



ARIZONA STATE SENATE
Fifty-Second Legislature, First Regular Session

FACT SHEET FOR S.B. 1446

TPT reform; contractors

Purpose

Makes various adjustments to statute regarding transaction privilege tax (TPT) pertaining to contractors.

Background

The Arizona TPT is commonly referred to as a sales tax, however, the tax is on the privilege of doing business in Arizona and is not a true sales tax. Under Arizona's TPT, the seller is responsible for remitting to the state the entire amount of tax due based on the gross proceeds or gross income of the business. The seller can include the tax in the purchase price or absorb the tax.

TPT is currently levied on 16 business classifications including retail, utilities, restaurants and bars, prime contracting, transient lodging, rental of personal property, telecommunications and amusements. Currently, statute provides for specific activities and transactions that a taxpayer can deduct from the gross proceeds of sales or gross income in determining the tax base prior to calculating the tax. Each business classification has its own deductions and exemptions.

On May 11, 2012, Governor Brewer issued an executive order (2012-01) establishing the Transaction Privilege Tax Simplification Task Force (Task Force) for the purpose of studying and making recommendations regarding the collection of revenues to the state General Fund, including individual and corporate income tax and TPT and recommendations to minimize the fiscal impact to cities, towns and counties.

The Task Force published its final report on December 13, 2012, and the recommendations resulted in Laws 2013, Chapter 255. This bill made numerous statutory changes regarding TPT including establishing a single and uniform TPT audit system and online portal, modifying the prime contracting classification, and making numerous administrative changes.

Laws 2014, Chapter 263, made further changes and revisions regarding TPT licensing, exemption certificates and administration procedures.

There is no anticipated fiscal impact to the state General Fund associated with this legislation.

Provisions

Issuance of Building Permits

1. Prohibits a city, town and board of supervisors from requiring an applicant for a building permit to hold a TPT or business license as a condition for the issuance of a permit.
2. Permits a city or town to require a person that has been issued a building permit, and does not hold a business license from the city or town, to apply for a business license within 30 days after the issuance of a building permit.

Licensure of Contractors

3. Removes the requirement that an applicant possess a TPT license in order to obtain or renew a contractor's license.

Liability for Retail TPT Owed

4. Specifies that a prime contractor, or subcontractor working under the control of a prime contractor, that purchases tangible personal property exempt from retail TPT or use tax and incorporates that property into a maintenance, repair, replacement or alteration (MRRA) project is liable for an amount equal to any tax the seller would be required to pay and outlines how the amount must be paid.
5. Specifies that a person who uses a canceled TPT license is liable for tax if property is purchased exempt from retail TPT or use tax and subsequently used or consumed and outlines how the amount must be paid.
6. Stipulates that a person that fails to report any tax due is liable for interest and penalties consistent with statute.
7. Entitles a person to an offset for tax paid on tangible personal property believed to be for a MRRA project if a final determination concludes the project was prime contracting.

Retail Classification

8. Exempts tangible personal property from retail TPT and use tax that will be incorporated or fabricated into a MRRA project for the following:
 - a) qualifying hospitals;
 - b) qualifying health care organizations;
 - c) qualifying community health centers;
 - d) nonprofit charitable organizations; and
 - e) qualifying health sciences educational institutions.
9. Exempts tangible personal property from retail TPT that is sold to a person that is not subject to tax under the prime contracting classification and has been provided an exemption certificate if the property is to be incorporated or fabricated into the project described in the certificate.

10. Exempts the sales of tangible personal property from retail TPT and use tax that will be incorporated or fabricated into a MRRA project that is located within an Indian reservation for which the owner of the project is an Indian tribe or affiliated Indian.
11. Clarifies that tangible personal property exempt under the telecommunications classification will be exempt under MRRA projects.
12. Clarifies that machinery and equipment used by a person engaged in the commercial production of livestock, livestock products or agricultural, horticultural viticultural or floricultural crops or products is exempt from retail TPT and use tax if the machinery and equipment are used directly and primarily to prevent, monitor, control or reduce air, water or land pollution.

Prime Contracting Classification

13. Removes modifying and the repairing of sprinklers or watering systems from the list of landscaping activities that are subject to tax under the prime contracting classification.
14. Clarifies that the gross proceeds of sales or income derived from a de minimis amount of modification activity does not subject the contract or any part of the contract to TPT under the prime contracting classification and specifies the following:
 - a) tangible personal property incorporated or fabricated into a MRRA project is subject to retail TPT;
 - b) each contract is independent of any other contract, except that any change order that directly relates to the scope of work of the original contract must be treated the same as the original contract regardless of the amount of modification; and
 - c) change orders that do not directly relate to the scope of work of the original contract must be treated as a new contract, with the tax treatment of any subsequent change order to follow tax treatment of the contract to which the scope of work of the subsequent change order directly relates.
15. Specifies that, with the exception of certain special taxing districts, contracts that primarily involve surface or subsurface and vertical improvements to land and subject to specific highway and public building statutes are subject to TPT under the prime contracting classification.
16. Requires agencies subject to procurement processes to notify bidders if projects are subject to prime contracting.
17. Defines *alteration* as an activity or action that causes a direct physical change to existing property subject to the following:
 - a) for existing residential property, projects are taxable under prime contracting if the contract amount is more than 25 percent of the higher value of the most recently available full cash value as of the date of any bid or the date of the contract; and
 - b) for existing commercial property, contracts are taxable under prime contracting if any of the following are true:
 - i. the contract amount is more than \$750,000;

- ii. the scope of work directly relates to more than 40% of the existing square footage of the existing property; or
 - iii. the scope of the work involves expanding the square footage of more than 10 percent of the existing property.
18. Prohibits project elements from being artificially separated from a contract to cause a project to qualify as an alteration and the Department of Revenue (DOR) has the burden of proof that project elements have been artificially separated.
19. Specifies that work under a contract qualifies as an alteration if a project for which the owner and the person performing the work reasonably believed, at the inception of the contract, would be treated as an alteration and on completion the project exceeded the applicable threshold by no more than 25 percent.
20. Requires a change order that directly relates to the scope of work of the original contract to be treated as part of the original contract and the contract amount must include any amount attributable to a change order that directly relates to the scope of work of the original contract.
21. Clarifies that *alteration* does not include maintenance, repair or replacement.
22. Clarifies that *modification* includes grading and leveling ground but does not include the following:
- a) improvement and movement;
 - b) any MRRA project;
 - c) any wreckage or demolition of existing property or any other activity that is a necessary component of a MRRA project; and
 - d) any mobilization or demobilization related to a MRRA project.
23. Defines *owner* as the person that holds title or improvements to the real property that is the subject of work, as well as an agent of the title holder and any person with the authority to perform or authorize work on the real property, including a tenant and a property manager.
24. Defines *replacement* as the removal of one component or system of existing property or tangible personal property installed in existing property, including machinery or equipment, and the installation of a new component or system or new tangible personal property that provides the same or upgraded functionality, regardless of the contract amount for the removal and installation.

Existing Materials

25. Allows a person that cancels a TPT license on or before the last day of the first month that occurs at least 60 days after the effective date to make a reasonable estimation of the value of any materials purchased tax exempt that are on hand at the time of cancellation and provides the following procedures for the payment of taxes:
- a) if the reasonable estimate of the value is \$10,000 or less, the person is not liable for any tax or similar amounts due by law;

- b) if the reasonable estimate of value is more than \$10,000, the person is not liable for tax on the first \$10,000, and the value in excess is subject to tax as follows:
 - i. if the materials are incorporated into an MRRA project, tax due is based on the purchase price of the materials and if the materials are sold or disposed, the tax is based on the revenue received;
 - ii. in a single payment with the tax based on the person's principal place of business; or
 - iii. in 12 equal monthly installments with the tax based on the person's principal place of business.

Hold Harmless

- 26. Specifies the following for any contracts that are bid or entered into or for any binding obligation executed on or before the last day of the first month that occurs at least 60 days after enactment:
 - a) permits a person to treat a contract as a contract that is taxable under the prime contracting classification; and
 - b) requires a person to be held harmless from any additional tax, penalty and interest if DOR determines, under audit, that the person's good faith treatment of the contract as, either subject or excluded from TPT under the prime contracting classification, was incorrect.

Miscellaneous

- 27. Stipulates that the treatment of change orders does not alter or affect the treatment of change orders in any other context, including with respect to the application of changes in the rate of tax.
- 28. Defines *enactment date* as the date the Governor signs the legislation or the date the Secretary of State receives the transmission of the unsigned act from the Governor.
- 29. Exempts DOR from rulemaking requirements until January 1, 2016, for the purposes of implementation.
- 30. Contains a legislative intent clause.
- 31. Defines terms.
- 32. Makes technical and conforming changes.
- 33. Becomes effective on signature of the Governor, if the emergency clause is enacted, retroactive to January 1, 2015.

