
Opinion of the Tax Commissioner

Date Issued: February 6, 2008

Opinion No: 08-0001

Tax: Commercial Activity

XXXX
c/o XXXX
XXXX
XXXX
XXXX
XXXX

Subject: Agent

This request for an Opinion of the Tax Commissioner was received on January 8, 2008. The request concerns whether the construction management agreement (“Agreement”) between XXXX (“General Contractor”) and XXXX (“Property Owner”) establishes an “agent” relationship as defined in R.C. 5751.01(P) for purposes of the commercial activity tax (“CAT”).

TAXPAYER STATEMENT OF THE FACTS

Property Owner proposes a major expansion to its existing main campus in XXXX, Ohio. The cornerstone of the expansion is a new main XXXX building involving XXXX floors and encompassing more than XXXX square feet. Construction is slated to begin in YYYY with the new XXXX opening in YYYY.

Property Owner proposes to enter into Agreement with General Contractor. Pursuant to Agreement, General Contractor will be responsible for overseeing all aspects of the construction of the facility. The only portion of Agreement not yet finalized relates to environmental issues associated with the site. Property Owner and General Contractor do not anticipate any substantive changes to the provisions provided.

General Contractor’s obligations under Agreement are provided in Article 2 of Agreement. Article 2 of Agreement establishes an anticipated close working relationship between General Contractor and Property Owner. Also, Article 2 of Agreement establishes the extent of control that is retained and exercised by Property Owner in all aspects of the work to be performed. General Contractor will be reimbursed for all “costs of work” as defined in Article 8 of Agreement and will be entitled to a fee as set forth in Article 7 of Agreement. Under Article 6 of Agreement, at its option, Property Owner may require General Contractor to provide a guaranteed maximum price (“GMP”) that includes all costs of work and the agreed fee.

With respect to the financial aspects of Agreement, General Contractor is required to act in the best interests of Property Owner. Under the first unnumbered paragraph of Article 1,

General Contractor agrees to use its best efforts “in the most expeditious and economical manner consistent with the best interest” of Property Owner.

Under Section 4.4, Agreement provides that all subcontracts between General Contractor and any subcontractors, as defined in Agreement, shall contain language that General Contractor is acting as the agent of Property Owner, and not as an agent of the subcontractors. In addition, under Section 11.4, with respect to payment of subcontractors, General Contractor is acting as a conduit for all payments by Property Owner to the subcontractors as provided within Agreement.

QUESTIONS PRESENTED BY TAXPAYER

1. Whether General Contractor, with respect to the payments received from Property Owner to be passed on to subcontractors, is acting as an “agent” as defined in R.C. 5751.01(P) for purposes of R.C. 5751.01(F)(2)(l) and O.A.C. 5703-29-13?
2. Whether General Contractor may exclude from its gross receipts under R.C. 5751.01(F)(2)(l), payments from Property Owner in excess of its fee that General Contractor is required to pay over to subcontractors pursuant to Agreement?

ANALYSIS

The CAT is levied on gross receipts that are situated to Ohio (*i.e.*, “taxable gross receipts”). R.C. 5751.02. The term “gross receipts” is broadly defined in R.C. 5751.01(F) as “the total amount realized by a person, without deduction for the cost of goods sold or other expenses incurred, that contributes to the production of gross income of the person, including the fair market value of any property and any services received, and any debt transferred or forgiven as consideration.” “Gross receipts” excludes money and other amounts received or acquired by an agent on behalf of another in excess of agent’s commission, fee, or other remuneration. R.C. 5751.01(F)(2)(l). An “agent” is a person authorized by another person to act on its behalf to undertake a transaction for the other. R.C. 5751.01(P).

The Tax Commissioner issued Information Release CAT 2006-03, Commercial Activity Tax Definition of “Agent” - Issued April 2006; Revised July 2006; Revised October 2006; Revised November 2007, and adopted a rule, O.A.C. 5703-29-13, effective October 5, 2006, to address that provision.¹ Divisions (C)(2)(b) and (c) of the rule specifically address the provision in the context of a construction contract. In division (C)(2)(b), the rule explains that no agency relationship exists because the general contractor is not required to act in the best interests of the owner. However, division (C)(2)(c) provides that an agency relationship will be found where the following factors are present:

- (i) The general contractor is required to act in the owner’s best interest;

¹ An amendment to the rule has been filed to correct an error therein.

- (ii) The general contractor, when bidding out the work, has an agreement in writing with the subcontractors that states that the general contractor is acting as the owner's agent and not as an agent of the subcontractors; and
- (iii) The general contractor acts as a conduit with respect to payments made to the subcontractors under the agreement.

Where those conditions are met, the rule provides that the payments the general contractor receives and pays over to the subcontractors may be excluded from the general contractor's gross receipts. However, the fee that the general contractor retains is included in its calculation of gross receipts.

In this case, the first paragraph of Article 1 of Agreement provides that General Contractor has an obligation to act in the best interests of Property Owner.

In addition, Property Owner retains extensive authority over cost and related issues. For example, under Article 2 of Agreement, during the Preconstruction Phase of the project, General Contractor must disclose to Property Owner all information regarding timing and costs, including preliminary budgets and possible economies (Section 2.2.1 of Agreement); coordinate with Property Owner with respect to the preparation of all documents and drawings (Section 2.2.1 of Agreement); develop, subject to the approval of Property Owner, a construction cost estimate sufficiently detailed to permit a full evaluation and understanding by Property Owner; and recommend bid alternatives to reduce costs (Section 2.2.3 of Agreement). In addition, Property Owner retains final approval of all bids or proposals relating to the project (Section 2.2.5.3 of Agreement).

During construction, General Contractor must develop and monitor a system of cost controls, apprise Property Owner when budgets are exceeded, and maintain cost accounting records accessible to the Property Owner in such form and detail as the parties may agree (Section 2.3.3 of Agreement). Moreover, Property Owner must approve all change orders (Section 2.3.4 of Agreement) and all payments to subcontractors (Section 2.3.5 of Agreement).

Section 4.4 of Agreement provides that all agreements between General Contractor and the subcontractors must contain language that General Contractor is acting as the agent of the Property Owner, and not as an agent of the subcontractors.

Finally, Section 11.4 of Agreement provides that General Contractor shall act as a conduit for all payments to the subcontractors. General Contractor shall make all such payments promptly, under such terms as are provided in Agreement, regardless of the fact that Property Owner may require a GMP, as the GMP may be adjusted. Section 6.6 of Agreement provides that the parties may establish allowances for costs of work that may result in an increase in the GMP. Similarly, under Section 6.5 of Agreement, savings in the cost of work must be passed on to Property Owner. In addition, Property Owner still retains significant control over cost issues. General Contractor is still required to use its best efforts on behalf of Property Owner and the agreements with subcontractors still must provide that General Contractor is the agent of Property Owner, rather than the subcontractors. Finally, General Contractor still acts as a

conduit with respect to payments passed through to the subcontractors. The payments General Contractor receives on behalf of the subcontractors are not its own; rather, General Contractor is required to pass those payments on promptly to the subcontractors on behalf of Property Owner. The payments do not contribute to General Contractor's gross income, and are excluded from General Contractor's gross receipts for CAT purposes pursuant to R.C. 5751.01(F)(2)(l).

If the parties conduct their affairs in a manner that is consistent with Agreement, General Contractor qualifies as an agent under R.C. 5751.01(P) and O.A.C. 5703-29-13, and the payments it receives to be passed on to subcontractors are excluded from its gross receipts under 5751.01(F)(2)(l).

ANSWER

With respect to the payments received from Property Owner to be passed on to subcontractors, General Contractor is acting as an "agent" as defined in R.C. 5751.01(P) for purposes of R.C. 5751.01(F)(2)(l) and O.A.C. 5703-27-13. General Contractor may exclude from General Contractor's gross receipts payments from Property Owner that General Contractor is required to pass on to subcontractors pursuant to Agreement. However, pursuant to R.C. 5751.01(F)(2)(l), General Contractor must include in General Contractor's gross receipts any fee General Contractor is entitled to retain.

CLOSING

This Opinion applies only to General Contractor with regard to Agreement with Property Owner. It may not be transferred or assigned. In addition, the tax consequences stated in this Opinion are subject to change for any of the reasons provided in R.C. 5703.53(C). It is the duty of General Contractor to be aware of such changes pursuant to R.C. 5703.53(E).

Richard A. Levin
Tax Commissioner