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## Opinion of the Tax Commissioner

Date Issued: November 11, 2008

Opinion No: 08-0011

Tax: Commercial Activity

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Subject: Agent

This request for an Opinion of the Tax Commissioner was received on August 19, 2008. The request concerns whether the construction management agreement (“Agreement”) and general conditions of the contract for construction (“General Conditions”) between XXXX (“Construction Manager”)<sup>1</sup>, and its client (“Property Owner”), establishes an “agent” relationship under the commercial activity tax (“CAT”) as defined in R.C. 5751.01(P) and Ohio Adm. Code 5703-29-13 for purposes of R.C. 5751.01(F)(2)(1) and Ohio Adm. Code 5703-29-13.

### **STATEMENT OF FACTS**

Construction Manager provides construction management and related services for clients throughout Ohio. In each instance, Construction Manager enters into Agreement with Property Owner. Also, Construction Manager enters into an agreement and general conditions of the contract between Construction Manager and its trade contractors<sup>2</sup> (“Trade Contractor Agreements”).

Pursuant to Agreement and Trade Contractor Agreements, Construction Manager is responsible for overseeing all aspects of the construction of the facility for Property Owner.

Construction Manager’s relationship with Property Owner is established in Agreement. Agreement establishes a close working relationship between Construction Manager and Property Owner. Agreement also establishes the extent of control that is retained and exercised by Property Owner over all aspects of the work performed.

Section 5.2 of Agreement provides that Construction Manager must complete all work contemplated by the Agreement for the lesser of: (1) the cost of such work plus the Construction

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<sup>1</sup> For purposes of this Opinion, the term “construction manager” has the same meaning as “general contractor.”

<sup>2</sup> For purposes of this Opinion, the term “trade contractor” has the same meaning as “subcontractor.”

Manager's fee; or (2) the guaranteed maximum price – as each may be adjusted. Additionally, section 5.2 of Agreement provides that if the total cost of such work exceeds the guaranteed maximum price, Construction Manager is responsible for such excess and cannot charge any portion of such excess to Property Owner.

Section 6.1 of Agreement defines “costs of work.” Section 5.1 of Agreement establishes Construction Manager's fee for services to Property Owner.

Section 1.1 of Agreement provides that Construction Manager is to oversee all aspects of the construction project for Property Owner. Section 1.1 further provides that with respect to the financial aspects of Agreement, Construction Manager is required to act in the best interests of Property Owner. Section 9.6.2 of General Conditions provides that Construction Manager acts as a mere conduit with respect to payments received from Property Owner, which are due to the trade contractors, all of which are to be paid over promptly to the trade contractors.

### **QUESTIONS PRESENTED**

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

### **ANALYSIS**

The CAT is levied on every “person” as defined in R.C. 5751.01 with gross receipts that are situated to Ohio (*i.e.*, “taxable gross receipts”) during a tax period. 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 that 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; Revised April 2008, and adopted a rule, Ohio Adm. Code 5703-29-13, to address that provision. Paragraphs (C)(2)(b) and (C)(2)(c) of the rule specifically address the provision in the context of a construction contract. In paragraph (C)(2)(b), the rule explains that an agency relationship does not exist in a lump sum contract with a property owner because the general contractor is not required to act in the best interests of the owner. Additionally, the

general contractor bears all the risk involved in completing the project in a cost-effective manner and does not have to disclose any cost details with the property owner. However, paragraph (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;
- (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.

#### **Best Interest of Property Owner**

In this case, Section 1.1 of Agreement provides that Construction Manager 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, Construction Manager must disclose to Property Owner all information regarding timing and costs, including preliminary budgets and possible economies (Section 2.1.5.1 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 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 (Sections 2.1.5.3 and 2.3.2.1 of Agreement). In addition, Property Owner retains final approval of all bids or proposals relating to the project (Section 2.3.2.1 of Agreement).

During construction, Construction Manager must develop and monitor a system of cost controls, apprise Property Owner when budgets are exceeded, and maintain cost accounting records accessible to Property Owner in such form and detail as the parties may agree (Section 2.3.2.7 of Agreement). Property Owner may examine Construction Manager's records to evaluate all such records (Section 6.4.1 of Agreement). Moreover, Property Owner must approve all change orders (Section 7.2.1 of General Conditions) and all payments to subcontractors (Section 9.3.1 of General Conditions).

#### **Construction Manager is Acting as the Owner's Agent**

For the reasons stated above, Construction Manager is required to use its best efforts on behalf of Property Owner and the Trade Contractor Agreements provide that Construction Manager is the agent of Property Owner, rather than of the trade contractor (Section 6.2.3 of Trade Contractor Agreements).

**Conduit for Payments**

Finally, Section 9.6.2 of General Conditions provides that Construction Manager shall act as a conduit for all payments to the subcontractors. Construction Manager shall make all such payments promptly, under such terms as are provided in Agreement, even if such payments exceed the guaranteed maximum price – as the guaranteed maximum price may be adjusted. Section 5.2 of Agreement provides that the parties may change the cost of work and that doing so may result in an increase or decrease in the guaranteed maximum price. Savings in the cost of work must be passed on to Property Owner. In addition, Property Owner still retains significant control over cost issues. Subcontract Agreements still must provide that Construction Manager is the agent of Property Owner, rather than the subcontractors. Finally, Construction Manager still acts as a conduit with respect to payments passed through to the subcontractors. The payments Construction Manager receives on behalf of the subcontractors are not its own; rather, Construction Manager is required to pass those payments on promptly to the subcontractors on behalf of the Property Owner.

If the parties conduct their affairs in a manner that is consistent with Agreement, Construction Manager appears to qualify as an agent under R.C. 5751.01(P) and Ohio Adm. Code 5703-29-13, and the payments it receives to be passed on to trade contractors are excluded from its gross receipts under 5751.01(F)(2)(1).

**ANSWER**

With respect to the payments received from Property Owner to be passed on to trade contractors, Construction Manager appears to be acting as an “agent” as defined in R.C. 5751.01(P) for purposes of R.C. 5751.01(F)(2)(1) and Ohio Adm. Code 5703-27-13. Construction Manager may exclude from Construction Manager’s gross receipts, payments from Property Owner that Construction Manager is required to pass on to trade contractors pursuant to Agreement. However, pursuant to R.C. 5751.01(F)(2)(1), Construction Manager must include in Construction Manager’s gross receipts any fee Construction Manager is entitled to retain.

**CLOSING**

This Opinion applies only to Construction Manager 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 Construction Manager to be aware of such changes pursuant to R.C. 5703.53(E).

Richard A. Levin  
Tax Commissioner