

Joint Legislative Budget Committee Staff
Fiscal Memorandum

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DATE: February 21, 2023

TO: Richard Stavneak, Director

FROM: Hans Olofsson, Chief Economist

SUBJECT: REVISED ESTIMATE OF SB 1263 (BUSINESS PERSONAL PROPERTY; TAX EXEMPTION)
WITH PROPOSED FLOOR AMENDMENT

This memo provides a revised estimate of the SB 1263 fiscal note issued on February 13, 2023. The proposed legislation would exempt personal property that is used for agricultural purposes or in a trade or business from property taxation, beginning in Tax Year (TY) 2024. The revision is based on a) correcting information found in the Department of Revenue's (DOR) State and County Abstract of Assessments and b) a proposed Senate floor amendment to make a technical change to the Senate Finance Committee amendment.

Estimated Impact

Under the original fiscal note (see attached), the bill's General Fund cost was estimated to be \$154.9 million in FY 2025 prior to applying state's Truth-in-Taxation (TNT) adjustment of the statutory K-12 tax rate known as the Qualifying Tax Rate (QTR). After the TNT rate adjustment, the General Fund cost was estimated to be \$47.8 million.

The bill's pre-TNT cost is now estimated to be \$65.2 million while the projected post-TNT cost is \$19.5 million, beginning in FY 2025.

Analysis

After the release of the February 13th fiscal note, two different changes have come to our attention that reduce the fiscal impact. First, the estimated Net Assessed Valuation (NAV) loss was overstated by \$2.8 billion due to erroneous data published in the Department of Revenue's *State and County 2022 Abstract of the Assessment Roll*. Second, the Senate Finance Committee amendment erroneously exempted the personal property of electric cooperatives from taxation, which had the effect of overstating the NAV loss by an additional \$77.5 million. The proposed floor amendment includes a correction for this error along with other technical changes.

We have attached the original fiscal note which describes the bill in more detail. We will update the fiscal note if the floor amendment is adopted.

HO:jbu



Fiscal Note

BILL # SB 1263

TITLE: business personal property; tax exemption

SPONSOR: Mesnard

STATUS: As Amended by Senate FIN

PREPARED BY: Hans Olofsson

Description

SB 1263, as amended by the Senate Finance Committee, exempts personal property that is used for agricultural purposes or in a trade or business from property taxation. The bill would become effective beginning in Tax Year (TY) 2024.

Estimated Impact

We estimate that the bill would have a General Fund cost of \$154.9 million, beginning in FY 2025 prior to applying the state's Truth-in-Taxation (TNT) adjustments. The proposal would reduce Net Assessed Valuation (NAV), which would increase the state's Basic State Aid (BSA) cost for K-12 schools.

The \$154.9 million cost increase would be partially offset by savings attributable to the automatic school tax rate adjustments provided under the state's TNT provisions. Once TNT savings are incorporated, the General Fund cost would be reduced from \$154.9 million to \$47.8 million, beginning in FY 2025. This estimate includes the bill's impact on both Basic State Aid (BSA) and the Homeowner's Rebate (HOR) program.

Analysis

Based on the Arizona Department of Revenue's *2022 Abstract of the Assessment Roll*, we estimate that the bill would reduce statewide NAV by \$(5.0) billion. Based on the 15 counties' levy limit worksheets, we estimate that 86% of this loss, or \$(4.3) billion would be for existing property and the remaining 14%, or \$(0.7) billion would be for new property.

Pre-TNT Impact – By reducing NAV by \$(5.0) billion in TY 2024, the proposal would result in a direct BSA cost increase of \$154.9 million, beginning in FY 2025, of which \$132.5 million would be attributable to the reduction of existing NAV and the remaining \$22.4 million due to loss of new NAV. Prior to TNT, there would be no impact on the HOR program since Class 3 (primary residential property) NAV would not be affected by the bill.

Post-TNT Impact - The NAV reduction under the proposal would have an impact on the state's TNT program. Under TNT, the Qualifying Tax Rate (QTR) is adjusted each year to offset the statewide annual valuation change of existing property. This rate change occurs automatically unless the Legislature decides to forgo the TNT adjustment. Due to the \$(4.3) billion NAV loss of existing property, the TNT adjustment would result in the estimated QTR being \$0.17 higher in FY 2025 under the proposal than under current law. Under TNT, the \$0.17 higher QTR ensures that the QTR levy on existing property would be the same under the bill as under current law. This means that the \$132.5 million BSA cost increase attributable to the loss of existing NAV prior to TNT is exactly offset by a \$(132.5) million in BSA savings due to the higher QTR after TNT. Therefore, the bill would have no impact on the BSA cost with respect to existing NAV.

As noted above, prior to TNT, the \$(0.7) billion NAV loss of new property under the bill would result in a BSA cost increase of \$22.4 million. The \$0.17 higher QTR after TNT would reduce this cost increase by \$(2.0) million, for a net BSA cost increase of \$20.4 million in FY 2025.

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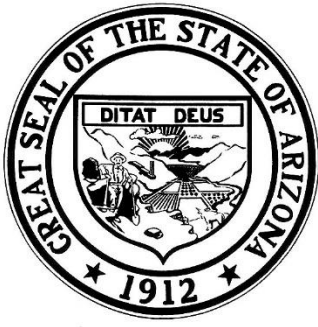


Under the HOR program, the state pays 50% of the QTR levied on Class 3 property. The remaining 50% is paid by the homeowner. Other classes of property do not receive the homeowner's rebate. While the bill would leave Class 3 NAV unchanged, the \$0.17 higher QTR levied on Class 3 property after TNT would raise the HOR cost by an estimated \$27.4 million in FY 2025. Therefore, after the application of TNT, the bill would result in total General Fund cost increase of \$47.8 million in FY 2025 [= \$20.4 million BSA cost + \$27.4 million HOR cost].

Local Government Impact

Lower property values as a result of the bill could reduce property tax collections for local tax jurisdictions or result in a tax shift to other property owners.

2/13/23



Bill Number: S.B. 1263

Mesnard Floor Amendment

Reference to: Finance Committee Amendment

Amendment drafted by: Leg Council

FLOOR AMENDMENT EXPLANATION

- 1. Reinserts, into the class 1 property classification, the centrally assessed personal property of electric cooperatives.**
- 2. Makes technical and conforming changes.**

Amendment explanation prepared by Molly Graver

02/20/2023

MESNARD FLOOR AMENDMENT
SENATE AMENDMENTS TO S.B. 1263
(Reference to FINANCE Committee amendment)

1 Page 34, after line 32, insert:

2 "Sec. 5. Section 42-5075, Arizona Revised Statutes, is amended to
3 read:

4 42-5075. Prime contracting classification; exemptions; definitions

5 A. The prime contracting classification is comprised of the business
6 of prime contracting and the business of manufactured building dealer. Sales
7 for resale to another manufactured building dealer are not subject to tax.
8 Sales for resale do not include sales to a lessor of manufactured buildings.
9 The sale of a used manufactured building is not taxable under this
10 chapter. The prime contracting classification does not include any work or
11 operation performed by a person that is not required to be licensed by the
12 registrar of contractors pursuant to section 32-1121.

13 B. The tax base for the prime contracting classification is sixty-five
14 percent of the gross proceeds of sales or gross income derived from the
15 business. The following amounts shall be deducted from the gross proceeds
16 of sales or gross income before computing the tax base:

17 1. The sales price of land, which shall not exceed the fair market
18 value.

19 2. Sales and installation of groundwater measuring devices required
20 under section 45-604 and groundwater monitoring wells required by law,
21 including monitoring wells installed for acquiring information for a permit
22 required by law.

23 3. The sales price of furniture, furnishings, fixtures, appliances
24 and attachments that are not incorporated as component parts of or attached
25 to a manufactured building or the setup site. The sale of such items may be

1 subject to the taxes imposed by article 1 of this chapter separately and
2 distinctly from the sale of the manufactured building.

3 4. The gross proceeds of sales or gross income received from a
4 contract entered into for the modification of any building, highway, road,
5 railroad, excavation, manufactured building or other structure, project,
6 development or improvement located in a military reuse zone for providing
7 aviation or aerospace services or for a manufacturer, assembler or fabricator
8 of aviation or aerospace products within an active military reuse zone after
9 the zone is initially established or renewed under section 41-1531. To be
10 eligible to qualify for this deduction, before beginning work under the
11 contract, the prime contractor must have applied for a letter of
12 qualification from the department of revenue.

13 5. The gross proceeds of sales or gross income derived from a contract
14 to construct a qualified environmental technology manufacturing, producing
15 or processing facility, as described in section 41-1514.02, and from
16 subsequent construction and installation contracts that begin within ten
17 years after the start of initial construction. To qualify for this
18 deduction, before beginning work under the contract, the prime contractor
19 must obtain a letter of qualification from the department of revenue. This
20 paragraph shall apply for ten full consecutive calendar or fiscal years after
21 the start of initial construction.

22 6. The gross proceeds of sales or gross income from a contract to
23 provide for one or more of the following actions, or a contract for site
24 preparation, constructing, furnishing or installing machinery, equipment or
25 other tangible personal property, including structures necessary to protect
26 exempt incorporated materials or installed machinery or equipment, and
27 tangible personal property incorporated into the project, to perform one or
28 more of the following actions in response to a release or suspected release
29 of a hazardous substance, pollutant or contaminant from a facility to the
30 environment, unless the release was authorized by a permit issued by a
31 governmental authority:

1 (a) Actions to monitor, assess and evaluate such a release or a
2 suspected release.

3 (b) Excavation, removal and transportation of contaminated soil and
4 its treatment or disposal.

5 (c) Treatment of contaminated soil by vapor extraction, chemical or
6 physical stabilization, soil washing or biological treatment to reduce the
7 concentration, toxicity or mobility of a contaminant.

8 (d) Pumping and treatment or in situ treatment of contaminated
9 groundwater or surface water to reduce the concentration or toxicity of a
10 contaminant.

11 (e) The installation of structures, such as cutoff walls or caps, to
12 contain contaminants present in groundwater or soil and prevent them from
13 reaching a location where they could threaten human health or welfare or the
14 environment.

15 This paragraph does not include asbestos removal or the construction
16 or use of ancillary structures such as maintenance sheds, offices or storage
17 facilities for unattached equipment, pollution control equipment, facilities
18 or other control items required or to be used by a person to prevent or
19 control contamination before it reaches the environment.

20 7. The gross proceeds of sales or gross income that is derived from
21 a contract for the installation, assembly, repair or maintenance of
22 machinery, equipment or other tangible personal property that is either
23 deducted from the tax base of the retail classification under section
24 42-5061, subsection B or that is exempt from use tax under section 42-5159,
25 subsection B and that has independent functional utility, pursuant to the
26 following provisions:

27 (a) The deduction provided in this paragraph includes the gross
28 proceeds of sales or gross income derived from all of the following:

29 (i) Any activity performed on machinery, equipment or other tangible
30 personal property with independent functional utility.
31

1 (ii) Any activity performed on any tangible personal property relating
2 to machinery, equipment or other tangible personal property with independent
3 functional utility in furtherance of any of the purposes provided for under
4 subdivision (d) of this paragraph.

5 (iii) Any activity that is related to the activities described in
6 items (i) and (ii) of this subdivision, including inspecting the installation
7 of or testing the machinery, equipment or other tangible personal property.

8 (b) The deduction provided in this paragraph does not include gross
9 proceeds of sales or gross income from the portion of any contracting activity
10 that consists of the development of, or modification to, real property in
11 order to facilitate the installation, assembly, repair, maintenance or
12 removal of machinery, equipment or other tangible personal property that is
13 either deducted from the tax base of the retail classification under section
14 42-5061, subsection B or exempt from use tax under section 42-5159,
15 subsection B.

16 (c) The deduction provided in this paragraph shall be determined
17 without regard to the size or useful life of the machinery, equipment or
18 other tangible personal property.

19 (d) For the purposes of this paragraph, "independent functional
20 utility" means that the machinery, equipment or other tangible personal
21 property can independently perform its function without attachment to real
22 property, other than attachment for any of the following purposes:

23 (i) Assembling the machinery, equipment or other tangible personal
24 property.

25 (ii) Connecting items of machinery, equipment or other tangible
26 personal property to each other.

27 (iii) Connecting the machinery, equipment or other tangible personal
28 property, whether as an individual item or as a system of items, to water,
29 power, gas, communication or other services.

30

1 (iv) Stabilizing or protecting the machinery, equipment or other
2 tangible personal property during operation by bolting, burying or performing
3 other similar nonpermanent connections to either real property or real
4 property improvements.

5 8. The gross proceeds of sales or gross income attributable to the
6 purchase of machinery, equipment or other tangible personal property that is
7 exempt from or deductible from transaction privilege and use tax under:

8 (a) Section 42-5061, subsection A, paragraph 25, 29 or 58.

9 (b) Section 42-5061, subsection B.

10 (c) Section 42-5159, subsection A, paragraph 13, subdivision (a),
11 (b), (c), (d), (e), (f), (j), (k), (m) or (n) or paragraph 55.

12 (d) Section 42-5159, subsection B.

13 9. The gross proceeds of sales or gross income received from a
14 contract for the construction of an environmentally controlled facility for
15 the raising of poultry for the production of eggs and the sorting, cooling
16 and packaging of eggs.

17 10. The gross proceeds of sales or gross income that is derived from
18 a contract entered into with a person who is engaged in the commercial
19 production of livestock, livestock products or agricultural, horticultural,
20 viticultural or floricultural crops or products in this state for the
21 modification of any building, highway, road, excavation, manufactured
22 building or other structure, project, development or improvement used
23 directly and primarily to prevent, monitor, control or reduce air, water or
24 land pollution.

25 11. The gross proceeds of sales or gross income that is derived from
26 the installation, assembly, repair or maintenance of clean rooms that are
27 deducted from the tax base of the retail classification pursuant to section
28 42-5061, subsection B, paragraph 17.

29 12. For taxable periods beginning from and after June 30, 2001, the
30 gross proceeds of sales or gross income derived from a contract entered into
31 for the construction of a residential apartment housing facility that
32

1 qualifies for a federal housing subsidy for low-income persons over sixty-two
2 years of age and that is owned by a nonprofit charitable organization that
3 has qualified under section 501(c)(3) of the internal revenue code.

4 13. For taxable periods beginning from and after December 31, 1996
5 and ending before January 1, 2017, the gross proceeds of sales or gross
6 income derived from a contract to provide and install a solar energy
7 device. The contractor shall register with the department as a solar energy
8 contractor. By registering, the contractor acknowledges that it will make
9 its books and records relating to sales of solar energy devices available to
10 the department for examination.

11 14. The gross proceeds of sales or gross income derived from a
12 contract entered into for the construction of a launch site, as defined in
13 14 Code of Federal Regulations section 401.5.

14 15. The gross proceeds of sales or gross income derived from a
15 contract entered into for the construction of a domestic violence shelter
16 that is owned and operated by a nonprofit charitable organization that has
17 qualified under section 501(c)(3) of the internal revenue code.

18 16. The gross proceeds of sales or gross income derived from contracts
19 to perform postconstruction treatment of real property for termite and
20 general pest control, including wood-destroying organisms.

21 17. The gross proceeds of sales or gross income received from
22 contracts entered into before July 1, 2006 for constructing a state
23 university research infrastructure project if the project has been reviewed
24 by the joint committee on capital review before the university enters into
25 the construction contract for the project. For the purposes of this
26 paragraph, "research infrastructure" has the same meaning prescribed in
27 section 15-1670.

28 18. The gross proceeds of sales or gross income received from a
29 contract for the construction of any building, or other structure, project,
30 development or improvement owned by a qualified business under section
31

1 41-1516 for harvesting or processing qualifying forest products removed from
2 qualifying projects as defined in section 41-1516 if actual construction
3 begins before January 1, 2024. To qualify for this deduction, the prime
4 contractor must obtain a letter of qualification from the Arizona commerce
5 authority before beginning work under the contract.

6 19. Any amount of the gross proceeds of sales or gross income
7 attributable to development fees that are incurred in relation to a contract
8 for construction, development or improvement of real property and that are
9 paid by a prime contractor or subcontractor. For the purposes of this
10 paragraph:

11 (a) The attributable amount shall not exceed the value of the
12 development fees actually imposed.

13 (b) The attributable amount is equal to the total amount of
14 development fees paid by the prime contractor or subcontractor, and the total
15 development fees credited in exchange for the construction of, contribution
16 to or dedication of real property for providing public infrastructure, public
17 safety or other public services necessary to the development. The real
18 property must be the subject of the development fees.

19 (c) "Development fees" means fees imposed to offset capital costs of
20 providing public infrastructure, public safety or other public services to
21 a development and authorized pursuant to section 9-463.05, section 11-1102
22 or title 48 regardless of the jurisdiction to which the fees are paid.

23 20. The gross proceeds of sales or gross income derived from a
24 contract entered into for the construction of a mixed waste processing
25 facility that is located on a municipal solid waste landfill and that is
26 constructed for the purpose of recycling solid waste or producing renewable
27 energy from landfill waste. For the purposes of this paragraph:

28 (a) "Mixed waste processing facility" means a solid waste facility
29 that is owned, operated or used for the treatment, processing or disposal of
30 solid waste, recyclable solid waste, conditionally exempt small quantity
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1 generator waste or household hazardous waste. For the purposes of this
2 subdivision, "conditionally exempt small quantity generator waste",
3 "household hazardous waste" and "solid waste facility" have the same meanings
4 prescribed in section 49-701, except that solid waste facility does include
5 a site that stores, treats or processes paper, glass, wood, cardboard,
6 household textiles, scrap metal, plastic, vegetative waste, aluminum, steel
7 or other recyclable material.

8 (b) "Municipal solid waste landfill" has the same meaning prescribed
9 in section 49-701.

10 (c) "Recycling" means collecting, separating, cleansing, treating and
11 reconstituting recyclable solid waste that would otherwise become solid
12 waste, but does not include incineration or other similar processes.

13 (d) "Renewable energy" means usable energy, including electricity,
14 fuels, gas and heat, produced through the conversion of energy provided by
15 sunlight, water, wind, geothermal, heat, biomass, biogas, landfill gas or
16 ~~other~~ ANOTHER nonfossil renewable resource.

17 21. The gross proceeds of sales or gross income derived from a
18 contract to install containment structures. For the purposes of this
19 paragraph, "containment structure" means a structure that prevents, monitors,
20 controls or reduces noxious or harmful discharge into the environment.

21 C. Entitlement to the deduction pursuant to subsection B, paragraph
22 7 of this section is subject to the following provisions:

23 1. A prime contractor may establish entitlement to the deduction by
24 both:

25 (a) Marking the invoice for the transaction to indicate that the gross
26 proceeds of sales or gross income derived from the transaction was deducted
27 from the base.

28 (b) Obtaining a certificate executed by the purchaser indicating the
29 name and address of the purchaser, the precise nature of the business of the
30 purchaser, the purpose for which the purchase was made, the necessary facts
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1 to establish the deductibility of the property under section 42-5061,
2 subsection B, and a certification that the person executing the certificate
3 is authorized to do so on behalf of the purchaser. The certificate may be
4 disregarded if the prime contractor has reason to believe that the
5 information contained in the certificate is not accurate or complete.

6 2. A person who does not comply with paragraph 1 of this subsection
7 may establish entitlement to the deduction by presenting facts necessary to
8 support the entitlement, but the burden of proof is on that person.

9 3. The department may prescribe a form for the certificate described
10 in paragraph 1, subdivision (b) of this subsection. The department may also
11 adopt rules that describe the transactions with respect to which a person is
12 not entitled to rely solely on the information contained in the certificate
13 provided in paragraph 1, subdivision (b) of this subsection but must instead
14 obtain such additional information as required in order to be entitled to
15 the deduction.

16 4. If a prime contractor is entitled to a deduction by complying with
17 paragraph 1 of this subsection, the department may require the purchaser who
18 caused the execution of the certificate to establish the accuracy and
19 completeness of the information required to be contained in the certificate
20 that would entitle the prime contractor to the deduction. If the purchaser
21 cannot establish the accuracy and completeness of the information, the
22 purchaser is liable in an amount equal to any tax, penalty and interest that
23 the prime contractor would have been required to pay under article 1 of this
24 chapter if the prime contractor had not complied with paragraph 1 of this
25 subsection. Payment of the amount under this paragraph exempts the purchaser
26 from liability for any tax imposed under article 4 of this chapter. The
27 amount shall be treated as a transaction privilege tax to the purchaser and
28 as tax revenues collected from the prime contractor in order to designate
29 the distribution base for purposes of section 42-5029.
30

1 D. Subcontractors or others who perform modification activities are
2 not subject to tax if they can demonstrate that the job was within the
3 control of a prime contractor or contractors or a dealership of manufactured
4 buildings and that the prime contractor or dealership is liable for the tax
5 on the gross income, gross proceeds of sales or gross receipts attributable
6 to the job and from which the subcontractors or others were paid.

7 E. Amounts received by a contractor for a project are excluded from
8 the contractor's gross proceeds of sales or gross income derived from the
9 business if the person who hired the contractor executes and provides a
10 certificate to the contractor stating that the person providing the
11 certificate is a prime contractor and is liable for the tax under article 1
12 of this chapter. The department shall prescribe the form of the
13 certificate. If the contractor has reason to believe that the information
14 contained on the certificate is erroneous or incomplete, the department may
15 disregard the certificate. If the person who provides the certificate is
16 not liable for the tax as a prime contractor, that person is nevertheless
17 deemed to be the prime contractor in lieu of the contractor and is subject
18 to the tax under this section on the gross receipts or gross proceeds received
19 by the contractor.

20 F. Every person engaging or continuing in this state in the business
21 of prime contracting or dealership of manufactured buildings shall present
22 to the purchaser of such prime contracting or manufactured building a written
23 receipt of the gross income or gross proceeds of sales from such activity
24 and shall separately state the taxes to be paid pursuant to this section.

25 G. For the purposes of section 42-5032.01, the department shall
26 separately account for revenues collected under the prime contracting
27 classification from any prime contractor engaged in the preparation or
28 construction of a multipurpose facility, and related infrastructure, that is
29 owned, operated or leased by the tourism and sports authority pursuant to
30 title 5, chapter 8.

1 H. For the purposes of section 42-5032.02, from and after
2 September 30, 2013, the department shall separately account for revenues
3 reported and collected under the prime contracting classification from any
4 prime contractor engaged in the construction of any buildings and associated
5 improvements that are for the benefit of a manufacturing facility. For the
6 purposes of this subsection, "associated improvements" and "manufacturing
7 facility" have the same meanings prescribed in section 42-5032.02.

8 I. The gross proceeds of sales or gross income derived from a contract
9 for lawn maintenance services is not subject to tax under this section if
10 the contract does not include landscaping activities. Lawn maintenance
11 service is a service pursuant to section 42-5061, subsection A, paragraph 1,
12 and includes lawn mowing and edging, weeding, repairing sprinkler heads or
13 drip irrigation heads, seasonal replacement of flowers, refreshing gravel,
14 lawn dethatching, seeding winter lawns, leaf and debris collection and
15 removal, tree or shrub pruning or clipping, garden and gravel raking and
16 applying pesticides, as defined in section 3-361, and fertilizer materials,
17 as defined in section 3-262.

18 J. Except as provided in subsection 0 of this section, the gross
19 proceeds of sales or gross income derived from landscaping activities is
20 subject to tax under this section. Landscaping includes installing lawns,
21 grading or leveling ground, installing gravel or boulders, planting trees
22 and other plants, felling trees, removing or mulching tree stumps, removing
23 other imbedded plants, building irrigation berms, installing railroad ties
24 and installing underground sprinkler or watering systems.

25 K. The portion of gross proceeds of sales or gross income attributable
26 to the actual direct costs of providing architectural or engineering services
27 that are incorporated in a contract is not subject to tax under this section.
28 For the purposes of this subsection, "direct costs" means the portion of the
29 actual costs that are directly expended in providing architectural or
30 engineering services.

1 L. Operating a landfill or a solid waste disposal facility is not
2 subject to taxation under this section, including filling, compacting and
3 creating vehicle access to and from cell sites within the landfill.
4 Constructing roads to a landfill or solid waste disposal facility and
5 constructing cells within a landfill or solid waste disposal facility may be
6 deemed prime contracting under this section.

7 M. The following apply in determining the taxable situs of sales of
8 manufactured buildings:

9 1. For sales in this state where the manufactured building dealer
10 contracts to deliver the building to a setup site or to perform the setup in
11 this state, the taxable situs is the setup site.

12 2. For sales in this state where the manufactured building dealer
13 does not contract to deliver the building to a setup site or does not perform
14 the setup, the taxable situs is the location of the dealership where the
15 building is delivered to the buyer.

16 3. For sales in this state where the manufactured building dealer
17 contracts to deliver the building to a setup site that is outside this state,
18 the situs is outside this state and the transaction is excluded from tax.

19 N. The gross proceeds of sales or gross income attributable to a
20 written contract for design phase services or professional services, executed
21 before modification begins and with terms, conditions and pricing of all of
22 these services separately stated in the contract from those for construction
23 phase services, is not subject to tax under this section, regardless of
24 whether the services are provided sequential to or concurrent with prime
25 contracting activities that are subject to tax under this section. This
26 subsection does not include the gross proceeds of sales or gross income
27 attributable to construction phase services. For the purposes of this
28 subsection:
29

1 1. "Construction phase services" means services for the execution and
2 completion of any modification, including the following:

3 (a) Administration or supervision of any modification performed on
4 the project, including team management and coordination, scheduling, cost
5 controls, submittal process management, field management, safety program,
6 close-out process and warranty period services.

7 (b) Administration or supervision of any modification performed
8 pursuant to a punch list. For the purposes of this subdivision, "punch list"
9 means minor items of modification work performed after substantial completion
10 and before final completion of the project.

11 (c) Administration or supervision of any modification performed
12 pursuant to change orders. For the purposes of this subdivision, "change
13 order" means a written instrument issued after execution of a contract for
14 modification work, providing for all of the following:

15 (i) The scope of a change in the modification work, contract for
16 modification work or other contract documents.

17 (ii) The amount of an adjustment, if any, to the guaranteed maximum
18 price as set in the contract for modification work. For the purposes of
19 this item, "guaranteed maximum price" means the amount guaranteed to be the
20 maximum amount due to a prime contractor for the performance of all
21 modification work for the project.

22 (iii) The extent of an adjustment, if any, to the contract time of
23 performance set forth in the contract.

24 (d) Administration or supervision of any modification performed
25 pursuant to change directives. For the purposes of this subdivision, "change
26 directive" means a written order directing a change in modification work
27 before agreement on an adjustment of the guaranteed maximum price or contract
28 time.

29 (e) Inspection to determine the dates of substantial completion or
30 final completion.

1 (f) Preparation of any manuals, warranties, as-built drawings, spares
2 or other items the prime contractor must furnish pursuant to the contract
3 for modification work. For the purposes of this subdivision, "as-built
4 drawing" means a drawing that indicates field changes made to adapt to field
5 conditions, field changes resulting from change orders or buried and
6 concealed installation of piping, conduit and utility services.

7 (g) Preparation of status reports after modification work has begun
8 detailing the progress of work performed, including preparation of any of
9 the following:

10 (i) Master schedule updates.

11 (ii) Modification work cash flow projection updates.

12 (iii) Site reports made on a periodic basis.

13 (iv) Identification of discrepancies, conflicts or ambiguities in
14 modification work documents that require resolution.

15 (v) Identification of any health and safety issues that have arisen
16 in connection with the modification work.

17 (h) Preparation of daily logs of modification work, including
18 documentation of personnel, weather conditions and on-site occurrences.

19 (i) Preparation of any submittals or shop drawings used by the prime
20 contractor to illustrate details of the modification work performed.

21 (j) Administration or supervision of any other activities for which
22 a prime contractor receives a certificate for payment or certificate for
23 final payment based on the progress of modification work performed on the
24 project.

25 2. "Design phase services" means services for developing and
26 completing a design for a project that are not construction phase services,
27 including the following:

28 (a) Evaluating surveys, reports, test results or any other information
29 on-site conditions for the project, including physical characteristics, legal
30 limitations and utility locations for the site.

1 (b) Evaluating any criteria or programming objectives for the project
2 to ascertain requirements for the project, such as physical requirements
3 affecting cost or projected utilization of the project.

4 (c) Preparing drawings and specifications for architectural program
5 documents, schematic design documents, design development documents,
6 modification work documents or documents that identify the scope of or
7 materials for the project.

8 (d) Preparing an initial schedule for the project, excluding the
9 preparation of updates to the master schedule after modification work has
10 begun.

11 (e) Preparing preliminary estimates of costs of modification work
12 before completion of the final design of the project, including an estimate
13 or schedule of values for any of the following:

14 (i) Labor, materials, machinery and equipment, tools, water, heat,
15 utilities, transportation and other facilities and services used in the
16 execution and completion of modification work, regardless of whether they
17 are temporary or permanent or whether they are incorporated in the
18 modifications.

19 (ii) The cost of labor and materials to be furnished by the owner of
20 the real property.

21 (iii) The cost of any equipment of the owner of the real property to
22 be assigned by the owner to the prime contractor.

23 (iv) The cost of any labor for installation of equipment separately
24 provided by the owner of the real property that has been designed, specified,
25 selected or specifically provided for in any design document for the project.

26 (v) Any fee paid by the owner of the real property to the prime
27 contractor pursuant to the contract for modification work.

28 (vi) Any bond and insurance premiums.

29 (vii) Any applicable taxes.

30

1 (viii) Any contingency fees for the prime contractor that may be used
2 before final completion of the project.

3 (f) Reviewing and evaluating cost estimates and project documents to
4 prepare recommendations on site use, site improvements, selection of
5 materials, building systems and equipment, modification feasibility,
6 availability of materials and labor, local modification activity as related
7 to schedules and time requirements for modification work.

8 (g) Preparing the plan and procedures for selection of subcontractors,
9 including any prequalification of subcontractor candidates.

10 3. "Professional services" means architect services, engineer
11 services, geologist services, land surveying services or landscape architect
12 services that are within the scope of those services as provided in title
13 32, chapter 1 and for which gross proceeds of sales or gross income has not
14 otherwise been deducted under subsection K of this section.

15 0. The gross proceeds of sales or gross income derived from a contract
16 with the owner of real property or improvements to real property for the
17 maintenance, repair, replacement or alteration of existing property is not
18 subject to tax under this section if the contract does not include
19 modification activities, except as specified in this subsection. The gross
20 proceeds of sales or gross income derived from a de minimis amount of
21 modification activity does not subject the contract or any part of the
22 contract to tax under this section. For the purposes of this subsection:

23 1. Tangible personal property that is incorporated or fabricated into
24 a project described in this subsection may be subject to the amount prescribed
25 in section 42-5008.01.

26 2. Each contract is independent of any other contract, except that
27 any change order that directly relates to the scope of work of the original
28 contract shall be treated the same as the original contract under this
29 chapter, regardless of the amount of modification activities included in the
30 change order. If a change order does not directly relate to the scope of
31 work of the original contract, the change order shall be treated as a new
32

1 contract, with the tax treatment of any subsequent change order to follow
2 the tax treatment of the contract to which the scope of work of the subsequent
3 change order directly relates.

4 P. Notwithstanding subsection O of this section, a contract that
5 primarily involves surface or subsurface improvements to land and that is
6 subject to title 28, chapter 19, 20 or 22 or title 34, chapter 2 or 6 is
7 taxable under this section, even if the contract also includes vertical
8 improvements. Agencies that are subject to procurement processes under those
9 provisions shall include in the request for proposals a notice to bidders
10 when those projects are subject to this section. This subsection does not
11 apply to contracts with:

12 1. Community facilities districts, fire districts, county television
13 improvement districts, community park maintenance districts, cotton pest
14 control districts, hospital districts, pest abatement districts, health
15 service districts, agricultural improvement districts, county free library
16 districts, county jail districts, county stadium districts, special health
17 care districts, public health services districts, theme park districts or
18 revitalization districts.

19 2. Any special taxing district not specified in paragraph 1 of this
20 subsection if the district does not substantially engage in the modification,
21 maintenance, repair, replacement or alteration of surface or subsurface
22 improvements to land.

23 Q. Notwithstanding subsection R, paragraph 10 of this section, a
24 person owning real property who enters into a contract for sale of the real
25 property, who is responsible to the new owner of the property for
26 modifications made to the property in the period subsequent to the transfer
27 of title and who receives a consideration for the modifications is considered
28 a prime contractor solely for purposes of taxing the gross proceeds of sale
29 or gross income received for the modifications made subsequent to the
30 transfer of title. The original owner's gross proceeds of sale or gross
31 income received for the modifications shall be determined according to the
32 following methodology:

1 1. If any part of the contract for sale of the property specifies
2 amounts to be paid to the original owner for the modifications to be made in
3 the period subsequent to the transfer of title, the amounts are included in
4 the original owner's gross proceeds of sale or gross income under this
5 section. Proceeds from the sale of the property that are received after
6 transfer of title and that are unrelated to the modifications made subsequent
7 to the transfer of title are not considered gross proceeds of sale or gross
8 income from the modifications.

9 2. If the original owner enters into an agreement separate from the
10 contract for sale of the real property providing for amounts to be paid to
11 the original owner for the modifications to be made in the period subsequent
12 to the transfer of title to the property, the amounts are included in the
13 original owner's gross proceeds of sale or gross income received for the
14 modifications made subsequent to the transfer of title.

15 3. If the original owner is responsible to the new owner for
16 modifications made to the property in the period subsequent to the transfer
17 of title and derives any gross proceeds of sale or gross income from the
18 project subsequent to the transfer of title other than a delayed disbursement
19 from escrow unrelated to the modifications, it is presumed that the amounts
20 are received for the modifications made subsequent to the transfer of title
21 unless the contrary is established by the owner through its books, records
22 and papers kept in the regular course of business.

23 4. The tax base of the original owner is computed in the same manner
24 as a prime contractor under this section.

25 R. For the purposes of this section:

26 1. "Alteration" means an activity or action that causes a direct
27 physical change to existing property. For the purposes of this paragraph:

28 (a) For existing property that is properly classified as class two
29 property under section 42-12002, paragraph 1, subdivision (c) ~~or paragraph~~
30 ~~2, subdivision (c)~~ and that is used for residential purposes, class three
31 property under section 42-12003 or class four property under section
32 42-12004, this paragraph does not apply if the contract amount is more than

1 twenty-five percent of the most recent full cash value established under
2 chapter 13, article 2 of this title as of the date of any bid for the work
3 or the date of the contract, whichever value is higher.

4 (b) For all existing property other than existing property described
5 in subdivision (a) of this paragraph, this paragraph does not apply if the
6 contract amount is more than \$750,000.

7 (c) Project elements may not be artificially separated from a contract
8 to cause a project to qualify as an alteration. The department has the
9 burden of proof that project elements have been artificially separated from
10 a contract.

11 (d) If a project for which the owner and the person performing the
12 work reasonably believed, at the inception of the contract, would be treated
13 as an alteration under this paragraph and, on completion of the project, the
14 project exceeded the applicable threshold described in either subdivision
15 (a) or (b) of this paragraph by ~~no~~ NOT more than twenty-five percent of the
16 applicable threshold for any reason, the work performed under the contract
17 qualifies as an alteration.

18 (e) A change order that directly relates to the scope of work of the
19 original contract shall be treated as part of the original contract, and the
20 contract amount shall include any amount attributable to a change order that
21 directly relates to the scope of work of the original contract.

22 (f) Alteration does not include maintenance, repair or replacement.

23 2. "Contracting" means engaging in business as a contractor.

24 3. "Contractor" is synonymous with the term "builder" and means any
25 person or organization that undertakes to or offers to undertake to, or
26 purports to have the capacity to undertake to, or submits a bid to, or does
27 personally or by or through others, modify any building, highway, road,
28 railroad, excavation, manufactured building or other structure, project,
29 development or improvement, or to do any part of such a project, including
30 the erection of scaffolding or other structure or works in connection with
31 such a project, and includes subcontractors and specialty contractors. For
32 all purposes of taxation or deduction, this definition shall govern without

1 regard to whether or not such a contractor is acting in fulfillment of a
2 contract.

3 4. "Manufactured building" means a manufactured home, mobile home or
4 factory-built building, as defined in section 41-4001.

5 5. "Manufactured building dealer" means a dealer who either:

6 (a) Is licensed pursuant to title 41, chapter 37, article 4 and who
7 sells manufactured buildings to the final consumer.

8 (b) Supervises, performs or coordinates the excavation and completion
9 of site improvements or the setup of a manufactured building, including the
10 contracting, if any, with any subcontractor or specialty contractor for the
11 completion of the contract.

12 6. "Modification" means construction, grading and leveling ground,
13 wreckage or demolition. Modification does not include:

14 (a) Any project described in subsection 0 of this section.

15 (b) Any wreckage or demolition of existing property, or any other
16 activity that is a necessary component of a project described in subsection
17 0 of this section.

18 (c) Any mobilization or demobilization related to a project described
19 in subsection 0 of this section, such as the erection or removal of temporary
20 facilities to be used by those persons working on the project.

21 7. "Modify" means to make a modification or cause a modification to
22 be made.

23 8. "Owner" means the person that holds title to the real property or
24 improvements to real property that is the subject of the work, as well as an
25 agent of the title holder and any person with the authority to perform or
26 authorize work on the real property or improvements, including a tenant and
27 a property manager. For the purposes of subsection 0 of this section, a
28 person who is hired by a general contractor that is hired by an owner, or a
29 subcontractor of a general contractor that is hired by an owner, is considered
30 to be hired by the owner.

1 9. "Prime contracting" means engaging in business as a prime
2 contractor.

3 10. "Prime contractor" means a contractor who supervises, performs or
4 coordinates the modification of any building, highway, road, railroad,
5 excavation, manufactured building or other structure, project, development
6 or improvement, including the contracting, if any, with any subcontractors
7 or specialty contractors and who is responsible for the completion of the
8 contract. Except as provided in subsections E and Q of this section, a
9 person who owns real property, who engages one or more contractors to modify
10 that real property and who does not itself modify that real property is not
11 a prime contractor within the meaning of this paragraph regardless of the
12 existence of a contract for sale or the subsequent sale of that real property.

13 11. "Replacement" means the removal from service of one component or
14 system of existing property or tangible personal property installed in
15 existing property, including machinery or equipment, and the installation of
16 a new component or system or new tangible personal property, including
17 machinery or equipment, that provides the same, a similar or an upgraded
18 design or functionality, regardless of the contract amount and regardless of
19 whether the existing component or system or existing tangible personal
20 property is physically removed from the existing property.

21 12. "Sale of a used manufactured building" does not include a lease
22 of a used manufactured building."

23 Renumber to conform

24 Page 39, line 3, strike "~~and personal~~" insert "and personal"

1 Page 46, between lines 20 and 21, insert:

2 "Sec. 12. Section 42-12007, Arizona Revised Statutes, is amended to
3 read:

4 42-12007. Class seven property

5 For THE purposes of taxation, class seven is established consisting of
6 real ~~and personal~~ property and improvements that meet the criteria for
7 property included in class one, ~~paragraphs~~ UNDER SECTION 42-12001, PARAGRAPH
8 12 ~~and 13~~ and also the criteria for commercial historic property as defined
9 in section 42-12101."

10 Renumber to conform

11 Page 49, line 2, strike "Section" insert "Sections"; after "42-13054" insert
12 ", 42-13055 and 42-13056"; strike "is" insert "are"

13 Strike lines 3 through 13

14 Renumber to conform

15 Between lines 23 and 24, insert:

16 "Sec. 17. Section 42-13351, Arizona Revised Statutes, is amended to
17 read:

18 42-13351. Method and procedures for valuing property of
19 manufacturers, assemblers or fabricators;
20 confidentiality

21 A. Real or personal property that is subject to valuation for property
22 tax purposes and that is used by any manufacturer, assembler or fabricator
23 of tangible personal property, except property that is included in class
24 one, ~~UNDER SECTION 42-12001, paragraphs 1, through 2, 3, 4, 5, 6, 7, 8, 9,~~
25 ~~and paragraphs 11, through 14~~ 12 AND 13 and classes two, three, four, five,
26 six, seven, eight or nine, ~~shall~~ shall be valued pursuant to this article.

27 B. All information that a taxpayer submits pursuant to this article
28 is confidential pursuant to chapter 2, article 1 of this title."
29

1 Page 49, between lines 25 and 26, insert:

2 "Sec. 19. Section 42-15005, Arizona Revised Statutes, is amended to
3 read:

4 42-15005. Assessed valuation of class five property

5 The director shall annually determine percentages to apply as a basis
6 for determining the assessed valuation of class five property described in
7 section 42-12005 equal to the ~~ratios~~ **RATIO** that the total net assessed
8 valuation of all taxable property for primary and secondary tax purposes in
9 class one **UNDER SECTION 42-12001**, and class six, ~~UNDER SECTION 42-12006~~,
10 paragraph 3 ~~and personal property in class two~~ bears to the total limited
11 valuation used for primary tax purposes of such property, and that ratio
12 shall be used for primary tax purposes as required by federal law."

13 Renumber to conform

14 Amend title to conform

J.D. MESNARD

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