

ARIZONA STATE AND LOCAL PRIME CONTRACTING TRANSACTION PRIVILEGE TAX OVERVIEW

Overview - as of 2-2-2015

This document was prepared for the general use of the Construction Industry. It is not intended to be a comprehensive summary, or to be relied upon as legal or tax advice.

PROPOSED 2015 Legislative and Administrative Changes

Item #	Issue	Current DOR and TPN positions	"no change" means the "Current DOR and TPN positions" remain as stated	Comments to Proposed 2015 Changes
		Based on House Bill 2389 enacted in 2014 and Arizona Transaction Privilege Tax Notice TPN 14-1	Based on SB1446/HB2590 introduced on 2-2-2015	
1	Modification : Prime Contracting tax (tax on revenues received by contractor)	Modification activities encompass construction, improvement, movement (including removal), wreckage, or demolition activities, to the extent that they cannot otherwise be characterized as maintenance, repair, replacement, or alteration activities.	Modification means construction, grading and leveling ground, wreckage or demolition; but does not include a) MRRRA work as defined in Subsection "O", or b) wreckage or demolition, or any modification activity necessary for MRRRA work or c) project mobilization.	Effectively, this means that a project that meets any of the components of MRRRA will be treated as MRRRA, unless: (1) Modification activities exceed 15% of the contract revenues under the De Minimis rule, or (2) the Alteration activities exceed the limitations outlined in section 2d below.
2a	Maintenance, Repair, Replacement, Alteration (MRRRA): Retail tax on contractor's cost of materials	"Maintenance" is the upkeep of property or equipment. Examples of maintenance include: an annual system checkup that includes topping off any fluids, restaining a wood deck, and refinishing hardwood floors.	no change	
2b		"Repair" is an activity that returns real property to a usable state from a partial or total state of inoperability or nonfunctionality. Examples of repairs include: recharging partially or totally nonfunctional air-conditioning units with refrigerant, clearing partially or completely blocked pipes of debris, readjusting satellite dishes to restore reception, and replacing worn washers in leaky or totally inoperable faucets.	no change	
2c		"Replacement" is the act of replacing something that exists with something else, including the upgrading of existing systems. Examples of replacement include replacing an HVAC system that is no longer functioning at optimum levels with a new, more efficient unit or replacing a deteriorated shingled roof with a new one.	"Replacement" means the removal of one component or system of existing property or tangible personal property installed in exiting property and installing a new component or system that provides the same or upgraded functionality, regardless of the contract amount.	

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2d		<p>"Alteration" is an activity that causes a direct physical change to real property without causing a change in the identity of the real property. Examples of alterations include: enlarging a patio, sandblasting a building façade, and tamping railroad ties.</p>	<p>Residential: If the contract for the project is more than 25% of the most recently available Full Cash Value of the existing property (including land) from the County Assessor for property tax purposes, then the project will be treated as a taxable prime contracting project. This includes all single-family residential, multi-family residential, condos, assisted living, student housing, etc.</p> <p>Commercial: Will be a taxable prime contracting project if ANY of the following are true:</p> <ol style="list-style-type: none"> 1) The contract for the project is more than \$750,000, OR 2) The scope of work directly relates to more than 40% of the existing square footage of the existing property, OR 3) The scope of work involves expanding the square footage by more than 10% of the existing property. <p>NOTE - 25% SAFE HARBOR: If the parties have a "reasonable belief" on contract date that the project would qualify as an Alteration but, at project completion, the project exceeds the applicable threshold by no more than 25%, no change in tax treatment. If any aspect of the project causes the applicable threshold to be exceeded by more than 25%, the project is no longer deemed an Alteration, and the ENTIRE project will be taxed as a prime contracting job.</p>	<p>Residential: Full Cash Value can be obtained on the County Assessor website (HINT: print out the screen to prove value at time of bid for your records) or by asking owner to provide a copy of most recent valuation notice. *Threshold with Safe Harbor is 31.25% of Full Cash Value.</p> <p>Commercial: The \$750,000 contract price threshold is the ROC threshold distinction between a B-02 license for "small commercial projects" and the B-01 license required for larger commercial contracts. Threshold components with Safe Harbor are: 1) Contract amount >\$937,500; 2) Work within existing property >50% of existing square footage; 3) Expansion >12.5% of existing square footage</p> <p>NOTE: Alteration does not include Maintenance, Repair or Replacement.</p>
3	Who is "owner" of real property	Owner includes agent or other person with authority to contract for work. If a contractor is working under another contractor who is contracted with an owner, the sub tier contractor is considered to be also working for the owner for TPT purposes.	Some language clean up included, but the intent is in line with current DOR and TPN positions.	
4	Form 5000	This form maintains its current use for Modification (prime contracting) projects. HOWEVER, should a contractor utilize this form to purchase materials tax-exempt for an MRRRA project, the contractor must report and pay the tax no later than in the period it receives final payment (subject to penalty and interest, if reported/paid after the reporting period when purchased); sourcing discussed below.	Contractors who will retain their TPT license because they do both MMRA and Modification projects may issue blanket 5000s and purchase materials tax-exempt. This will allow those whose purchase materials in bulk to purchase tax-exempt. Materials that are later incorporated into an MRRRA project will require sales tax be reported and paid as discussed below. Purchasing all materials with Form 5000s will entitle the contractor to an offset for tax paid on materials against the prime contracting tax, if the project is ultimately determined to be prime contracting.	NOTE: This form can also be used on a "project specific" basis by checking the "single transaction certificate" box and specifying the contract and project description just to the right of this box in that section of the form; then also checking box 3 under "Reason for Exemption", if prime contracting, or noting on page 2 in the description section "Materials to be used in MRRRA project".

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5	Form 5005	This form maintains its current use: It is used by GCs who are doing a Modification project (prime contracting) to communicate to subs that the GC will be the taxable prime contractor, and that the GC assumes liability for the tax that the sub would otherwise owe.	The legislation provides for the use of a form for MRRRA projects that mirrors the current Form 5000 for Modification projects.	Currently, it is anticipated that the Form 5005 will be updated to provide for its use in MRRRA projects (in addition to Prime Contracting projects) so that contractors will only have one form to issue to subs, regardless of the type of project. Effectively, a contractor will be able to issue this form to advise the down-chain subcontractor that the tax obligation will be at the contractor level. And, even if the project is MRRRA, and the subcontractor is purchasing materials exempt (via Form 5000), the sub will not pay the tax; rather the contractor issuing the 5005 will report and pay the tax.
6	Form 5009L	This form is ONLY for a prime contracting taxable project and ONLY IF a prime contractor is using a subcontractor who is NOT TPT LICENSED on the project - use of this form should be a rare exception. If the situation meets this criteria, the prime contractor must submit an application to DOR for approval, and once returned from DOR, the prime contractor should pass on to the non-TPT licensed sub. The non-TPT licensed sub will not be able to purchase materials tax-exempt until he has such form to provide to supplier. This form is NOT to be used for MRRRA projects.	Some language clean up included, but the intent is in line with current DOR and TPN positions.	
7a	Inventories/Material purchases	A: TAXPAYERS NOT RENEWING TPT LICENSE (Contractor who will only do MRRRA work going forward): Inventories will need to be calculated as of 12/31/2014, then reported and tax paid over 12 months during 2015 - 1/12th each month. Sourcing of tax discussed below.	A: Taxpayers with a canceled license will be required to pay tax on materials as they are a) incorporated into a project where tax would be required on the materials or otherwise used or consumed, or b) sold or disposed of.	If the materials are incorporated into an MRRRA project, the tax due is based on the purchase price of the materials; if sold or disposed, the tax is based on the revenue received. NOTE A: There will be a transition period exclusion from tax on the first \$10,000 of "on hand" materials (inventory), but ONLY for contractors with licenses canceled before the last day of the month that is 60 days after the bill is signed by the Governor (or enacted without signature). Materials on hand in excess of this threshold will be subject to the terms of this provision. NOTE B: There is also the option for these license-canceling contractors to determine materials on hand (inventory) as of the day before their license cancellation is effective, and to report and pay tax on such value (in excess of \$10,000), in a lump sum or over a 12 month period, based on the contractor's cost of the materials, at the retail rate, and based on the contractor's principal place of business. This is a simple process to avoid needing to have two inventory systems during the period while materials purchased tax-free are stored awaiting for future use, without special reporting or recordkeeping.

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7b		B: TAXPAYERS <u>RETAINING</u> TPT LICENSE, who will be doing both MRRA and Modification projects, will establish 12/31 inventories, and any inventory materials that are used in an MRRA job will be reported and tax paid as they are used. Sourcing of tax discussed below.	B: no change	
7c		C: TAXPAYERS <u>RETAINING</u> TPT LICENSE, who will be doing both MRRA and Modification projects, should track materials purchased after 1/1/15 for MRRA projects separately from Modification projects; any purchases made exempt (via form 5000) that are utilized in MRRA work must be reported and tax paid no later than in the period you receive final payment (subject to penalty and interest). Sourcing of tax discussed below.	C: TAXPAYERS <u>RETAINING</u> TPT LICENSE, who will be doing both MRRA and Modification projects, will be allowed to EITHER purchase material for MRRA projects and pay the tax to the supplier at the time of purchase, OR purchase materials exempt (via form 5000) and then report and pay the tax on materials that are utilized in an MRRA project. The reporting period and tax payment is based on the period when the material is incorporated into the project. Sourcing of tax discussed below.	See also comment under item 9
8a	Sourcing of taxes (what jurisdiction they are reported to?)	A: Principal place of contractor's business	A: If incorporated into a MRRA project, the sourcing is the project location; all other circumstances, the sourcing is the principal office location	
8b		B: Principal place of contractor's business	B: Sourced to project location	
8c		C: Principal place of contractor's business	C: Purchases where the tax is paid at purchase, is sourced at the seller location, as seller will report the tax. Purchases exempt, and later incorporated into a MRRA project will be sourced at the project location.	
9	What happens if, upon audit, an MRRA project is determined to be a prime contracting project?	Not addressed	Payment of tax on tangible personal property believed to be for MRRA project and later determined to be prime contracting will be allowed an offset for the tax paid against the prime contracting tax assessed.	NOTE: This offset will ONLY be allowed if proof of payment of the tax is provided. The DOR will not consider an offset for taxes paid by any other person, whether in the contracting chain or a vendor.
10	Use tax	No change to pre-existing rules. Applicable only for purchases from vendors out of state w/o nexus in AZ. If purchased for an MRRA project, the materials are now taxable and must report use tax. If for a Modification project, materials will continue to be purchased exempt.	All materials purchased tax-free for incorporation or fabrication into a project, if they are not otherwise exempt from tax, will now be subject to an amount equal to retail TPT at the job location.	Effectively, all materials that are incorporated or fabricated into an MRRA project are subject to retail tax at the job location if tax was not paid to the vendor when the materials were purchased. This is true regardless of whether the vendor was located outside of Arizona or has nexus with Arizona. In other words, use tax won't apply to materials that are used in a project."

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11	Change orders	Each change order is a separate contract - and must be evaluated for Modification vs. MRRRA tax application; and taxes applied according to this determination	Each change order is to be evaluated as to its "relationship" to the original contract. If the change order is "directly related" to the original contract, it is taxed the same as the original contract. If the change order is NOT directly related to the original contract, it must be evaluated independently as a new contract, with the tax treatment based solely on that change order. The tax treatment of subsequent change orders will track the tax treatment of the related "original" contract/change order.	
12	De Minimis test	Established at 15%; any MRRRA project that includes 15% or more of Modification activities becomes subject to Prime Contracting tax	no change	
13	Safe Harbor	Not addressed	Retroactivity: For bids submitted or contracts entered into, or any other binding obligation executed prior to the last day of the month that is 60 days after the bill is signed by the Governor (or enacted without signature), the contractor may treat such contracts as: a) prime contracting, with receipts taxed in accordance with A.R.S. Section 42-5075, or b) MRRRA, with post 1/1/15 receipts and material purchases taxed in accordance with Section 42-5075(O).	Within this timeframe, contractors are allowed to treat contracts/commitments (on a contract-by-contract basis) as either prime contracting or MRRRA. However the contractor must make a good-faith effort in determining which taxing method is applied. Safe Harbor applies to additional tax, penalties and interest.
14	Excluding certain Heavy Highway contracts from MRRRA treatment	Not addressed	Contracts for surface or subsurface improvements subject to Titles 28 and 34 will NOT be subject to MRRRA treatment.	There are many Special Taxing Districts that are not excluded here; the State is not excluded, either, other than projects covered by Title 28; NOTE: Private owners will not be exempt
15	Exempting certain projects and materials previously exempt under prime contracting	Not addressed	Any project previously exempt (such as a contract with a Native American Tribe) or materials previously exempt (such as hospital tangible personal property) or machinery & equipment previously exempt (such as manufacturing, mining, electric generation, etc.) will be exempt under MRRRA projects	
16	ROC requires TPT license	Not addressed	Eliminates TPT license requirement for ROC license	
17	City and County Permits - TPT license requirement	Not addressed	Eliminates TPT license requirement as a condition for issuing permits	
18	Landscaping activities	Not addressed	Statutory language to remove "modifying" and "repairing sprinkler or watering systems" in the definition of Landscape activities	This eliminates the possible confusion over language found in MRRRA terminology; effectively places Landscaping activities in same position as other contracting activities. Note that Landscaping as defined in statute is not the same as "lawn maintenance services", which are not taxed as prime contracting.