

PRIVATE TAXPAYER RULING LR95-011

October 19, 1995

The following private taxpayer ruling is in response to your letter of September 1, 1995. You request the department to rule whether the agency agreement between ... and ... meets the requirements of Arizona Administrative Code (A.A.C.) R15-5-608.C.

The following is a restatement of the facts presented in correspondence from you dated April 21, 1995 and September 1, 1995.

Statement of Facts:

... is the prime contractor on a project for ... on the installation of a mini process line. ... provided you with an exemption certificate in which they claim that they are exempt from tax under the exemption for machinery and equipment used directly in manufacturing.

The contract documents provided in your request show that ... was responsible for providing all labor, equipment and material required for the installation of the mini process line.

The machinery and equipment actually used in the process line was purchased by only performed the installation of the equipment, along with related other necessary work to make the process line functional.

Subsequent to correspondence with the department, dated May 23, 1995, an agency agreement was entered into as part of a change order by This agency agreement was not part of the original contract.

Issues:

1. Is the change order document acceptable to the state as an agency agreement?
2. Does the agency agreement apply to the purchase of any or all construction materials for this project?

Applicable Statutory Provisions:

Arizona Revised Statutes (A.R.S.) § 42-1310.01.B1 provides the transaction privilege tax imposed on the retail classification does not apply to machinery and equipment used directly in the manufacturing process.

A.R.S. § 42-1310.16 imposes the transaction privilege tax on the gross proceeds of sale or gross income derived from the business of prime contracting.

Arizona Administrative Code (A.A.C.) R15-5-608.C provides that when a contract between a builder and an 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:

A.R.S. § 42-1310.16 levies the 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.

Currently, there are no statutory provisions under the prime contracting classification which exempt the income from installation of a process line from tax. Therefore, the income from such a contract is subject to tax.

However, A.R.S. § 42-1310.01.A.27 exempts from the retail classification sales of tangible personal property to a prime contractor if the tangible personal property is to be incorporated into a contracting project. The cost of the materials which is included in the contract price is not deductible when computing the contractor's tax base.

Machinery and equipment used directly in manufacturing or processing are exempt from transaction privilege tax. (A.R.S. § 42-1310.01.B.1) However, it is the specific use of the machinery and equipment in a given situation which will determine taxability or exemption in each case. The machinery and equipment must be directly connected to a manufacturing or processing operation. It does not include machinery or equipment which is not used in a manufacturing or processing operation.

However, as provided by A.A.C. R15-5-608.C, if the contractor purchases machinery or equipment used directly in manufacturing or processing as part of the contract, the cost of the equipment may be excluded from the contractor's gross proceeds if the contractor has an agency agreement with the owner. This provision only applies to the contractor's purchase of the machinery or equipment used directly in the manufacturing process. It does not apply to all construction materials and equipment used to perform the contract, nor does it apply to the installation contract.

In general, once the agency relationship is contractually established, the exempt or taxable status of materials purchased on behalf of the principal under the agency agreement is determined by the retail transaction privilege tax provisions. The agency relationship must be

manifested by written agreement between the contractor and the owner.

If a prime contractor's contract with a customer includes an agency agreement, the cost of the (exempt or non-taxable) building materials purchased by the prime contractor, as the purchasing agent for the customer, will not be deemed contracting income to the prime contractor. The agency agreement must be part of the original contract, either incorporated in or as an addendum to it. If an agency is established during this project, it is accepted prospectively, not retroactively.

The amount the contractor receives as reimbursement for the exempt purchases is excludable from the prime contractor's gross contracting revenue before computing its tax liability for the project. Therefore, the gross proceeds of sales or gross income which is reported on the monthly transaction privilege tax report (Form TPT-1) should not include the amount of the proceeds which is attributable to the exempt purchases.

With regard to the acceptability of the agency agreement included in your contract with ..., it appears from the dates on the document that the agency agreement was entered into after the original contract had been accepted by the parties. In addition, the agreement does not manifest an intent to create an agency relationship by providing that ... is appointed as special purchasing agent. The agreement also does not vest in ... the authority to bind ... by providing that purchases are to be made in the name of the principal (...) or by ... as special purchasing agent for Finally, the agreement does not provide that title to the material procured by ... is to pass directly from vendors to In light of these facts, the agreement included in your contract with ... does not meet the state's requirements for an agency agreement.

Conclusion and Ruling:

The following rulings are given based on the facts presented in your request.

The department rules that the agency agreement included as a change order, after the original execution of the contract between ... and ..., does not meet the requirements necessary to establish an agency relationship.

The department also rules that an acceptable agency agreement does not apply to the purchase of any and all construction materials for the ... contract.

The conclusions in this private taxpayer ruling do not extend beyond the facts presented in your letters dated April 21, 1995, and September 1, 1995.

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 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.