



PRIVATE TAXPAYER RULING LR08-005

Janet Napolitano
Governor

Gale Garriott
Director

July 8, 2008

This private taxpayer ruling is in response to your January 10, 2005 letter requesting a private taxpayer ruling, as updated on March 15, 2005, June 16, 2005, June 28, 2005 and May 15, 2006. I apologize on behalf of the Arizona Department of Revenue ("Department"), for the long delay in responding to your request and for any undue inconvenience caused by this delay.

You request the Department to rule on behalf of your client, . . . , on the application of Arizona transaction privilege tax relative to property management services . . . performs for its clients pursuant to either the Independent Contractor ("IC") Engagement or Agency Engagement.

Pursuant to Arizona Revised Statutes (A.R.S.) § 42-2101, the Department may issue private taxpayer rulings to taxpayers and potential taxpayers on request.

Statement of Facts

Your January 10, 2005 request for a private taxpayer ruling, as supplemented by the March 15, 2005, June 16, 2005, June 28, 2005 and May 15, 2006 correspondence, provide in part the following information:

. . . , a . . . corporation with offices in Arizona and throughout the country, performs property management services in Arizona for owners and occupiers of commercial real estate in Arizona. For each client engagement, . . . operates under one of two types of arrangements, as determined by marketplace conditions:

IC Engagement: In an IC Engagement, . . . operates as an independent contractor under a Facilities Management Agreement. Unless expressly stated, . . . does not operate with express agency authority from the client in an IC Engagement.

Agency Engagement: In an Agency Engagement, . . . acts as an agent for the client under an express grant of authority given in the Property Management Agreement entered into between . . . and the client.

This request relates to [the] manner in which Arizona transaction privilege and use taxes apply to each type of property management engagement

PRIVATE TAXPAYER RULING LR08-005

July 8, 2008

Page 2

relative to the procurement of goods and services from third-party vendors necessary for the operation of the property being managed by . . .

In the normal course of a property management engagement, whether an IC Engagement or an Agency Engagement, . . . procures all goods and/or services from third-party vendors necessary to operate the properties being managed for a particular client. Examples of such goods and services include: landscaping services; washroom supplies; and elevator maintenance services. The goods and services provided by third-party vendors are provided directly to a specific client's property for immediate use on that property to satisfy an immediate need. The third-party provided goods are never held as inventory of . . . for use at a later time, or for performing property management services for any of its other clients.

. . . receives invoices for these goods and services from the third-party vendors, and presents the invoices to the subject client for approval. All invoices include separate and distinct charges for transaction privilege taxes passed on, or any applicable use taxes. Once an invoice is approved, the client deposits funds into a segregated bank account, from which . . . is authorized to withdraw funds to pay the invoice, including all amounts designated as transaction privilege or use taxes. It is agreed to by the third-party vendor and . . . that the vendor will only be paid from funds deposited by the client into the segregated bank account, and . . . does not pay the vendors using its own funds. It is further agreed between the third-party vendor and . . . that . . . will have no liability in the event of non-payment by the client.

* * *

The only differentiating feature between IC Engagements and Agency Engagements is the way that a third-party vendor makes its contract. In an IC Engagement, the third-party vendor makes its contract directly with . . . but still on behalf of its vendors. In an Agency Engagement, due to the express agency . . . obtains from its client, the third-party vendor makes its contract with . . . as agent for . . .'s client. All of the attributes summarized in the preceding paragraph are the same with either an IC Engagement or an Agency Engagement.

Article 6 of the IC Agreement from the June 28, 2005 correspondence provides in part:

The relationship between _____ and SERVICE PROVIDER under this Agreement is that of an owner/lessor/lessee and an independent contractor, and SERVICE PROVIDER shall render the Services in its capacity as an independent contractor of _____. § 6.01(a).

PRIVATE TAXPAYER RULING LR08-005

July 8, 2008

Page 3

The recitals section of the IC Agreement from the June 28, 2005 correspondence provides in part:

- A. Currently, _____ performs or contracts for the performance of a variety of services relating to such real estate, including facilities management and planning, project management, construction management, and related financial and accounting services.

- B. _____ desires to engage one or more independent contractors to perform and/or manage some or all of the performance of the above services (i) with improved levels of service, (ii) at a significant reduction of costs, (iii) for a three-year term with extension rights and termination provisions in favor of _____ and (iv) with access to state-of-the-art property management technology and methods. SERVICE PROVIDER is one of one or more independent contractor(s) who is or will be performing such services.

Article 9 of the IC Agreement from the June 28, 2005 correspondence provides in part:

SERVICE PROVIDER shall select, oversee and guide all subcontractors retained by SERVICE PROVIDER competently and in a diligent and careful manner, consistent with the competence, diligence and care used by first class property managers of facilities like the Managed Facilities within the industry. SERVICE PROVIDER shall be responsible to _____ for losses and Losses caused by SERVICE PROVIDER'S negligence, default under this Agreement or other fault or malfeasance in selecting or dealing with all such subcontractors and Vendors. § 9.01.

Article 3 of the Agency Agreement from the June 28, 2005 correspondence provides in part:

Manager shall perform its Services in an efficient and satisfactory manner. Manager agrees (i) to generally do and perform, or cause to be done and performed, all things necessary, required or desirable in Manager's judgment for the proper and efficient management, operation and maintenance of the Facilities, and (ii) to faithfully and diligently render the Services to be performed hereunder during the term hereof. § 3.2(b).

Manager shall keep the Facilities and all parts thereof in a clean and slightly condition and shall use its best efforts to attend to the making and supervision of all ordinary and extraordinary repairs, decorations, replacements, additions, alterations and landscaping necessary or advisable for the proper operations of the Facilities, for the performance of Owner's obligations under

PRIVATE TAXPAYER RULING LR08-005

July 8, 2008

Page 4

any lease or agreement respecting any Facilities, and to comply with all applicable governmental or insurance requirements, subject to the limits of the Approved Operating Budget. All such work shall be done in a good and workmanlike manner. § 3.8.

Manager shall be authorized to enter into contracts for cleaning, maintaining, repairing or servicing any Facility or any of the constituent parts of any Facility as provided in the Approved Operating Budget. All service contracts shall: (a) be signed by Manager as agent for Owner, (b) be assignable, at Owner's option, to Owner's nominee, (c) include a provision for cancellation thereof by Owner upon not more than 30 days written notice unless such provision is waived by Owner, and (d) require that all contractors provide evidence of the insurance set forth below unless waived by Owner. § 3.10.

Issue

Is . . . subject to transaction privilege tax when . . . performs property management services for its clients under the IC Engagement or Agency Engagement?

Your Position

All transaction privilege taxes should be determined, collected and remitted to the Arizona Department of Revenue by the third-party vendors, regardless of whether . . . 's agreement with its client constitutes an IC Engagement or Agency Engagement. If the third party vendor has no nexus with Arizona, then the tax clients of . . . should file and remit appropriate use tax returns.

Conclusion and Ruling

The Department rules that:

. . . is subject to transaction privilege tax when . . . performs property management services for its clients under the IC Engagement or Agency Engagement.

When . . . modifies real property under the IC Engagement or the Agency Engagement, . . . is a contractor subject to transaction privilege tax under the prime contracting classification A.R.S. § 42-5075(A). A "contractor" is a "person or organization that undertakes to . . . personally or by or through others, modify any building . . . or other structure, project, development or improvement . . ." A.R.S. § 42-5075(N)(2). "Modify" means "to construct, alter, repair, add to, subtract from, improve, move, wreck or demolish." A.R.S. § 42-5075(N)(6).

. . . supervises or coordinates the modification of real property and is responsible for the completion of the contract or project under the IC Engagement or the Agency Engagement.

PRIVATE TAXPAYER RULING LR08-005

July 8, 2008

Page 5

Therefore, . . . is a prime contractor subject to transaction privilege tax under the prime contracting classification. A.R.S. § 42-5075(A).

A “prime contractor” is “a contractor who supervises, performs or coordinates the modification 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.” A.R.S. § 42-5075(N)(8). “Modification” is defined as “construction, alteration, repair, addition, subtraction, improvement, movement, wreckage or demolition.” A.R.S. § 42-5075(N)(5).

For the IC Engagement and the Agency Engagement, . . . ’s purchases of tangible personal property for incorporation into a construction project are not subject to state transaction privilege or use taxes if . . . incorporates the personal tangible property into the real property, structure, project, development or improvement and provides a properly completed exemption certificate to the vendor. A.R.S. §§ 42-5061(A)(27)(a), 42-5159(A)(13)(g)(i); Arizona Transaction Privilege Tax Procedure TPP 00-3.

If . . . has identifiable income from an activity that is exempt under a specific statutory provision within A.R.S. § 42-5075, that income will not be included in the prime contracting tax base and is not subject to tax under the prime contracting classification.

From . . . ’s March 15, 2005 correspondence, the Facilities Management Agreement provides the following:

Manager shall manage third-party vendors or perform the following Services for the Facilities: Interior plant maintenance, janitorial services, window cleaning, flooring maintenance, pest control, recycling, waste, mail delivery, shipping & receiving, switchboard, room scheduling, employee dining, catering, convenience store, vending, coffee service, copy paper services, toner services, fax machine maintenance, fleet copier maintenance, procurement services for office supplies, off-site copy services, document archive services, utilities management services, courier services, audio visual services and all other services necessary or appropriate to ensure that Owner receives a complete suite of professional facilities management services for the Facilities. Schedule B, Scope of Services, Section IV, Part A, Facilities Management Services, Facilities Management Agreement, pages 36 - 37.

“[I]t is presumed that all gross proceeds of sales and gross income derived by a person from business activity classified under a taxable business classification comprise the tax base for the business until the contrary is established.” A.R.S. § 42-5023. Under the IC Engagement or Agency Engagement, . . . may be required to perform a variety of property management services whose gross proceeds may be taxable under other transaction privilege tax classifications including for example but not limited to the retail

PRIVATE TAXPAYER RULING LR08-005

July 8, 2008

Page 6

classification, the job printing classification, the restaurant classification or the transporting classification.

Where it can be readily ascertained without substantial difficulty which portion of the business is for non-taxable professional services (design and engineering), the amounts in relation to the company's total taxable Arizona business are not inconsequential, and those services cannot be said to be incidental to the contracting business, the professional services are not merged for tax purposes into the taxable contracting business and are not subject to taxation. *State Tax Commission v. Holmes & Narver, Inc.*, 113 Ariz. 165, 548 P.2d 1162 (1976).

It is possible for a taxpayer to be engaged in two or more lines of business. The determination of whether . . . engages in more than one line of business activity depends on the facts and circumstances surrounding . . . 's business activities, and is so fact intensive the Department is unable to rule on that issue. Pursuant to Arizona General Tax Procedure GTP 07-1, the Department does not issue private taxpayer rulings if the problem or question involves a fact intensive issue.

Because the Department may issue private taxpayer rulings to *taxpayers* only, the Department is unable to give a ruling on the transaction privilege tax obligations of third-party vendors from sales made pursuant to either the IC Engagement or Agency Engagement. However, as a point of information only, third-party retail vendors would be required to pay transaction privilege tax unless otherwise provided by statute.

Arizona's use tax is a tax on the storage, use or consumption in Arizona of tangible personal property purchased from a retailer or utility business, as a percentage of the sales price. A.R.S. § 42-5155(A). Every person storing, using or consuming in this state tangible personal property purchased from a retailer or utility business is liable for the tax. A.R.S. § 42-5155(E). As noted above, the Department is unable to give . . . a ruling on the use tax obligations of . . . 's clients due to the storage, use or consumption of tangible personal property from purchases made pursuant to either the IC Engagement or Agency Engagement.

The conclusions in this private taxpayer ruling do not extend beyond the facts presented in your correspondence dated January 10, 2005, March 15, 2005, June 16, 2005, June 28, 2005 and May 15, 2006, respectively.

This response is a private taxpayer ruling and the determinations herein are 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.

PRIVATE TAXPAYER RULING LR08-005

July 8, 2008

Page 7

The determinations in this private taxpayer ruling are applicable only 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.

Lrulings/08-005-D