



HOUSE OF REPRESENTATIVES

SB 1446/HB 2590

TPT reform; contractors

Sponsors: Senators Lesko, Farley, Worsley, et al.

DP Committee on Ways and Means

DP Caucus and COW

X As Transmitted to the Governor

OVERVIEW

HB 2590 alters statute regarding transaction privilege tax (TPT) pertaining to contractors.

HISTORY

TPT is imposed on a vendor for the privilege of conducting business in Arizona. Under this tax, 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. While the tax is commonly passed on to the consumer at the point of sale, it is ultimately the seller's responsibility to remit the tax. Business activities subject to TPT include, but are not limited to: retail, restaurants and bars, hotel/motel, commercial leasing, advertising, amusements, personal property rentals, real property rentals, construction contracting, owner/builders, manufactured building, mining, timbering, transportation, printing, publishing, utilities, communications, air/railroad, and private cars/pipelines. The current Arizona TPT rate is 5.6%. The Arizona Department of Revenue (DOR) collects TPT and administers distribution to the state General Fund (GF) and counties, cities and towns.

Pursuant to Arizona Revised Statutes § 42-5075 the prime contracting classification is comprised of business engaged in prime contracting and the dealership of manufactured buildings. The TPT base for prime contracting is 65% of the gross sale proceeds or gross income derived from the business. Subsection O, as added by Laws 2014, Chapter 263, Section 13, provides that prime contractors are not subject to tax from the gross sale proceeds or gross income resulting from contracts for the maintenance, repair, replacement or alteration (MRRA) of real property if the contract does not include modification activity.

PROVISIONS

Building Permits

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

Contractor Licensure Qualifications

3. Eliminates the requirements for an applicant to possess a TPT license and to submit the license number to the Registrar of Contractors to obtain or renew a contractor's license.

Liability for Retail TPT

4. States that a contractor or subcontractor working under the control of a prime contractor, that purchases tangible personal property exempt from TPT or use tax that incorporates such property into a MRRA project, is liable for an amount equal to any tax that the seller would have been required to pay.
5. Outlines the process by which a contractor or subcontractor working under the control of a prime contractor pays liable tax if tangible personal property is purchased exempt from TPT or use tax that is incorporated into a MRRA.
6. States that if a person purchases tangible personal property exempt from TPT or use tax with a canceled TPT license, that person is liable to pay tax on that property if used, consumed, sold or discarded.
7. Outlines the method of payment for a person who purchases tangible personal property exempt from TPT or use tax with a canceled TPT licensee.
8. States that if a person fails to report or pay taxes under this section, that person is liable for interest and penalties.
9. Entitles a person to an offset for taxes paid on tangible personal property believed to be for a MRRA project if a final determination finds the project was prime contracting.

Retail Classification

10. Exempts tangible personal property from retail TPT and use tax that will be utilized in a MRRA project for:
 - a. Qualifying hospitals.
 - b. Qualifying health care organizations.
 - c. Qualifying health centers.
 - d. Nonprofit charitable organizations.
 - e. Qualifying health science educational institutions.
11. Exempts from retail TPT and use tax tangible personal property that is sold to a person representing or working on behalf of another person under an exemption certificate.
12. Exempts from retail TPT and use tax the sale of tangible personal property utilized in a MRRA project that is located within the exterior boundaries of an Indian reservation for which the owner of the project is an Indian tribe or affiliated Indian.
13. Adds a person representing or working on behalf of a prime contractor to the TPT telecommunications exemption from MRRA.
14. Adds a person representing or working on behalf of a prime contractor to the TPT machinery and equipment for production of livestock, livestock products or agriculture, horticultural, viticultural or floricultural crops exemption from MRRA.

Change Orders

15. 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. The contract amount must include any amount attributable to a change order that directly relates to the scope of work of the original contract.
16. Requires a change order that does not directly relate to the scope of work of the original contract to be treated as a new contract.

17. 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.

Prime Contracting Classification

18. Replaces *construction, alteration, repair, improvement, movement, wrecking or, demolition or addition to or subtraction* with *modification* in various A.R.S. subsections regarding prime contracting.
19. Specifies, with the exception of special taxing districts, that surface, subsurface and vertical improvement to land contracts are subject to:
 - a. Specific highway and public building statutes.
 - b. The prime contracting classification of TPT.
20. Defines *alteration* as an activity or action that causes a direct physical change to existing property and that meets one of the following requirements:
 - a. Is a residential property with a contract amount less than 25% of the most recent full cash value assessment of the property.
 - b. Is a nonresidential property with a contract that meets all of the following requirements:
 - I. A contract value of less than \$750,000.
 - II. The scope of the work directly relates to no more than 40% of the square footage of the existing property.
 - III. The scope of the work expands the square footage no more than 10% of the existing property.
21. Prohibits project elements from being artificially separated from a contract to cause a project to qualify as an alteration. DOR has the burden of proof that project elements have artificially separated from a contract.
22. Specifies that work under a contract qualifies as an alteration if 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 %.
23. Specifies that *alteration* does not include *maintenance, repair or replacement*.
24. Clarifies the definition of *modification* means construction, grading and leveling ground, wreckage or demolition, that does not include:
 - a. Improvement or 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.
 - d. Any mobilization or demobilization related to a MRRA project, such as erection or removal or temporary facilities to be used by persons working on the project.
25. Clarifies the definition of *modify* means to make a modification or cause a modification to be and not construct, improve, move, wreck or demolish.
26. Defines *owners* as the person that holds the title to the real property or improvements to real property that is subject to the work, as well as an agent of the title holder or any person with the authority to perform or authorize work on the real property or improvements, including a tenant and a property manager.

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27. Defines *replacement* as the removal of one component or system of existing property or tangible personal property installed in existing property, 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 Inventory

28. Permits a person that cancels their TPT license on or before the last day of the first month that occurs at least 60 days after the effective date to estimate the value of inventory purchased tax exempt, and provides the following procedures for the payment of taxes:
- a. If the estimation is a value of \$10,000 or less, the person is not liable for any tax.
 - b. If the estimation is a value of more than \$10,000, the person is only liable for the tax above \$10,000 and is required to pay the excess value by one of the following methods:
 - i. A single payment with the tax based on the person's principle place of business.
 - ii. In 12 equal monthly installments with the tax based on the person's principle place of business.
 - iii. When the materials are incorporated into a MRRA project, tax is due based on the purchase price of the materials and if the materials are sold or disposed, the tax is based on the revenues received.

Hold Harmless

29. Specifies the following for any contracts that are bid or entered into or any bidding obligation executed on or before the prescribed deadline:
- a. A person may treat the contract as taxable under the prime contracting classification.
 - b. A person must be held harmless from any additional tax, penalty and interest if DOR determines by audit that the person's good faith treatment of the contract was either subject to or excluded from TPT under the prime contracting classification, or was incorrect.

Miscellaneous

30. Alters language requiring DOR to establish an exemption certificate to permit a person not subject to prime contracting to be employed by a contractor that is subject to prime contracting.
31. Adds to the definition of *tangible personal property*.
32. Defines numerous terms.
33. Makes technical and conforming changes.
34. Exempts DOR from rulemaking for the purpose of implementing this Act.
35. Contains a legislative intent clause.
36. Applies retroactively to January 1, 2015.
37. Contains an emergency clause.