

ARIZONA STATE AND LOCAL PRIME CONTRACTING TRANSACTION PRIVILEGE TAX OVERVIEW

Overview - as of 4-9-2015

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.

		2015 CHANGES			
Item #	Issue			COMMENTS TO 2015 CHANGES	
		Based on changes in SB1446/HB2590			
1	Modification : Prime Contracting tax (tax on revenues received by contractor)	<p>Modification encompasses "ground up" construction, grading and leveling ground, and wreckage or demolition of existing property to the extent they cannot be characterized as MRRA; but does not include a) MRRA work as defined in ARS 42-5075(O) (section 2 below), or b) wreckage or demolition, or any modification activity necessary for MRRA work or c) project mob/demob on MRRA project.</p>		<p>Effectively, this means that a project that meets any of the components of MRRA will be treated as MRRA, 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.</p>	
2a	MRRA - Maintenance	<p>"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.</p>			
2b	MRRA - Repair	<p>"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.</p>			
2c	MRRA - Replacement	<p>"Replacement" means the removal of one component or system of existing property, including machinery or equipment, and the installation of a new component or system or new tangible personal property, including machinery and equipment, that provides the same or upgraded design or functionality, regardless of the contract amount. Examples of replacements include any required removal and installation of: bathroom fixtures, a tile roof, a sprinkler system, or an HVAC unit.</p>		<p>NOTE: <u>Effective 7-3-2015; retroactive to 1-1-15</u> "Replacement" means the removal <u>from service</u> of one component or system of existing property, including machinery or equipment, and the installation of a new component or system or new tangible personal property, including machinery and equipment, that provides the same or upgraded design or functionality, regardless of the contract amount <u>and regardless of whether the existing component or system or tangible personal property is physically removed from the existing property.</u></p>	

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 on as legal or tax advice.

Item #	Issue		COMMENTS TO 2015 CHANGES
Based on changes in SB1446/HB2590			
2d	MRRA - Alteration	<p>Alteration is an activity or action that causes a direct physical change to existing property.</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% "CUSHION": 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 document value at time of bid for your records) or by asking owner to provide a copy of most recent valuation notice.</p> <p>*Threshold with "cushion" 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.</p> <p>*Threshold components with "cushion" 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	<p>Owner means the person that holds title to the real property or improvement to real property that is the subject of the 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 or improvements, including a tenant and a property manager. A person who is hired by a general contractor that is hired by and owner or a subcontractor of a general contractor that is hired by an owner is considered to be hired by the owner.</p>	

Item #	Issue		COMMENTS TO 2015 CHANGES
		Based on changes in SB1446/HB2590	
4	Form 5000	<p>Contractors who will retain their TPT license because they do both MRRRA and Modification projects may issue blanket 5000's and purchase all materials tax-exempt. This will allow those who purchase materials in bulk to purchase tax-exempt. Materials that are later incorporated into an MRRRA project will require tax to be reported and paid as discussed in Item #7 below, unless acting as a Sub where GC issues a 5005 (see Item #5 below). Purchasing materials with a Form 5000 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.</p>	<p>This is basically back to "business as usual" pre-2015, and is key to simplifying the law that took effect 1-1-2015. The Form 5000 will be updated to reflect that it may be used to purchase materials tax-exempt for MRRRA projects. A person that cancels its TPT license will not be able to use a Form 5000 to purchase materials tax-exempt.</p> <p>NOTE: The amount reported on form TPT-1 for materials incorporated into an MRRRA project should <u>NOT</u> be reported under Business Code 015. Business Code 315 has been created by DOR to report such materials.</p>
5	Form 5005	<p>A GC will be able to issue a Form 5005 to all subs on any project (whether Modification or MRRRA). This will pass the tax obligation to the GC. By issuing Form 5005 to subs on MRRRA projects, the GC will be allowed to claim an offset for materials tax that the GC pays in the event the job is later determined to be prime contracting. This means that the GC will need to know the total cost of all materials for the job, including his subcontractors.</p>	<p>The Form 5005 will be updated to provide for its use in MRRRA projects (in addition to Prime Contracting projects) so that GCs 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 sub that the tax obligation will be at the GC level. And, even if the project is MRRRA, and the sub 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. A sub who is not licensed for TPT purposes may only rely on a Form 5005 from a GC for materials that the sub purchased tax-exempt before the sub canceled its TPT license. A subcontractor to a subcontractor can rely on either a copy of the 5005 issued to the first tier Sub; or the GC may issue a 5005 direct to the 2nd tier sub.</p>
6	Form 5009L	<p>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 registered and 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.</p>	

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 on as legal or tax advice.

Item #	Issue			COMMENTS TO 2015 CHANGES
			Based on changes in SB1446/HB2590	
7A	Inventories/Material purchases: Taxpayers canceling TPT license (Contractor who will only do MRRA work going forward)		<p>7A: 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.</p> <p>Sourcing of tax: If incorporated into an MRRA project, the sourcing is the project location; all other circumstances, the sourcing is the principal place of business in Arizona</p>	<p>If the materials are incorporated into an MRRA 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.</p> <p>NOTE: 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 May 1, 2015. Materials on hand in excess of this threshold will be subject to tax..</p> <p>Options to pay: a) as incorporated into an MRRA project sourced to the project, b) a single payment sourced to your principal place of business or c) 12 equal monthly installments sourced to your principal place of business.</p>
7B	Inventories/Material purchases: Taxpayers retaining TPT license - 12/31/14 inventories		<p>7B: For contractors who intend to purchase all materials tax-exempt going forward, the 12/31 inventory becomes essentially irrelevant.</p> <p>Sourcing of tax is to the project location</p>	
7C	Inventories/Material purchases: Taxpayers retaining TPT license - post 1/1/15 purchases		<p>7C: Purchase materials tax-exempt (via Form 5000) and then report and pay the tax on materials that are utilized in an MRRA project (unless acting as a sub, where the GC has issued the sub a Form 5005 - in that case, GC pays tax on the materials and sub is off the hook). The reporting period and tax payment is based on the period when the materials are incorporated into the project.</p> <p>Sourcing of tax: Materials purchased tax-exempt via Form 5000, and later incorporated into an MRRA project will be sourced at the project location.</p>	
8	What happens if, upon audit, an MRRA project is determined to be a prime contracting project?		<p>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.</p>	<p>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.</p>
9	Use tax		<p>All materials purchased tax-free for incorporation or fabrication into an MRRA project, if they are not otherwise exempt from tax, will now be subject to an amount equal to retail TPT at the job location.</p>	<p>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 an MRRA project.</p>

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 on as legal or tax advice.

Item #	Issue			COMMENTS TO 2015 CHANGES
			Based on changes in SB1446/HB2590	
10	Change orders		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.	
11	Job Order Contracting		Job order contracting (JOC) is a contracting method by which an owner engages a contractor for a specific duration or general scope of services which may be MRRA, or a combination of these activities.	Each work order shall be considered separately when determining whether the work order/contract is a nontaxable MRRA contract or a taxable prime contracting contract.
12	De Minimis test		Any MRRA project that includes more than 15% of Modification activities becomes subject to Prime Contracting tax	Remember that Modification does not include certain activities "necessary" for MRRA (See item 1 above)
13	Safe Harbor		Retroactivity: For bids submitted or contracts entered into, or any other binding obligation executed prior to May 1, 2015, the contractor may treat such contracts as: a) prime contracting, with receipts taxed in accordance with A.R.S. Section 42-5075, or b) MRRA, with post 1/1/15 receipts not taxed, 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 MRRA. 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 surface/subsurface work		Contracts for surface or subsurface improvements subject to Titles 28 and 34 will NOT be subject to MRRA treatment. Applies to contracts with ADOT, cities, counties and certain taxing districts	There are many Special Taxing Districts that are not excluded here; the State is not excluded, other than ADOT; NOTE: Private owners will not be exempt

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 on as legal or tax advice.

Item #	Issue			COMMENTS TO 2015 CHANGES
			Based on changes in SB1446/HB2590	
15	Exempting certain projects and materials previously exempt under prime contracting		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 retain their exempt status for MRRRA projects	
16	ROC requires TPT license		Eliminates TPT license requirement for ROC license	
17	City and County Permits - TPT license requirement		Eliminates TPT license requirement as a condition for issuing permits	
18	Landscaping activities		Statutory language was included 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.

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 on as legal or tax advice.