

TPT REFORM – PRIME CONTRACTING 2015 Pending Legislation (SB1446 and HB2590)

The tax code for the construction industry was rewritten in 2013 and again in 2014 by the Arizona Legislature. The legislation produced unintended ambiguities for contractors who operate in the new construction and remodeling fields. A comprehensive set of stakeholders started working last summer to clarify and simplify the tax code for the construction industry. This year's bills address those issues and create a tax system that more closely mirrors how contractors actually operate. This will eliminate risk to contractors and allow for simplified audit and tax payment processes.

1. **All Project Materials Can Once Again Be Purchased Tax-Exempt with Blanket Form 5000¹** (ARS 42-5061(A)(27))
 - Contractors can purchase all materials tax-exempt, as they always did before 2015, for both:
 - Prime Contracting projects
 - Maintenance, Repair, Replacement and Alteration (MRRRA) projects
 - Vendors can rely on a Contractor's blanket Form 5000 without concern about the type of project
 - Avoids impractical "dual inventory" problem for Contractors and compliance problem for Vendors
 - *Exception:* Persons that have canceled their TPT license must pay tax on materials when purchased, unless hired by GC that has issued a Form 5009L

2. **GC Can Once Again Issue Blanket Form 5005² to Subs for All Projects** (ARS 42-5008.01(A) and (B); ARS 42-5075(E))
 - GC can once again issue a blanket Form 5005 to Subs, as they always did before 2015, for both:
 - Prime Contracting projects
 - MRRRA projects
 - Allows Subs to issue blanket Form 5000 for tax-exempt purchase of materials, avoiding:
 - Risk of paying tax on materials without reimbursement from GC
 - Uncertainty whether it's reasonable to rely on GC's treatment of MRRRA vs. Prime Contracting
 - Incentivizes GC to issue Form 5005 to assume tax liability for materials used by Subs in an MRRRA project
 - GC will pay tax on materials when used by Subs in an MRRRA project, based on location of project
 - If audited and project is found to be Prime Contracting, GC gets offset for materials tax paid by GC
 - *Exception:* Sub cannot rely on Form 5005 to avoid tax on materials purchased after TPT license is canceled; Form 5009L is the only certificate a Sub may rely upon after the Sub has canceled its TPT license

3. **Change Orders** (ARS 42-5075(O)(2))
 - If the scope of work of a change order directly relates to the scope of work of the original contract, then the tax treatment of the change order follows the original contract
 - If the scope of work of a change order does not directly relate to the original, the tax treatment of the change order will depend solely on the scope of work of the change order

4. **Definition of Alteration** (ARS 42-5075(R)(1)) Creates thresholds for determining tax status of Alteration project:
 - Residential Property: Tax on cost of materials, if the contract price for the work is 25% or less of the property's Full Cash Value for property tax purposes (31.25%, with 25% cushion described below)
 - Commercial Property: Tax on cost of materials, if all of the following are true:
 - Contract amount is \$750,000 or less (\$937,500, with 25% cushion)
 - Scope of work directly relates to 40% or less of existing square footage (50%, with 25% cushion)
 - Scope of work includes an expansion of existing square footage that is 10% or less of pre-existing square footage (12.5%, with 25% cushion)
 - 25% Cushion for All Property: If project qualifies for Alteration treatment when at time of contract, it will continue to qualify even if the threshold is blown by no more than 25% (cost overruns, change orders, etc.)
 - Specifically excludes Maintenance, Repair and Replacement, which have no thresholds

¹ The Form 5000 will be revised to apply to a Contractor's purchase of materials for an MRRRA project.

² The Form 5005 is going to be revised to apply to both Prime Contracting and MRRRA projects.

5. **Clarifies Definition of Prime Contracting Taxable "Modification"** (ARS 42-5075(R)(6))
 - Deletes terms that cause confusion ("improvement" and "movement")
 - Specifically excludes MRRRA activities (MRRRA trumps Prime Contracting)
 - Specifically excludes mobilization and demobilization (erection of temporary facilities, fencing, etc.)
6. **Provides Consistent Treatment for MRRRA Projects with Tax-Exempt Parties or for Tax-Exempt Property**
 - Qualifying hospitals, qualifying health care organizations, etc. (ARS 42-5061(A)(25))
 - On-reservation projects for Tribal government or Enrolled Member (ARS 42-5061(A)(60))
 - Electric generation, mining, manufacturing, etc. machinery and equipment (ARS 42-5008.01(A)(2), (B)(5))
7. **Excludes Roadway and other Surface/Subsurface Projects from MRRRA Treatment** (ARS 42-5075(P))
 - Maintain Prime Contracting tax treatment for most public works projects without vertical construction for
 - ADOT
 - Cities
 - Counties
 - Certain Special Taxing Districts addressing surface/subsurface needs
 - Does not apply to state projects other than ADOT
 - Does not apply to most Special Taxing Districts
8. **Persons Canceling Prime Contracting TPT License Are Protected** (ARS 42-5008.01(B) and Session Law)
 - Issuance of building permit no longer conditioned on holding TPT license
 - Materials purchased tax-exempt that are on hand when TPT license canceled will be taxed as used
 - *Alternative:* If TPT license canceled before May 1, 2015 (assuming the Governor signs the bill in February 2015), the value of materials on hand can be calculated when TPT license canceled and associated tax spread equally over 12 months based on business location
 - *First \$10,000 Exempt:* If TPT license canceled before May 1, 2015 (assuming the Governor signs the bill in February 2015), no tax due on the first \$10,000 of materials on hand
 - Reasonable estimation of value of materials on hand is acceptable if TPT license is canceled before May 1, 2015 (assuming the Governor signs the bill in February 2015)
9. **Safe Harbor to Protect Industry During Transition Period** (Session Law)
 - Protection provided for good-faith bids/contracts entered into before May 1, 2015 (assuming the Governor signs the bill in February 2015) throughout entire term of the contract
 - Prime contracting treatment permitted for all projects started during this period, regardless of when completed