United States Small Business Administration
Office of Hearings and Appeals

SIZE APPEAL OF: Hal Hayes Construction, Inc., Appellant, Appealed From Size Determination Nos. 6-2011-037 & 038	SBA No. SIZ-5217 Decided: March 17, 2011

APPEARANCES

Antonio R. Franco, Esq., Steven J. Koprince, Esq., and Ryan C. Bradel, Esq., Piliero Mazza PLLC, Washington, D.C.. for Appellant

DECISION

I. Introduction & Jurisdiction

On February 9, 2011, the U.S. Small Business Administration (SBA) Office of Government Contracting, Area VI (Area Office) issued a size determination in case numbers 6-2011-037 & 6-2011-038 finding Hal Hays Construction, Inc. (Appellant) other than small. For the reasons discussed below, this matter is remanded to the Area Office for a new calculation of Appellant's average annual receipts.

SBA's Office of Hearings and Appeals (OHA) decides size determination appeals under the Small Business Act of 1958, 15 U.S.C. § 631 *et seq.*, and 13 C.F.R. Parts 121 and 134. Appellant filed the instant appeal within fifteen days of receiving the size determination. Thus, the appeal is timely. 13 C.F.R. § 134.304(a). Accordingly, this matter is properly before OHA for decision.

II. Background

A. Solicitation and Protest

On January 8, 2010, the U.S. Department of Homeland Security, Customs and Border Protection issued Solicitation No. HSBP10-10-R-0018 seeking offers for maintenance and repair of the border fence and related infrastructure. The Contracting Officer (CO) set aside the procurement for Historically Underutilized Business Zone (HUBZone) small businesses and

designated North American Industry Classification System (NAICS) code 237990, Other Heavy and Civil Engineering Construction, with a corresponding size standard of $33.5 million in average annual receipts. Initial proposals were due March 1, 2010. With its proposal, Appellant self-certified as a small business.

On January 14, 2011, offerors were notified that Appellant was the apparent successful offeror. On January 18, 2011, a disappointed offeror, Cerrudo Services, filed a protest challenging Appellant's size. A similar protest was filed on January 20, 2011, by Mission Critical Solutions, another disappointed offeror.

B. Size Determination

On February 9, 2011, the Area Office issued its size determination. The Area Office rejected Appellant's contention that Arizona Transaction Privilege Tax (ATPT) payments should be excluded from Appellant's receipts under 13 C.F.R. § 121.104(a)(1), which allows for the exclusion of tax payments collected for and remitted to a taxing authority. The Area Office cited language from the Arizona Department of Revenue's website[1] stating that the ATPT is a tax "on the privilege of doing business in Arizona and is not a true sales tax." The website further explains that "[a]lthough the [ATPT] is usually passed on to the consumer, it is actually a tax on the vendor." On these facts, the Area Office determined the ATPT is not a sales tax collected for a taxing authority, but a tax levied directly on a vendor and, therefore, not excludable under the regulation. (Size Determination 3.)

The Area Office went on to analyze the relationship between Appellant and Golden Arrow Engineering (GAE), a construction company owned by the son and daughter-in-law of Appellant's owners. Due to this familial relationship, the Area Office presumed that an identity of interest exists between the firms. 13 C.F.R. § 121.103(f). The Area Office observed that GAE was formed in August, 2008, and that Appellant and GAE are in the same line of business. The Area Office also noted that Appellant awarded fifteen subcontracts to GAE in 2009. Based on GAE's federal income tax returns and financial statements, the Area Office found that a vast majority of GAE's revenue in 2009 and 2010 (the only years the firm has generated revenue) was derived from the contracts awarded to it by Appellant in 2009. Consequently, the Area Office concluded GAE is economically dependent upon Appellant because "GAE would not be a viable business without the revenue it has derived from the contracts" with Appellant. (Size Determination 4.) The Area Office determined this economic dependence constitutes a separate basis for finding an identity of interest between the firms and found no clear fracture between Appellant and GAE. Thus, the Area Office concluded the firms are affiliated. After rejecting Appellant's claimed exclusions and aggregating Appellant's receipts with those of GAE, the Area Office concluded Appellant's average annual receipts are in excess of the applicable $33.5 million size standard.

[1] Arizona Department of Revenue, Transaction Privilege Tax (2011), http:// www.azdor.gov/Business/TransactionPrivilegeTax.aspx.

C. Appeal Petition

On February 24, 2011, Appellant filed the instant appeal claiming the size determination contains several errors of fact and law. Appellant first reiterates its claim that the ATPT should be excluded from its receipts. To support this assertion, Appellant offers three arguments. First, Appellant contends the ATPT operates like a sales tax. That is, Appellant collects the tax from its customers and passes it on to the State of Arizona. Appellant emphasizes that various courts have also determined the ATPT is similar to a traditional sales tax and is generally passed on to a firm's customers. *Atchison, Topeka & Santa Fe Ry. Co. v. Arizona*, 78 F.3d 438 (9th Cir. 1996); *Rigel Corp. v. State*, 234 P.3d 633 (Ariz. Ct. App. 2010); *Ariz. Dep't of Revenue v. Canyoneers, Inc.*, 23 P.3d 684 (Ariz. Ct. App. 2001); *People of Faith, Inc. v. Ariz. Dep't of Revenue*, 779 P.2d 829 (Ariz. T.C. 1989). Appellant insists that it would be impractical and inequitable to ignore the marketplace reality that the ATPT is a pass-through tax.

Second, Appellant argues that the ATPT tax operates in the same manner as sales taxes in other states. Specifically, Appellant maintains that California, Michigan, and several other states have sales tax statutes under which the legal liability for the tax falls on the vendor, not the customer. *See, e.g., Minor v. Christie's, Inc.*, No. 08-05445, 2010 WL 2735040 (N.D. Cal. July 12, 2010); *Gen. Motors Corp. v. Dep't of Treasury*, No. 213186, 2000 WL 33421269 (Mich. App. May 9, 2000); *Collins v. State*, 750 A.2d 1257 (Me. 2000). Thus, Appellant asserts the Area Office refused to exclude the ATPT solely on the basis of its name—in other words, simply because the tax is not called a "sales tax."

Third, Appellant asserts the ATPT would have been excluded from its receipts if Appellant had reported its income on a "net" rather than a "gross" basis. Appellant explains that if it had reported on a net basis, it would not have been required to include its ATPT receipts.[2] Thus, according to Appellant's calculations, Appellant's average annual receipts would have fallen within the applicable size standard even though its actual revenues would not be any different than those currently reported on its tax returns. Appellant argues this discrepancy further illustrates the inequity of the Area Office's refusal to exclude the ATPT from its annual receipts.

Next, Appellant disputes its alleged affiliation with GAE. Appellant asserts there is sufficient evidence to rebut the presumption of affiliation that arises under the familial identity of interest rule. Appellant points out that OHA has previously recognized that a family relationship alone is insufficient to create affiliation where the business operations of the firms are not closely

[2] With its appeal petition, Appellant filed a Motion to Admit New Evidence seeking to admit three documents: (1) the declaration of a Certified Public Accountant whose firm conducts audits of Appellant and prepares its financial statement; (2) Federal Accounting Standards Board (FASB) Emerging Issues Task Force (EITF) Issue No. 06-3; and (3) Financial Accounting Standards code sections 605-45-15 and 605-45-50. Appellant claims these documents clarify the nature of the transaction privilege tax and how receipts from the tax should be reported. Because Appellant has established good cause for admission of these documents, and because they will not unduly enlarge the issues at hand, I GRANT Appellant's motion and ADMIT the evidence into the record. 13 C.F.R. § 134.308(a)(2).

related. *See Size Appeal of Golden Bear Arborists, Inc.*, SBA No. SIZ-1899 (1984); *see also Size Appeal of Bob Jones Realty Co.*, SBA No. SIZ-4059 (1995); *Size Appeal of Aumann, Inc.*, SBA No. SIZ-3743 (1993). Appellant emphasizes that it does not share ownership, management, facilities, employees, or capital with GAE. Appellant contends the firms work at arm's length on a number of contracts and operate completely independently of one another. Appellant concludes the firms are not affiliated and requests that OHA reverse the size determination. In the alternative, Appellant argues that if it is GAE is found to be its affiliate, the receipts from any transactions between the firms must be excluded from Appellant's receipts as interaffiliate transaction receipts. 13 C.F.R. § 121.104(d).

III. Discussion

A. Standard of Review

Appellant has the burden of proving, by a preponderance of the evidence, all elements of its appeal. Specifically, Appellant must prove the size determination is based upon a clear error of fact or law. 13 C.F.R. § 134.314. Consequently, OHA will disturb the Area Office's size determination only if, after reviewing the record, the administrative judge has a definite and firm conviction that the Area Office erred in making its key findings of fact or law. *Size Appeal of Taylor Consultants, Inc.*, SBA No. SIZ-4775, at 11 (2006).

B. Analysis

1. Arizona Transaction Privilege Tax

The regulation that governs the calculation of a firm's annual receipts provides, in pertinent part: “Receipts do not include ... taxes collected for and remitted to a taxing authority if included in gross or total income, such as sales or other taxes collected from customers and excluding taxes levied on the concern or its employees.” 13 C.F.R. § 121.104(a). In interpreting this provision, OHA has recognized that “the only taxes SBA excludes from a firm's annual receipts are those taxes which the firm receives as an agent for the taxing authority or as a conduit.” *Size Appeal of Uniband, Inc.*, SBA No. SIZ-4326, at 5 (1998). Thus, sales taxes collected from customers are properly excludable. Conversely, direct taxes on a firm, such as corporate income taxes or an employer's share of Social Security and Medicare taxes, are included in a firm's receipts. *Size Appeal of Res. Consultants, Inc.*, SBA No. SIZ-2163 (1985). Taxes in this latter group are not collected from other parties, and are “purely and simply another part of [a firm's] cost of doing business (not at all unlike the rent it pays for the building and the cost of its utilities).” *Id.* at 5.

In this case, I agree with Appellant that the ATPT operates essentially as a sales tax and should be treated as such for the purpose of calculating Appellant's receipts. There is no dispute that Appellant collects the ATPT from its customers and remits the proceeds to the State of Arizona. Indeed, Arizona law requires that any ATPT funds collected must be transmitted in full to the State. Ariz. Rev. Stat. § 42-5002(A)(1) (“A person who imposes an added charge to cover the tax levied by this article or which is identified as being imposed to cover transaction privilege tax shall not remit less than the amount so collected to the [Arizona] [D]epartment [of

Revenue].") Because Appellant does not retain the ATPT funds, but merely collects them and passes them onto the State, there is no logical reason to include such taxes in Appellant's receipts. Instead, Appellant is acting as a mere conduit to the taxing authority.

In determining that ATPT proceeds should not be excluded from Appellant's receipts, the Area Office appears to have been influenced by the statement on the Arizona Department of Revenue website that that the ATPT is "not a true sales tax." Appellant cites a number of court decisions, however, in which tribunals have nevertheless recognized that the ATPT acts as a sales tax and is passed on to a vendor's customers. *See, e.g., People of Faith, Inc.*, 779 P.2d at 832 (referring to the ATPT as a "sales tax" and explaining that "[t]he sales tax is a transaction tax on the sale" and "is imposed upon the seller but ordinarily is passed through to the buyer"); *Atchison, Topeka & Santa Fe Ry. Co.*, 78 F.3d at 439 (noting that ATPT "is similar to a sales tax" and "is generally imposed ... on the sale of goods and services occurring in the state"). Moreover, the State of Arizona itself acknowledges that the ATPT is, fundamentally, a sales tax. The same website referenced by the Area Office repeatedly refers to the ATPT as the "Arizona Transaction Privilege (Sales) Tax."

The Area Office also attached weight to the fact that the ultimate legal liability for the ATPT rests with the seller (in this case, Appellant), rather than with the customer. It is true that the legal incidence of a tax is an important consideration in deciding whether the tax should be included or excluded from a firm's annual receipts. *Size Appeal of Leader Commc'ns, Inc.*, SBA No. SIZ-5036, at 3 (2009) (finding that the New Mexico gross receipts tax could not be excluded from the calculation of annual receipts because the seller was solely responsible for payment of the tax). Appellant correctly observes, however, that in California and many other states with traditional sales taxes, the legal incidence of the sales tax falls upon the seller. *See, e.g., Minor*, 2010 WL 2735040 at *3 (In California, "[w]hether or not a retailer collects the sales tax from its purchasers, the *retailer* is liable to remit the tax due."); *Gen. Motors Corp.*, 2000 WL 33421269 at *2 (In Michigan, "[t]he sales tax is a 'privilege tax' imposed directly on the seller, which the seller may pass on to the purchaser and collect at the point of sale."); *Beare Co. v. Olsen*, 711 S.W.2d 603, 605 (Tenn. 1986) (In Tennessee, "the legal incidence of the retail sales tax is upon the vendor of the taxable services or property, and not upon the vendee or consumer."). Thus, if the ATPT cannot be excluded from Appellant's receipts because the seller is ultimately responsible for the tax, the same reasoning would suggest that the sales taxes in many other states likewise could not be excluded. Such a result is untenable as it is plainly contrary to 13 C.F.R. § 121.104(a), which provides "[r]eceipts do not include ... sales or other taxes collected from customers." I decline to follow *Leader Communications* insofar as that case stands for the proposition that it is not possible for a sales tax to be "collected for ... a taxing authority" if the legal incidence of the tax falls upon the seller.

Based upon the foregoing, I find that the ATPT is substantively indistinguishable from a traditional sales tax. Appellant acts as a conduit by collecting the tax from its customers and forwarding the proceeds to the State of Arizona. The ATPT is therefore a tax "collected for and remitted to a taxing authority" in accordance with 13 C.F.R. § 121.104(a) and OHA case precedent. Although the legal incidence of the tax falls on Appellant, the same is true of many state sales taxes that place liability for the tax on the vendor instead of the customer. I conclude

the Area Office should have excluded Appellant's ATPT payments from the calculation of Appellant's annual receipts.

2. Identity of Interest

Appellant also challenges the Area Office's conclusion that it is affiliated with GAE based upon an identity of interest. The applicable regulation provides:

> Affiliation may arise among two or more persons with an identity of interest. Individuals or firms that have identical or substantially identical business or economic interests (such as family members, individuals or firms with common investments, or firms that are economically dependent through contractual or other relationships) may be treated as one party with such interests aggregated. Where SBA determines that such interests should be aggregated, an individual or firm may rebut that determination with evidence showing that the interests deemed to be one are in fact separate.

13 C.F.R. § 121.103(f). On the basis of this regulation, the Area Office presumed an identity of interest between Appellant and GAE because the owners of the firms are related. The Area Office also determined GAE is economically dependent upon Appellant because the majority of GAE's revenue in 2009 and 2010 was derived from fifteen subcontracts awarded by Appellant to GAE in 2009. In its appeal petition, Appellant strenuously argues that the familial relationship between Appellant's owners and the owners of GAE is insufficient to create an identity of interest and also contends there is no other connection between the firms.

I find no error with the Area Office's conclusion that Appellant and GAE share an identity of interest. OHA has consistently held that a family relationship is sufficient to create an identity of interest between two concerns, unless, as noted in 13 C.F.R. § 121.103(f), a party has rebutted the presumption of an identity of interest by showing a clear fracture between the two entities. *See, e.g., Size Appeal of Technical Support Servs.*, SBA No. SIZ-4794 (2006). Such "clear fracture" may be shown if family members are "either estranged or not involved with each other's business transactions." *Size Appeal of Osirus, Inc.*, SBA No. SIZ-4546, at 4 (2003).

In this case, Appellant claims that because it does not share ownership, management, facilities, employees, or capital with GAE, Appellant has demonstrated a clear fracture between its own business operations and those of GAE. Appellant fails to address, however, the fifteen subcontracts that the Area Office found constitute the vast majority of GAE's revenues. Specifically, the record reflects that Appellant awarded fifteen subcontracts to GAE totaling over $600,000. Appellant's only discussion of these subcontracts is to assert that the firms "work at arm's length from one another on a handful of contracts." (Appeal Petition 13.) Needless to say, fifteen contracts are hardly a mere "handful," but rather evince a significant contractual relationship between Appellant and GAE, especially in light of GAE's modest revenues, which are also reflected in the record.

In *Size Appeal of Black Box Technology, Inc.*, SBA No. SIZ-5011 (2008), OHA determined that a challenged firm had failed to show a clear fracture between itself and an

alleged affiliate. OHA noted that, in addition to a family relationship between the owners of the firms, the challenged firm was a relatively new enterprise and had "substantial ongoing business arrangements" with the alleged affiliate. *Id.* at 5. OHA concluded that "[t]he facts of this appeal present a compelling example of affiliation by identity of interest through a familial relationship without fracture." *Id.*

Similarly, in this case Appellant failed to demonstrate a clear fracture between itself and GAE. Although it is true that a family relationship alone may be insufficient to create an identity of interest, the facts and circumstances of this case demonstrate a continuing business relationship between the firms. The firms may not share employees or facilities, but it is clear they have substantial contractual relations. Furthermore, it appears these contracts were of great import to GAE's operations. Thus, I find no error in the Area Office's conclusion that Appellant shares an identity of interest with GAE.

Given that I find no error with the Area Office's conclusion that Appellant and GAE are affiliated, Appellant is correct that proceeds from transactions between Appellant and GAE should be excluded from Appellant's annual receipts pursuant to 13 C.F.R. § 121.104(a). That regulation specifically provides that "[r]eceipts do not include ... proceeds from transactions between a concern and its domestic or foreign affiliates." Appellant does not specifically enumerate the amounts it considers to be excludable under this regulation, but the Area Office should have considered whether there were any properly-excludable interaffiliate transaction receipts between the firms.

3. Remand

On remand, the Area Office must recalculate Appellant's average annual receipts. The Area Office must exclude from Appellant's receipts the ATPT payments made to the State of Arizona. The Area Office must also determine whether there were any properly-excludable interaffiliate transaction receipts between Appellant and GAE and, if so, in what amount. Those amounts must also be excluded from the calculation of Appellant's average annual receipts. Finally, because Appellant and GAE are affiliated, Appellant's receipts must be aggregated with those of GAE. 13 C.F.R. § 121.104(a), (d)(1).

IV. Conclusion

The size determination contains clear errors. Accordingly, the size determination issued in case numbers 6-2011-037 and 6-2011-038 is VACATED, and this matter is REMANDED to the Area Office for a recalculation of Appellant's average annual receipts.

KENNETH M. HYDE
Administrative Judge