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## Opinion of the Tax Commissioner

Date Issued: November 21, 2008

Opinion No: 08-0012

Tax: Commercial Activity

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Subject: Agent

This request for an Opinion of the Tax Commissioner was received on August 20, 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, XXXX (“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)(l) and Ohio Adm. Code 5703-29-13.

### **STATEMENT OF FACTS**

Construction Manager entered into Agreement and General Conditions with Property Owner to construct the XXXX Campus.

Construction Manger is required to act in the best interest of Property Owner. Pursuant to Agreement, Construction Manager is responsible for overseeing all aspects of the construction of the facility. The relationship of parties is described in Article 1 of Agreement and Article 3 of General Conditions, where it states that Construction Manager accepts the relationship of trust and confidence established with Property Owner by Agreement, and covenants with Property Owner to furnish Construction Manager’s reasonable skill and judgment and to cooperate with the architect in furthering the interests of Property Owner. Construction Manager shall furnish efficient construction administration and management services and use Construction Manager’s best efforts to perform in an expeditious and economical manner consistent with the interests of Property Owner.

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

Article 2 of General Conditions establishes the extent of control of the Property Owner over all aspects of the work to be performed. Construction Manager will be reimbursed for the “Contract Sum” as defined in Section 5.1.1 of Agreement to include “the Cost of Work as defined in Article 6 of Agreement plus the Construction Manager’s Fee” set forth in Section 5.1.1 of Agreement, all of which are included in the required guaranteed maximum price (“GMP”) defined in Section 5.2 of Agreement and 1.1.12 of General Conditions.

There is no provision requiring that all subcontracts between Construction Manager and any subcontractors shall contain language that Construction Manager is acting as an agent of the Property Owner, and not as an agent of the subcontractors. Such language has not been included in any of the subcontracts executed pursuant to Agreement.

As specified in Section 9.6.2 of General Conditions, Construction Manager acts as a conduit for all payments by Property Owner to subcontractors as provided in Agreement.

### **QUESTIONS PRESENTED**

1. Whether Construction Manager, 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 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 subcontractors pursuant to Agreement?

### **ANALYSIS**

The CAT is levied 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 Interests 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 2.1.2 of Agreement) and recommend bid alternatives to reduce costs (Section 5.2.1 of General Conditions). In addition, Property Owner retains final approval of all bids or proposals relating to the project (Section 2.2.4 of Agreement).

During construction, Construction Manager must develop and monitor a system of cost controls, apprise Property Owner when budgets are exceeded, report variances between actual and estimated costs, and maintain cost accounting records accessible to Property Owner (Section 2.3.2.7 and Section 6.4.1 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 7.1.2 of General Conditions) and all payments to subcontractors (Article 9 of General Conditions).

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

No provision in Agreement or General Conditions provides that all subcontracts between Construction Manager and any subcontractors contain language that Construction Manager is acting

as the agent of Property Owner, and not as an agent of the subcontractors. However, the Tax Commissioner will look beyond the wording of the contract to the actual facts and circumstances of the situation to determine whether an agency relationship actually exists. Ohio Adm. Code 5703-29-13(B)(2). Taking into consideration all the aspects of Agreement and General Conditions, the Tax Commissioner can infer that Construction Manager is acting as the agent of Property Owner, and not as an agent of the subcontractors. Specifically, Construction Manager shall not obtain for its own benefit any discounts, rebates or refunds in connection with the work prior to notification of Property Owner so that Property Owner may take advantage of such discount, rebate or refund (Section 6.3.1 of Agreement). Moreover, the parties' relationship established in Article 1 of Agreement and Article 3 of General Conditions provides that Construction Manager has an obligation to act in the best interests of Property Owner. Thus, the second prong of the test appears to be satisfied.

### **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 and 5.3 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. 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 subcontractors 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 subcontractors, 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 subcontractors 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