

ARIZONA STATE SENATE

RESEARCH STAFF



TO: MEMBERS OF THE SENATE
APPROPRIATIONS COMMITTEE

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SUBJECT: Strike everything amendment to H.B. 2111, relating to transaction privilege tax changes

Purpose

Makes a variety of changes to the transaction privilege tax (TPT) system.

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, (http://www.azgovernor.gov/tpt/documents/Materials/TPT_121312_TaskForceFinalReport.pdf) and includes the following recommendations:

- a) state and local governmental entities, in cooperation with taxpayers, should aggressively work to standardize the tax base, definitions and interpretations of taxable transactions to the maximum extent possible;
- b) any future proposal to the tax base by the state or a municipality should be scrutinized and not enacted without a clear understanding of the potential impact of such a change of state and local standardization and budgets;
- c) statewide TPT administration;
- d) standardized TPT licensing for the state, cities and towns;
- e) an online portal, as required by H.B. 2466 (2012), to be expanded to have all licenses issued and all TPT returns filed through the portal;

- f) a single audit, in accordance with existing statutory schedules, including a multi-jurisdictional audit if applicable;
- g) continued monitoring and feedback by state and local governments and taxpayers regarding federal legislation allowing state taxation of online retail and remote sales;
- h) action by the Arizona State Legislature to ensure Arizona is well-positioned to benefit from the taxation of online retail and remote sales by passing legislation clarifying that taxable transactions are sourced at the destination for both state and local taxes;
- i) continued economic analysis of the impact of taxation on online retail and remote sales; and
- j) transition to a tax on materials at the point of sale;

According to a memorandum provided by the Joint Legislative Budget Committee (JLBC), the fiscal impact associated with this legislation is difficult to determine due to data limitations.

Provisions

Elimination of Prime Contracting Classification

1. Eliminates the prime contracting classification and conforms statute to reflect the removal as follows:
 - a) removes the requirement that the Arizona Commerce Authority certify prime contractors that contract for the construction of any building, project, development or improvement owned by a qualified business for a project that promotes forest health in the state for the purpose of a deduction from the tax base for prime contracting;
 - b) eliminates language allowing for an exemption from TPT for contracting activities in a military reuse zone;
 - c) repeals statute regarding taxpayer security in regards to out-of-state prime contractors;
 - d) removes the tax increase exemption for contracts entered into or written bids by prime contractors on or before the effective date of the legislation or the date of the election enacting the increase; and
 - e) eliminates the revenue-sharing requirement with the Tourism and Sports Authority of the amount designated as the distribution base received from prime contractors conducting business at an Authority-owned and operated multipurpose facility.
2. Replaces the prime contracting classification with the manufactured building dealer classification as follows:
 - a) includes businesses that sell manufactured buildings;
 - b) maintains the current tax base used for the prime contracting classification; and
 - c) eliminates all deductions from the gross proceeds of sales or gross income currently provided for the prime contracting classification except:
 - i. the sales price of land, which is prohibited from exceeding fair market value; and
 - ii. the sales price of furniture, furnishings, fixtures, appliances and attachments not incorporated as component parts of or attached to a manufactured building or setup site;
 - d) applies all of the following in determining taxable location of sales in the state of manufactured buildings:
 - i. for sales where the manufactured building dealer contracts to deliver the building to a setup site or to perform the setup, the taxable location is the setup site;

- ii. for sales where the manufactured building dealer does not contract to deliver the building to a setup site or does not perform the setup, the taxable location is the location of the dealership where the building is delivered to the buyer; and
 - iii. for sales where the manufactured building dealer contracts to deliver the building to a setup site that is outside of the state, the taxable location is outside the state and the transaction is excluded from tax; and
- e) defines *manufactured building dealer* as a dealer who either:
- i. is licensed and sells manufactured buildings to the final consumer; or
 - ii. supervises, performs or coordinates the excavation and completion of site improvements or the setup or moving of a manufactured building, including the contracting, if any, with any subcontractor or specialty contractor for the completion of the contract.
3. Clarifies that *sale of a used manufactured building* does not include a lease of a used manufactured building.
4. Repeals statute regarding the owner builder sales classification beginning January 1, 2014.
5. Replaces references to the current 20 percent rate for revenue-sharing under the prime contracting classification with the current 40 percent rate under the retail classification.

Highway, Street and Bridge Construction Classification

6. Establishes the highway, street and bridge construction (HSBC) TPT classification comprised of the business of constructing, a highway, street or bridge and conforms statute to reflect the establishment of the classification.
7. Establishes the tax base for the HSBC classification as 65 percent of the gross proceeds of sales or gross income derived from business.
8. Specifies amounts in the HSBC classification that are deducted from the tax base.
9. Stipulates that subcontractors who perform services with respect to the construction, alteration or repair of a highway, street or bridge are not subject to tax under the HSBC classification if it can be demonstrated that the job was within the control of a contractor liable for the tax on the gross income, gross proceeds of sales or receipts attributable to the job for the which the subcontractor was paid.
10. Requires the Department of Revenue (DOR) to prescribe a form for a certificate to be used to establish entitlement to the deduction of TPT relating to highway, street and bridge construction.
11. Requires a highway, street or bridge contractor to obtain a new certificate for each project and is subject to the following requirements and conditions:
- a) a HSBC contractor can use a certificate only with respect to materials that will be incorporated into a highway, street or bridge;
 - b) DOR must issue a certificate to HSBC contractors on receiving sufficient documentation to establish that the HSBC contractor meets statutory requirements;

- c) if a HSBC contractor that has a delinquent tax balance, DOR is prohibited from issuing a certificate; and
- d) any deductions from the use of a certificate are subject to recapture if DOR establishes that a HSBC contractor has failed to meet statutory requirements.

12. Stipulates that any increase in the TPT rate by the legislature or a vote of the people does not apply to contracts entered into or written bids made by HSBC contractors on or before the effective date of the legislation or the date of the election enacting the increase.

13. Defines terms.

Distribution of Revenues for City, Town or County Infrastructure Improvements Related to Manufacturing Facilities

14. Stipulates that revenues paid to cities, towns or counties for public infrastructure improvements for the benefit of a manufacturing facility is the total amount of TPT revenues collected for sales of materials instead of from persons conducting business under the prime contracting classification.

15. Requires revenues to be distributed each month to be paid in equal installments over the life of the contract to construct buildings and associated improvements.

16. Requires a manufacturing facility to provide a copy of the construction contract to the Arizona Commerce Authority and the applicable city, town or county showing the cost of the materials to be used in the construction of buildings and associated improvement for the manufacturing facility.

17. Modifies the written agreement that cities, towns and counties enter into with **DOR** before commencement of the construction of buildings and associated improvements for the benefit of a manufacturing facility as follows:

- a) includes the identify the specific cost of materials used for infrastructure improvements;
- b) removes language requiring the inclusion of the identity of prime contractors on the construction of buildings and associated improvements and to state that each prime contractor has been notified as to which portion of the contractor's income will be separately identified to DOR for purposes of taxation under the prime contracting classification;
- c) specifies cities, towns or counties must agree that any amounts paid by DOR that exceed the amount of TPT paid on the sale of materials used in the construction of buildings or other associated improvements for the benefit of the manufacturing facility; and
- d) removes the requirement for the agreement to state that cities, towns or counties agree that if, upon notification from DOR, the State Treasurer ceases payment due to specified conditions, the municipalities have no claim to additional payments if DOR subsequently pays a prime contractor due to an audit adjustment or claim for credit or refund of certain taxes.

18. Requires the manufacturing facility each year, and on completion of the contract, to construct buildings and improvements to provide a reconciliation of the cost of materials used in the

construction of the buildings and other associated improvements, including amounts representing a reimbursement of TPT paid by the retailer.

Sourcing of Certain Transactions Involving Tangible Personal Property

19. Requires retail sales of tangible personal property, except manufactured buildings, to be sourced as follows:
 - a) to the seller's business location if the seller receives the order at a business located in the state; and
 - b) to the purchaser's location in the state if the seller receives the order at a business located outside the state.
20. Specifies that for the purposes of municipal taxes, the jurisdiction with the right to tax a sale of tangible personal property is the city or town as follows:
 - a) where the order is received:
 - i. an order is received when all of the necessary information to accept the order has been received by or on behalf of the seller, regardless of where the order is accepted or approved, however, the place of business of the purchaser does not determine where the order is received;
 - b) where the stock is located from which the tangible personal property is taken, if the above does not apply to a city or town; and
 - c) where the transfer of title of possession of the tangible personal property occurred, if neither of the above apply to a city or town.
21. Requires the gross receipts from the leasing of tangible personal property to be sourced as follows:
 - a) to the lessor's business location if the lessor has a business in the state; and
 - b) to the lessee's address if the lessor does not have a business location in the state, however, the gross receipts are taxable when the property is shipped, delivered or otherwise brought into the state for use in the state.
22. Defines the following:
 - a) *lessee's address* as the residential address of an individual lessee and the primary business address of any other lessee;
 - b) *lessor's business location* as the business address that appears on the lessor's TPT license; and
 - c) *seller's business location* as the location where:
 - i. the order is received;
 - ii. the stock is located from which the tangible personal property is taken; or
 - iii. the transfer of title or possession occurs.
23. Removes the TPT exemption for the sales of tangible personal property shipped or delivered directly to a destination outside the United States for use in that country.
24. Exempts TPT under the retail sales classification for sales of tangible property to be incorporated or installed as part of environment response or remediation activities.

25. Stipulates that the sale of tangible personal property to a contractor, regardless of whether it will be incorporated into a building or structure, is considered a sale at retail and is subject to TPT under the retail classification unless the contractor provides a certificate signed by the owner of the property to be improved and states that the personal property purchased will be used for purposes identified under the retail classification exemption.
26. States that if a person who is in the business of selling tangible personal property at retail also engages in business as a contractor and removes tangible personal property from retail stock for use in contracting activities, the purchase price must be subject to use tax.
27. Specifies that TPT under the retail classification and use tax does not apply to tangible personal property sold to a person by reason of being engaged in business under the manufactured building dealer or HSBC classification or to a subcontractor working under the control of a HSBC contractor, is the property sold is:
 - a) to be incorporated or fabricated by the person into a manufactured building; or
 - b) to be incorporated or fabricated into a highway, street or bridge.
28. Exempts tangible personal property purchased or to be incorporated or installed as part of site preparation, constructing, furnishing or installing machinery, equipment or other property, including structures necessary to protect exempt incorporated materials to perform certain action in response to a release or suspected release of a hazardous substance, pollutant or contaminant from a facility from TPT under the retail classification and use tax.
29. Exempts tangible personal property sold to a qualified business if the property sold is to be incorporated or fabricated into a building, or other structure, project, development or improvement for harvesting or processing qualifying forest products from TPT under the retail classification and requires the qualified business to present its approved DOR certification at the time of purchase in order to qualify for the deduction.
30. Specifies that sales of machinery and equipment or other tangible personal property used by a contractor in the performance of a contract are not exempt from TPT and use tax.

Collection and Administration of TPT and Affiliated Excise Taxes

31. Requires, rather than allows, DOR to collect and administer any TPT and affiliated excise taxes imposed by any city or town.
27. Requires DOR to provide a coordinated electronic method for collecting state and municipal TPT and affiliated excise taxes.
32. Requires, rather than allows, DOR and any city or town to enter into intergovernmental contracts or agreements to provide a uniform method of administration, collection, audit and licensing of TPT and affiliated taxes imposed by the state, cities or towns.
33. Removes language requiring a city or town to report the total amount of taxes collected in the preceding year if an agreement is not entered into for the collection of municipal TPT and affiliated taxes.

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34. Requires DOR to establish a uniform licensing, collection and audit committee with cities and towns.
35. Removes language allowing a taxpayer who is required to pay municipal TPT and affiliated taxes to a city or town that has not entered into an agreement with DOR to provide a coordinated method of collecting those taxes to report and pay through an online portal.
36. Stipulates that cities and towns must utilize procedures used by DOR for the levy, collection and enforcement of TPT and affiliated taxes.
37. Clarifies that cities and towns are prohibited from employing auditors or entering into contracts with a third party, other than the state, for the collection, administration or processing of TPT or affiliated taxes levied by cities or towns.
38. Eliminates the municipal TPT and affiliated tax exemption on the gross proceeds of sales or gross income derived for any amount attributable to development fees incurred in relation to the construction, development or improvement of real property and paid by the taxpayer as defined in the Model City Tax Code (MCTC) or by a contractor providing services to the taxpayer.
39. Exempts municipal TPT and affiliated taxes on the gross proceeds of sales or gross income derived from construction contracting, owner builder sales or speculative building.
40. Declares that county excise taxes do not apply to the gross proceeds of sales or gross proceeds of sales or gross income derived from contracts entered into before the date of the election to authorize the tax by HSBC contractors unless stipulated.
41. Stipulates that if a county levies one or more excise taxes, and if approved by voters in a county-wide election, the county can levy an excise tax equal to the sum of the rates of all excise taxes levied by the county on the storage, use or consumption of tangible personal property purchased from a retailer, as a percentage of the sales price.
42. Requires a county that seeks to levy future excise taxes to include in the levy an excise tax at the same rate on the storage, use or consumption in the county of tangible personal property purchased from the retailer.
43. Permits a county jail district and a public health services district that levy excise taxes, upon voter approval, to levy an excise tax, to be collected by DOR, on the storage, use or consumption in the county of tangible personal property purchased from a retailer or utility business, as a percentage of the sales price.
44. Permits the governing body of an incorporated city or town and DOR to enter into an agreement whereby:
 - a) DOR will furnish part or full-time auditors within the boundaries of the city or town; and
 - b) the incorporated city or town will pay DOR an agreed amount for audit services.
53. Equalizes the county jet fuel tax base with the state tax base.

Unified Audit Committee

45. Specifies that a taxpayer that conducts business in more than one jurisdiction is subject to a single audit for all taxing jurisdictions.
46. Removes language in regards to joint audits for cities and towns.

Municipal Contracting Excise Tax

47. Establishes the municipal contracting excise tax.
48. Establishes the residential and commercial contracting (RCC) classification in the municipal contracting excise tax base.
49. Specifies that the RCC classification is comprised of the business of residential and commercial contracting.
50. Stipulates that the tax base for the RCC classification is 65 percent of the gross proceeds of sales or gross income derived from the business.
51. Specifies amounts in the RCC that are deducted from the municipal contracting excise tax base.
52. Stipulates services that are subject and not subject to municipal contracting excise tax.
53. States that a person owning real property who enters into for the sale of real property, who is responsible to the new owner of the property for modifications to the property in the period subsequent to the transfer of title and receives a consideration for the modifications is considered a residential or commercial contractor solely for the purposes of taxing the gross proceeds of sale or gross income received for the modifications made subsequent to the transfer of title.
54. Includes the HSBC classification in the municipal contracting excise tax.
55. Specifies amounts in the HSBC classification that are deducted from the municipal contracting excise tax base.
56. Defines terms.

Use Tax

57. Requires, instead of allows, the board of directors of a county jail district that levies an excise tax to also levy a use tax on the storage, use or consumption in the county of tangible property purchased from a retailer or utility business, as a percentage of the sales price.
58. Removes language permitting the board of directors of a county jail district that levies an excise tax to also levy a use tax, to be collected by DOR, on each retail electric or natural gas customer in the district and subject to use tax pursuant to statute.

59. Requires the State Treasurer to remit to the treasurer of a public health services district the net revenues from TPT and affiliated taxes, including use tax, levied by the district.
60. Requires the board of directors of a public health services district that levies an excise tax to also levy a use tax, to be collected by DOR, on the storage, use or consumption in the county of tangible personal property purchased from a retailer, as a percentage of the sales price.
61. Stipulates that for the purposes of defining *subcontractor*, *contractor* has its ordinary and common meaning.
62. Specifies that tangible personal property purchased before January 1, 2015, by a person under the current prime contracting classification or who performed contracting services within the control of a prime contractor and was not incorporated into a project for which the contract was entered into before January 1, 2015, is subject to use tax.
63. Declares that tangible personal property purchased before January 1, 2015, by a person engaged in business under the construction contracting, owner builder or speculative builder classification or who performed contracting services within the control of a construction contractor, owner builder or speculative builder pursuant to the construction contracting sections of the MCTC and was not incorporated into a project for which the contract was entered into before January 1, 2015, is subject to use tax under the MCTC.

Preexisting Contracts

64. Specifies that tax liability is not affected for prime contracting, construction contracting, owner-builder or speculative builder contracts entered into pursuant to the MCTC prior to January 1, 2015.
65. Stipulates that TPT and affiliated taxes are levied and must be collected at a rate of five and six-tenths percent of the tax base under the prime contracting classification as it exists on the date immediately preceding the effective date for contracts entered into prior to January 1, 2015.
66. Requires prime contractors to maintain and provide to DOR, on request, documentation regarding payments received for contracts subject to taxation under the prime contracting classification.
67. Stipulates that 20 percent of the tax revenues collected from contracts entered into before January 1, 2015, is designated as distribution base for revenue-sharing purposes prescribed by statute.
68. Requires TPT imposed by an incorporated city town to be levied and collected at the rate in effect on December 31, 2014, as determined by the MCTC, derived pursuant to contracts entered into prior to January 1, 2015, by construction, contractors, owner builders and speculative builders subject to tax under the MCTC prior to January 1, 2015, unless the contract does not contain a provision that entitles the taxpayer to recover the amount of the tax.
69. Specifies that county excise taxes apply to the tax base as determined pursuant to the prime contracting and owner builder sales classifications in effect on December 31, 2014, derived

pursuant to contracts entered into after the date of election to authorize the tax and before January 1, 2015, by prime contractors and owner builders who engage in business pursuant to statute.

70. Declares that contracts entered into before the date of election to authorize the tax by prime contractors and owner builders who engage in business under the prime contracting and owner builder classifications are subject to county excise tax on the tax base determined by statute as in effect on December 31, 2014, unless the contract does not contain a provision that entitles the taxpayer to recover the amount of the tax from a purchaser.
71. Stipulates that, unless the context otherwise requires, current administrative procedures for levying and collecting TPT and affiliated taxes govern the administration of the tax imposed on preexisting contracts.

Preexisting Tax Exempt Contracts

72. Effective January 1, 2015, the sale of tangible personal property to a contractor for incorporation or fabrication, pursuant to a contract entered into prior to January 1, 2015, into any project subject to deduction under the prime contracting classification, as in effect on December 31, 2014, is not subject to retail TPT.
73. Effective January 1, 2015, the sale of tangible personal property to a construction contractor, owner builder or speculative builder for incorporation or fabrication pursuant to a contract entered into before January 1, 2015, into any project that subject to deduction under the MCTC, as in effect on December 31, 2014, is not subject to use tax under the MCTC.

City and Town Auditors

74. Effective January 1, 2015 through December 31, 2015, DOR is required to enter into an agreement with the governing body of an incorporated city or town to furnish part and full-time auditors within the city or town.
75. Requires the incorporated city or town to pay DOR an agreed amount for auditor services.

Rate Limitation

76. Prohibits an incorporated city or town from imposing a municipal contracting excise tax rate higher than the rate imposed on construction contracting, speculative builder or owner-builder as in effect on December 31, 2012.

Effective Dates

77. Provides an effective date of January 1, 2014, for changes to the following sections:
 - a) sourcing of certain transactions involving tangible personal property;
 - b) county use tax;
 - c) county transportation excise tax; and
 - d) county, county jail district and public health services district excise taxes.

78. Provides an effective date of January 1, 2015, for changes to the following sections:
- a) highway, street and bridge classification;
 - b) municipal contracting excise tax;
 - c) residential and commercial contracting classification;
 - d) healthy forest enterprise incentives;
 - e) tax incentives related to military reuse zones;
 - f) administrative provisions related to delinquent taxpayers;
 - g) definitions related to administrative provisions for TPT and affiliated taxes;
 - h) taxpayer bonds for out-of-state licensed contractors and manufactured building dealers;
 - i) certificates for establishing tax deductions and liability for making a false certificate;
 - j) rates related to the distribution base;
 - k) distribution on monies designated as distribution base;
 - l) revenue distribution for the Tourism and Sports Authority;
 - m) distribution of revenues for city, town or county infrastructure improvements for manufacturing facilities;
 - n) retail classification;
 - o) personal property rental classification;
 - p) mining classification;
 - q) prime contracting classification;
 - r) use tax definitions;
 - s) use tax rate and purchaser's liability;
 - t) use tax exemptions;
 - u) use tax liability;
 - v) collection and administration of TPT and affiliated taxes, coordinated licensing and collection and audit functions;
 - w) municipal procedures for levy, collection and enforcement of TPT and affiliated taxes,
 - x) municipal tax exemptions;
 - y) unified audit committee;
 - z) county excise tax administrative procedures exemptions;
 - aa) credit for increased excise taxes paid;
 - bb) replacement of motor vehicle or refund of monies; and
 - cc) exemption from water quality permit requirements.

Miscellaneous

79. Stipulates that in regards to the general administrative purposes for TPT, the definition used for *contracting* and *contractor* is the same that is currently used for prime contracting classification;
80. Allows DOR to adopt emergency rules necessary for implementation purposes.
81. Makes technical and conforming changes.
82. Becomes effective on the general effective date with delayed effective dates as noted.

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