

## PRIVATE TAXPAYER RULING LR95-007

July 27, 1995

The following private taxpayer ruling is in response to your letter of June 12, 1995. You request the department to rule that the purchase agency structure between ... and ..., as detailed in your request and the documents which you submitted, meets the requirements of Arizona Administrative Code (A.A.C.) R15-5-629.B.

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

### Statement of Facts:

... has retained ... as the prime contractor for the construction of a 50,000 square foot facility in Tempe that will be used as a laboratory. ... is a "qualifying health care organization" exempt from certain transaction privilege and use taxes. As such, the qualifying health care organization's exemption applies to qualified purchases of tangible personal property pursuant to Arizona Revised Statutes (A.R.S.) § 42-1310.01.A.25(b).

... will enter into an Agency Agreement for Procurement of Material (Agency Agreement) with ... directing .. to purchase tangible personal property on behalf of ....

The Agency Agreement appointing ... as special purchasing agent for ... basically provides as follows:

1. Purchases are to be made by ... in the name of ... or by ... as purchasing agent. (Paragraph 3 of agreement.)
2. Title to material procured by ... is to pass from the vendors directly to .... (Paragraph 4 of agreement.)
3. Payment for purchases is to be made from accounts maintained by .... (Paragraph 11 of agreement.)
4. Invoices and billings are to be reviewed by ... and are also subject to review by .... (Paragraphs 8 and 10 of agreement.)

### Applicable Statutory and Administrative Provisions:

A.R.S. § 42-1310.01.A.25(b) provides that the transaction privilege tax imposed on the retail

classification does not apply to the gross proceeds of sale or gross income from the sale of tangible personal property to a qualifying health care organization if the tangible personal property is used by the organization solely to provide health and medical related educational and charitable services.

A.R.S. § 42-1310.16 imposes the transaction privilege tax on the gross proceeds of sale 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 comprise the tax base.

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. Effective January 1, 1978, this agency agreement provision includes contracts made with qualified health service organizations.

### Discussion:

A.R.S. § 42-1310.01.A.25(b) states that in order for tangible personal property to be purchased tax exempt by a qualifying health care organization, the qualifying health care organization must use the tangible personal property in the providing of health and medical related education and charitable services. There is no similar "use" requirement for the purchase of tangible personal property by a qualifying hospital. The prior statute did not contain the restrictive language found in the current statute. The restrictive language first appeared in A.R.S. § 42-1317 in 1988.

The administrative rule, R15-5-629, which provides for the same treatment for both qualifying hospitals and qualifying health care organizations was adopted in 1978, following a change in the exemption statute. The Legislature in 1977 amended A.R.S. § 42-1321, the exemption statute at that time, to provide an exemption for personal property purchased by any *licensed hospital organized and operated exclusively for charitable purposes, ... or any licensed nursing care institution or licensed residential care institution which provides medical services, nursing services or health related services and not used or held for profit or any licensed hospital, licensed nursing care institution or licensed residential care institution ...* (amended language appears in italics). [See Laws 1977, Chapter 172, section 18]. The effective date of the legislation was January 1, 1978.

It appears that the adoption of the administrative rule was done to accommodate the statutory changes by extending to qualified health care organizations the retail exemption for all tangible personal property, comparable to what was allowed for nonprofit hospitals. However, this rule

provision can no longer apply in the same way because the statutory parameters of such "exempt" property have changed. In this situation, the concepts of R15-5-629.B apply, but not to the same extent as it applied before the 1988 statutory changes limiting the retail exemption for sales of tangible personal property to qualifying health care organizations. A rule can only be relied on to the extent that it is not inconsistent with statute. Where a subsequently enacted statute conflicts with an administrative rule, the statute supersedes and effectively overrides the administrative rule, in whole or in part, where that rule is inconsistent with the statute.

Therefore, the exemption for sales to a qualifying health care organization does not extend to all items purchased under an agency agreement which are to be incorporated into a construction project. A.R.S. § 42-1310.01.A.25(b) requires that the tangible personal property purchased by the contractor as the agent of the qualifying health care organization be used by the organization solely to provide health and medical related educational and charitable services for the transaction to be exempt.

For purposes of the exclusion provided in A.A.C. R15-5-629.B, an agency relationship must be manifested by written agreement between the qualifying health care organization and builder which is incorporated in or appended to their construction agreement. 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. These essential elements must be substantiated by conduct of the parties consistent with the agreement.

The Agency Agreement submitted with your request contains 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 special purchasing agent.

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 special purchasing agent for the principal. Additionally, the agreement provides that title to the material procured by ... is to pass directly from the vendors to the principal.

The agreement reserves to the principal a right of control by providing that invoices and billings are subject to review by the principal prior to payment. Additionally, the agreement provides that payment for the items purchased is to be made by the principal.

### Conclusion and Ruling:

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

The Agency Agreement provides that purchases are to be made in the name of the qualifying health care organization, with the health care organization's funds. Title to the items purchased

will pass to the health care organization at the time of purchase. The department rules that this agreement is sufficient to establish an agency relationship enabling ... to purchase tangible personal property tax free under the qualifying health care organization exemption provided by A.R.S. § 42-1310.01.A.25. The result is that the cost of tangible personal property, which is used by the organization solely in providing health services, purchased by ... or ... subcontractors, as purchasing agent for ... would not be deemed to be contracting income to .... This would allow the cost of the building materials purchased by ..., as the purchasing agent for ..., to not be deemed contracting income to .... These amounts would then be excludable from ... gross contracting revenue before computing its tax liability for the ... project under the prime contracting classification of A.R.S. § 42-1310.16. The agreement must however, be appended to the construction agreement between ... and ....

However, the department also rules that the current statutory exemption does not extend to all items which are to be incorporated into a construction project. A.R.S. § 42-1310.01.A.25(b) requires that the tangible personal property purchased by a qualifying health care organization be used by the organization solely to provide health and medical related educational and charitable services for the transaction to be exempt.

Therefore, the agency agreement provisions of A.A.C. R15-5-629.B do not apply to "qualifying health care organizations" in regard to all items which will be incorporated into the construction project. Only if the items purchased consist of tangible personal property to be used by the health care organization solely in its providing health services, would those items fall under the purchase agency agreements provisions of A.A.C. R15-5-629.B. Only in that instance would the Agency Agreement remove the cost of such tangible personal property from the contractor's gross receipts.

The conclusion in this private taxpayer ruling does not extend beyond the face of the submitted agreements. It is the responsibility of all parties involved in this transaction to maintain appropriate supporting documentation.

This response is a letter ruling and the determination herein is based solely on the facts provided in your request. The determination in this letter ruling is the present position of the department and is valid for a period of four years from 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 letter 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.