



The taxpayer's watchdog for over 75 years

ARIZONA TAX RESEARCH ASSOCIATION

ATRA SUPPORTS SB1446/HB2590 *TPT Clean-up Legislation*

Background:

In 2013, former Governor Jan Brewer signed into law the TPT reform legislation that resulted from the year-long effort of the TPT Simplification Task Force. For decades, ATRA and the business community have sought to pass major reforms to fix Arizona's complicated and dysfunctional TPT system. The passage of HB2111, which was championed by Rep. Debbie Lesko, represented historic progress by simplifying Arizona's sales tax system and decreasing compliance costs for Arizona businesses.

Although Governor Brewer's TPT Task Force adopted the aggressive recommendation to eliminate Arizona's unique and complicated prime contracting tax, that provision in the TPT reform bill as introduced drew significant opposition from the cities and towns. As a result, the final enacted version limited the prime contracting reform to only the maintenance and repair contractors that would be allowed to pay tax on materials at retail rather than be subject to the prime contracting tax. Although the fix to prime contracting was intended to make compliance less complicated, additional clarification was needed to implement those reforms effective for January 1, 2015.

TPT clean-up bill provisions:

The TPT simplification reform bill specified that a contractor working directly on behalf of an owner for the maintenance, repair, and replacement of existing property is exempt from the prime contracting tax and instead is required to pay tax on the materials purchased at retail. In 2014, additional changes were made under HB2389 to add the term "alteration" to the list of activities that would not be subject to the prime contracting tax, which also allowed a de minimis amount of modification activity that is essential to the completion of the maintenance, repair, replacement or alteration (MRRRA) contract. This year's TPT clean-up bill provides further clarity to the recent TPT reforms and the following are a few of the major clarifications included in the proposals under SB1446 and HB2590:

MRRRA projects: To provide additional clarity regarding MRRRA projects, the term "alteration" was defined to include an activity or action that causes a direct physical change to existing property and subject to the following thresholds:

For residential property, the contractor will pay tax on materials at retail if the contract price for the work is 25% or less of the property's full cash value for property tax purposes. For commercial property, the contractor pays tax on materials at retail if all of the following are true: 1) the contract amount is \$750,000 or less; 2) scope of the work directly relates to 40% or less of the existing square footage; and 3) scope of the work includes an expansion of existing square footage that is 10% or less of pre-existing square footage. Additionally, a provision was added to provide a 25% cushion for the performance of work that was reasonably believed to be an alteration project at the inception of the contract but exceeded the applicable thresholds for any reason would still qualify as an alteration project.

The thresholds stated above only apply to “alteration” projects and do not apply to projects pertaining to maintenance, repair, and replacement since those contracts are wholly subject to tax on materials at retail.

Safe Harbor: A retroactivity clause was included to address the disconnect in the timing of this year’s TPT clean-up bill and the January 1, 2015 effective date of the 2013 TPT reform bill. As session law, the proposal provides a “safe harbor” provision to protect good-faith MRRA bids and contracts entered into before May 1, 2015 for a person that is no longer required to hold a TPT licence and cancels the license on or before the last day of the first month that occurs at least 60 days after the enactment date of the legislation. For contractors that purchased materials tax exempt at retail but incorporate the materials into an MRRA project, the contractor is liable for the retail tax on materials in which the value exceeds \$10,000. Additionally, a provision was added in permanent law that protects a person that reasonably believed should pay taxes under prime contracting and a final determination is made that the project was actually an MRRA project, the person is entitled to an offset for the amount of tax liability assessed.

Roadway, surface & subsurface projects: To address concerns raised by the public works industry, this year’s legislation maintains the pre-TPT reform treatment of roadway and other surface/subsurface projects that may include vertical construction. The change does not apply to state projects other than ADOT projects and most special taxing districts.