... . ... is also a partner in .... Upon completion of the sale of the land to the four homebuilders, ... will succeed to all the rights and obligations of .... Specifically, ... will:

1. Assume the obligations and contracts of ..., including the obligation to construct the infrastructure.
2. Be assigned all the rights of ..., including the escrowed funds.
3. Purchase an additional 90 acres of land for \$2 million plus assumption of debt. ... will also have an option to acquire additional property for cash plus assumption of debt in the future. In order to fulfill its obligation to complete the infrastructure, ... will hire contractors and a construction manager.

Payment to these entities will be made out of the escrow account based upon the construction manager's authorization. Funds remaining in the escrow account after completion of the infrastructure, if any, belong to ....

The right of way on which the infrastructure will be constructed will be dedicated to either the city or the property owners' association. Therefore, as construction occurs it will be on land owned by the city or the property owners' association. Under the city development agreement, the city will partially reimburse ... for the cost of the infrastructure based on the impact fees paid by the homebuilders as they apply for building permits. These reimbursements are capped at actual cost of the infrastructure, and ... will actually receive far less than its cost in reimbursements from the city. None of the relevant

documents have been finalized.

### **Recap of Your Position:**

... is an owner of property within ... and has an obligation to ensure that the infrastructure is completed. The infrastructure affects the property of related and unrelated homebuilders, as well as .... As successor, ... is an owner fulfilling the obligation precedent to selling the land. As such, ... succeeds to the right to use the escrow account to meet its obligation. The use of that account is neither gross income nor gross proceeds of sales to ... within the meaning of Arizona Revised Statutes (A.R.S.) 42-1301.4, 5 and 6. Likewise, the city reimbursements do not constitute gross income or gross proceeds of sales for ....

The reimbursements represent the city's share of the cost to complete the infrastructure which the city must have in place and are established pursuant to the C & D Infrastructure Plan. The city receives the benefit of the infrastructure at a much lower cost than if it had developed the infrastructure itself. ... believes it is an owner-builder. Consequently, none of the escrow account funds or the city reimbursements constitute taxable gross income or gross proceeds of sales to .... As a result, the contractors working with ... will be considered taxable prime contractors.

### **Applicable Statutory Provisions:**

A.R.S. 42-1310.16 levies transaction privilege tax on the business of prime contracting. Prime contracting includes altering, repairing, adding to or subtracting from real property. The tax base for the prime contracting classification is 65 percent of the gross proceeds of sales or gross income derived from the business.

A.R.S. 42-1310.16.F.2 provides that "contractor" is synonymous with the term "builder" and means a person firm, partnership, corporation, association or other organization that undertakes to or does himself or by or through others, construct, alter, repair, or add to any building.

A.R.S. 42-1310.16.F.5 provides that "prime contracting" means engaging in business as a prime contractor.

A.R.S. 42-1310.16.F.6 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 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.

A.R.S. 42-1310.16.D provides that subcontractors or others who perform services in respect to any improvement, building, highway, road, railroad, excavation, manufactured building or other structure, project, development or improvement are not subject to tax if they can demonstrate that the job was

within control of a prime contractor or contractors or dealership of manufactured buildings and that the prime contractor or dealership is liable for the tax on the gross income, gross proceeds of sales or gross receipts attributable to the job and from which the subcontractors or others were paid.

A.R.S. 42-1310.17 levies transaction privilege tax on the owner-builder classification. An owner-builder is a person who sells real property within 24 months after improving that real property. An owner-builder is subject to transaction privilege tax on the sales price of those improvements.

### **Discussion:**

The Prime Contracting Classification Transaction privilege tax is imposed on the business of prime contracting. A prime contractor is defined 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 with subcontractors or specialty contractors.

Generally, contractors who are performing construction work on their own property have not entered into a contract with a third party whereby the contractor agrees to perform construction work for that third party. In that case, the contractor is not responsible for the completion of the contract for purposes of taxation under the prime contracting classification.

Arizona Administrative Code (A.A.C.) rule R15-5-602.C.1 states that subcontractors are exempt from transaction privilege (sales) tax provided that such persons are not acting in the capacity of prime contractors. A subcontractor is considered to be a prime contractor, and therefore liable for the tax, if work is performed for and payments are received from the owner of the property.

**Owner-Builder Classification** An owner-builder is a person who sells real property within 24 months after improving that real property. This applies only if the improved real property was substantially suitable for use or occupancy at the start of the improvements.

### **Conclusion and Ruling:**

On the basis of the information provided we rule that in regard to the escrow account ..., as the successor to ..., is an owner fulfilling an obligation precedent to selling land. As such, ... succeeds to the right to use the escrow account to meet its obligation. The use of that account is neither gross income nor gross proceeds of sales to ... within the meaning of A.R.S. 42-1301.4, 5 and 6.

However, as the actual documents are not available for review, this ruling is limited to the facts as presented in the request for a private taxpayer ruling. If the actual documents provide that ... will purchase the interest of ... rather than stepping into the shoes of ..., this ruling will be subject to re-evaluation by the department.

Likewise, if the reimbursements represent the actual impact fees paid by the homebuilders and cannot be characterized as payments for contracting activities performed by ..., the city reimbursements would not constitute gross income or gross proceeds of sales subject to tax under the prime contracting classification for ....

Consequently, none of the escrow account funds or the city reimbursements constitute taxable gross income or gross proceeds of sales to .... As a result, the contractors working with ... are taxable prime contractors. The contracts between ... and the contractors should provide that the contractors on the project are the taxable prime contractors and subject to transaction privilege tax on their gross proceeds of sales or gross income derived from this project.

In addition, ... may wish to include a hold back provision in their contracts which provides that final payment will not be made until the contractor can demonstrate to ... that all applicable transaction privilege taxes have been paid.

The conclusion in this private taxpayer ruling does not extend beyond the facts as presented in the request for a private taxpayer ruling dated September 9, 1994. 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.