STATE BAR OF ARIZONA

tax law news

[SEPTEMBER 2015]

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contents

We welcome comments about this newsletter and invite you to suggest topics or submit an article for consideration.

Tax Law Section of the State Bar of Arizona
4201 N. 24th St., Suite 100, Phoenix, AZ 85016

message from the chair

Dear Tax Section Members

I am excited to serve as the Chair of the Tax Section of the State Bar of Arizona this year and am looking forward to providing valuable resources to our members and the greater legal community.

This year, we are excited about the transition to the State Bar's Online Community (**community.azbar.org**), which will allow members to utilize the Tax Section's networking and communication opportunities. I would like to encourage all Tax Section members to sign up and visit the new Online Community, and take advantage of the ability to pose tax-related questions to fellow members, and to provide the Tax Section feedback about education and networking opportunities that would best suit member needs. The Online Community is also going to replace our newsletter and provide the opportunity to share timely publications and articles with the section. If you would like to contribute, please reach out to me or Randy Evans, our Articles Chair.

In addition, we will continue to provide the numerous programs and resources that our section has traditionally offered, including

(1) regular, affordable continuing legal education opportunities, and an extended State Bar Convention program;
(2) updates regarding important tax developments;
(3) networking opportunities with fellow local practitioners;
(4) articles and opportunities for publication;
(5) scholarship awards for Arizona law students; and
(6) a mentor program for the benefit of new lawyers and law students.

Finally, thank you to all of our volunteers for devoting their time, expertise, and guidance to the Tax Section. If you are interested in becoming more involved in the Tax Section, I look forward to hearing from you at **havraham@swlaw.com**.

— Hadar Avraham, Section Chair
American Findings Corporation, Inc.

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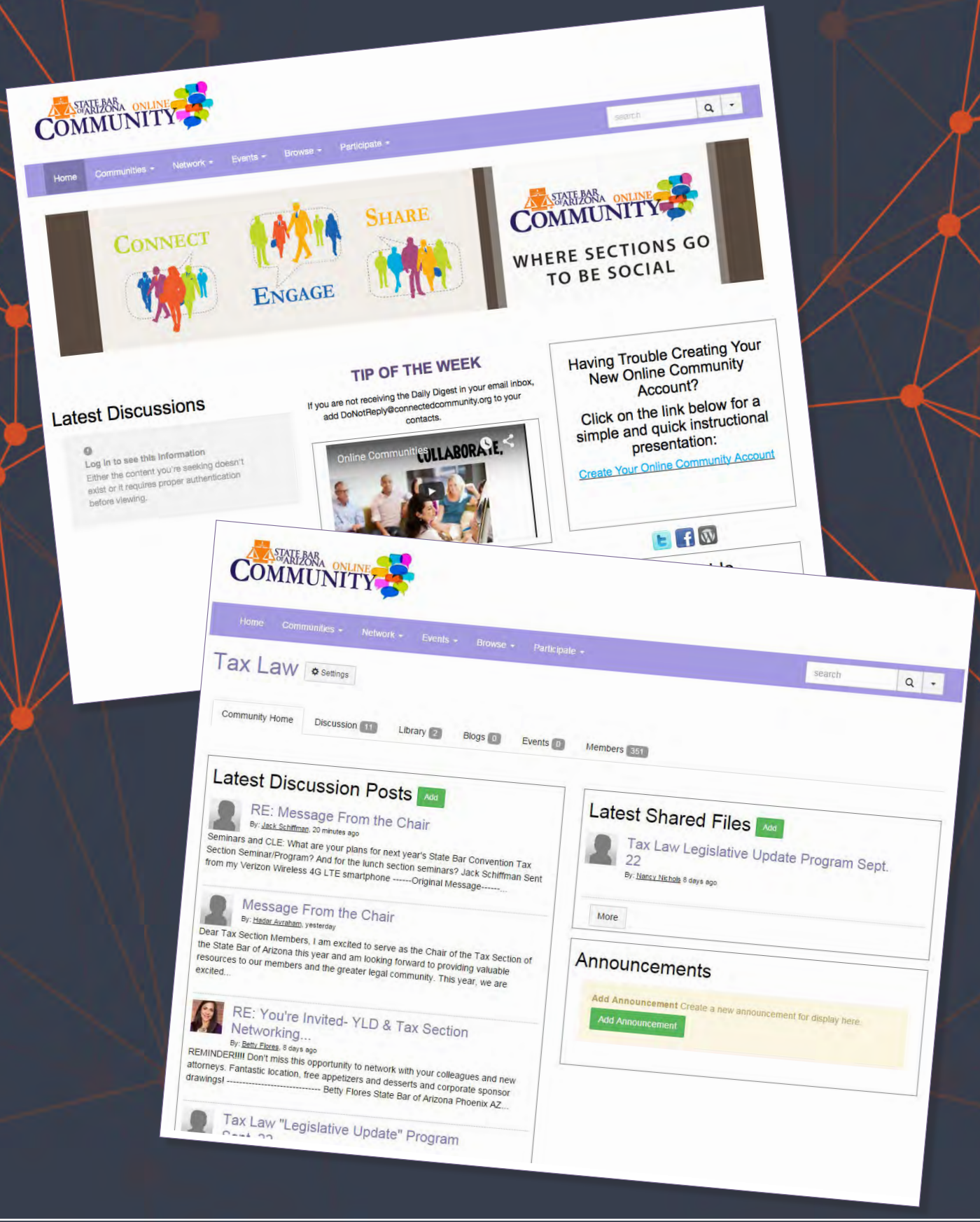
logon now at: community.azbar.org/home



By James G. Busby, Jr.

Qualified Manufacturers are No Longer Subject to Arizona Sales Tax on Purchases of Electricity and Natural Gas

Arizona added a new transaction privilege ("sales") tax deduction for purchases of electricity and natural gas by qualified manufacturers. The deduction went into effect on August 1, 2014.

General Qualifications

To qualify for the sales tax deduction, businesses must be "principally engaged" in manufacturing, and at least 51 percent of the electricity or natural gas purchased must be used in manufacturing. The deduction does not apply to the cost of gas transportation services.

Definition of "Manufacturing"

The statute defines "manufacturing" as "the performance as a business of an integrated series of operations that places tangible personal property in a form, composition or character different from that in which it was acquired and transforms it into a different product with a distinctive name, character or use."

But, for purposes of the deduction, manufacturing does not include "processing, fabricating, job printing, mining, generating electricity or operating a restaurant."

What does it Mean to be "Principally Engaged" in Manufacturing?

The new statute provides that "principally engaged" in manufacturing means at least 51 percent of the business is a manufacturing operation.

According to draft guidance from the Arizona Department of Revenue ("ADOR"), businesses that do not qualify for the deduction at the entity level may still qualify at the facility level.

ADOR's draft guidance provides that companies are principally engaged in manufacturing if 51 percent or more of their business is directly related to manufacturing based on the percentage of their: (1) capital equipment costs that are directly related to manufacturing; (2) revenue that is directly related to manufacturing; (3) head count that is directly related to manufacturing; and (4) square footage that is directly related to manufacturing. According to ADOR's draft guidance, businesses are "principally engaged" in manufacturing if they satisfy the 51 percent test for two or more of these criteria.

The Other 51 Percent Test

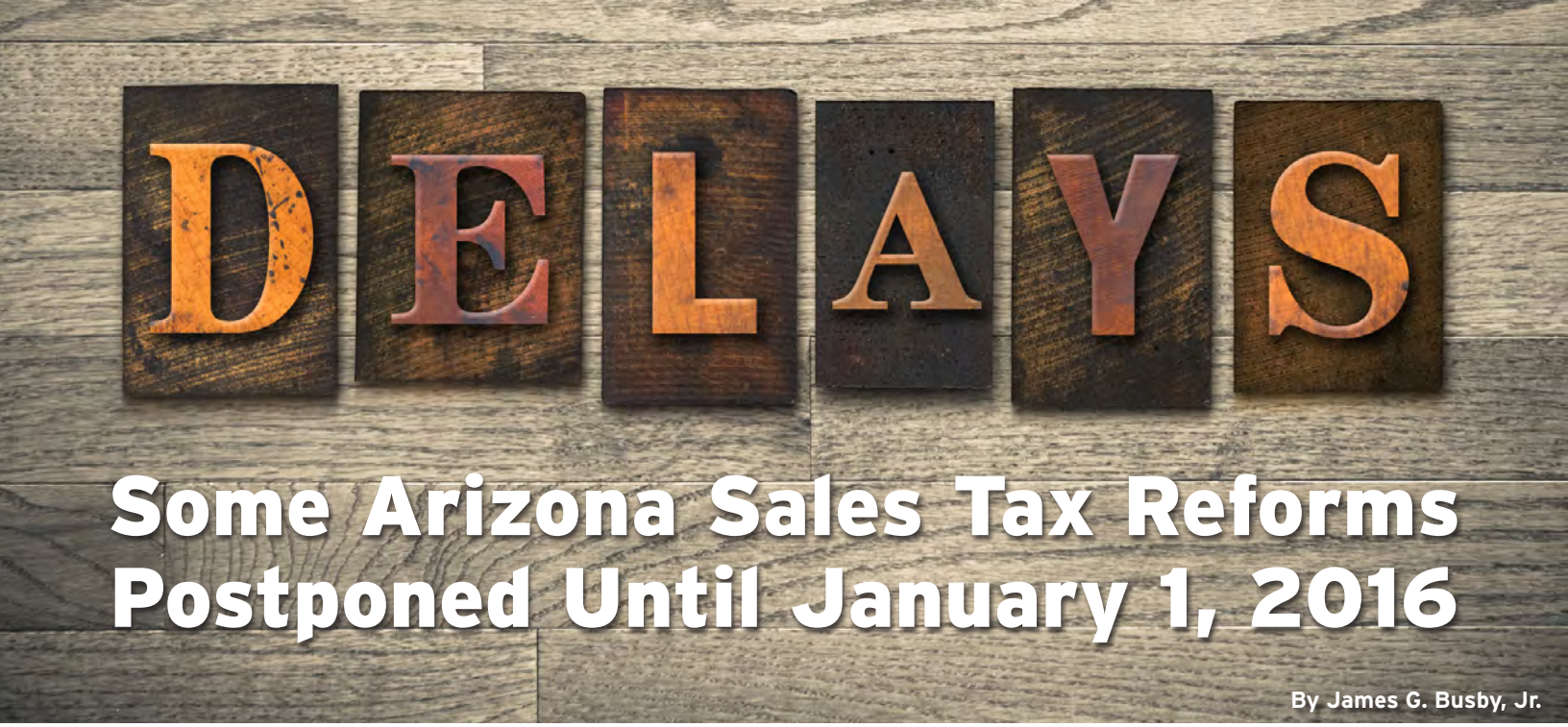
To qualify for the deduction, businesses that are principally engaged in manufacturing also must use at least 51 percent of the electricity that they purchase in manufacturing operations in order to qualify for the electricity deduction and at least 51 percent of the natural gas that they purchase in manufacturing operations in order to qualify for the natural gas deduction.

Some Arizona Municipalities May Not Allow the Deduction

The legislature left it up to each Arizona city and town to decide for itself whether to provide a corresponding local sales tax deduction. We should know soon which municipalities follow the state's lead by adding this incentive for manufacturers to locate and expand their operations in Arizona to their local tax codes. tlh

WORK SMARTER
A PRACTICE TIP!

If any of your clients are manufacturers, or fall under the relatively broad language that the Arizona Legislature used to define "manufacturing" for purposes of this new deduction, your client will appreciate it if you bring this potential tax savings opportunity to their attention and help them determine whether it applies to them.



Some Arizona Sales Tax Reforms Postponed Until January 1, 2016

By James G. Busby, Jr.

Because some of the effective dates have changed, this issue's state and local tax ("SALT") column outlines when particular Arizona transaction privilege ("sales") tax reforms will go into effect. Most importantly, the Arizona Department of Revenue ("ADOR") recently announced that "non-program" cities and towns that currently collect their own sales and use taxes will continue to do so until January 1, 2016.

Changes Postponed Until January 1, 2016

- ADOR will begin collecting sales and use taxes for non-program cities and towns that currently collect their own taxes, and will require taxpayers with multiple locations to report their gross receipts, deductions, and taxes by location.
- ADOR will issue and renew all municipal sales tax licenses in effect for January 1, 2016 using a new electronic license renewal program.

Changes Effective January 1, 2015

- Bullhead City, Somerton, and Willcox have become program cities, so ADOR began collecting and administering sales taxes for them.
- Starting January 1, 2015, taxpayers must renew municipal sales and use tax licenses that were issued by ADOR, and taxpayers also licensed with non-program cities may have to separately renew their sales and use tax licenses with those cities for 2015.
- Taxpayers conducting business in two or more locations, or under two or more business names, must begin filing their sales and use tax returns electronically.
- When filing sales and use tax returns, taxpayers must use standardized codes to report the nature of their business and to claim deductions. There will no longer be codes for "miscellaneous" deductions.
- Taxpayers whose estimated annual sales and use tax liability is less than $2,000 may receive permission to report and pay sales taxes on an annual basis. Those whose estimated liability is between $2,000 and $8,000 may receive permission to report and pay on a quarterly basis.
- Sales and use tax returns must be received by ADOR on or before the business day preceding the last business day of the month or, if filing electronically, on the last business day of the month. But, it will no longer be sufficient for a return to be postmarked by the twenty-fifth day of the month.
- Arizona municipalities may only conduct sales and use tax audits for companies that are only engaged in business in that municipality, or when ADOR authorizes the municipality to conduct the audit.
- All sales and use tax audits must be conducted in accordance with procedures outlined in ADOR's online audit manual by auditors trained in such

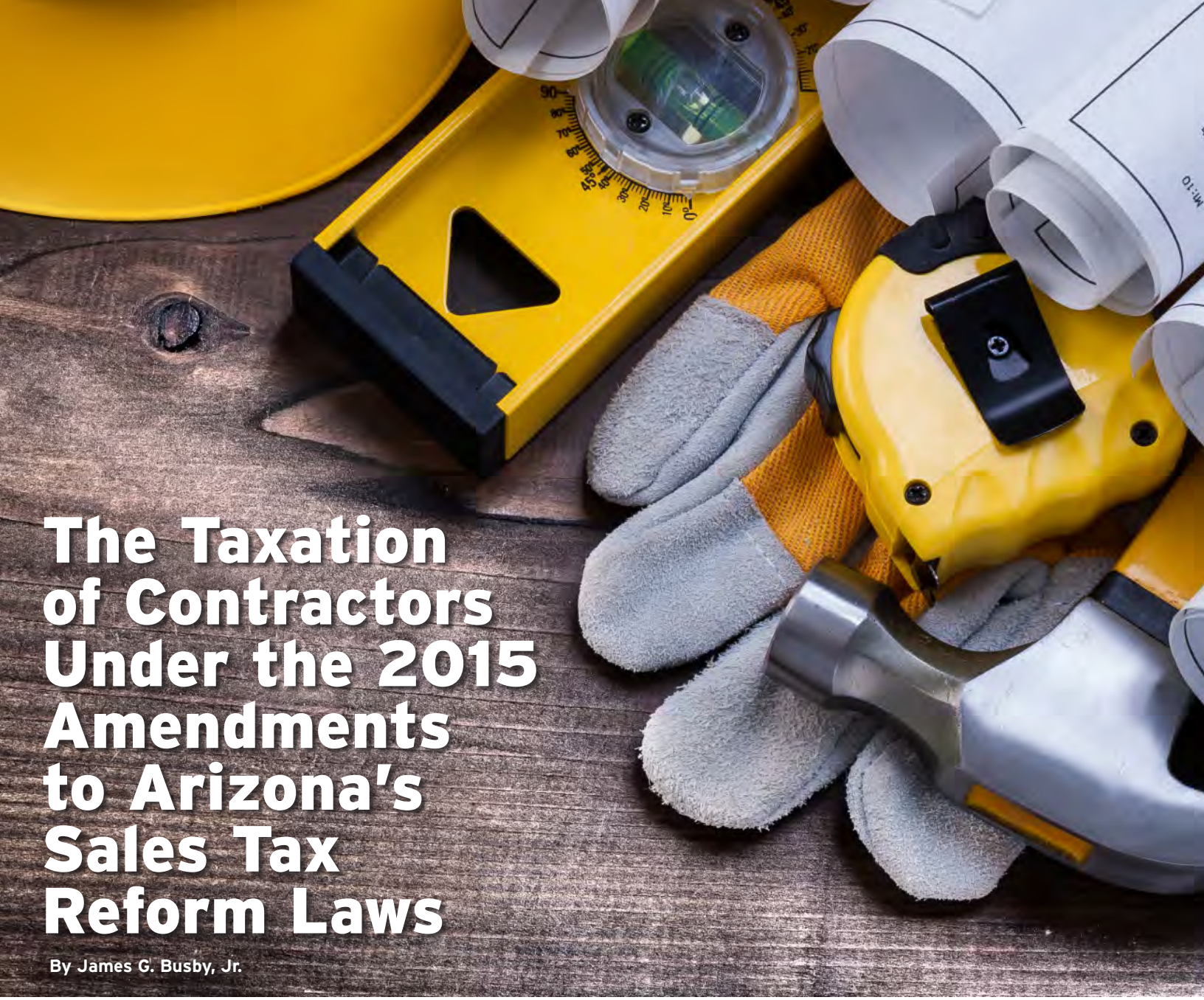
procedures, and all assessments for all jurisdictions must be issued in a single notice to the taxpayer from ADOR.

- All appeals of municipal sales tax audits initiated after the first of the year must be directed to ADOR, and will be administered by ADOR.
- Refund claims for all municipal sales and use taxes related to tax periods from and after January 1, 2015 will be administered by ADOR.
- Construction contractors who only enter into contracts with owners of real property to maintain, repair, replace, or alter their property will be subject to retail sales or use tax when purchasing the building materials used in such contracts, but will not be subject to Arizona's separate prime contracting tax. Contractors who only perform such services will no longer be required to have a sales tax license. When a prime contractor hires such a contractor who is not licensed to collect and remit prime contracting tax to work on a project that is subject to Arizona's prime contracting tax, the prime contractor must obtain a project-specific exemption certificate, Arizona Form 5009L, to enable the unlicensed contractor to purchase building materials tax free for that particular project.
- Construction contractors who have building materials in inventory on January 1, 2015 that were purchased tax free but will be used on jobs that will not be subject to prime contracting tax are expected to take an inventory of such materials at the beginning of the year and pay tax on 1/12 of such materials each month during 2015 at the retail sales tax rate in effect at their principal place of business in Arizona.
- Construction contractors who enter into contracts with owners of real property to maintain, repair, replace, or alter their property and engage in other construction activities will have to separately account for: (1) taxable construction materials used on nontaxable jobs, and (2) nontaxable materials used on taxable jobs. tln

To help educate the public, ADOR created a special page on their website dedicated to sales tax reform:

https://www.azdor.gov/TPTSimplification.aspx

Taxpayers and tax professionals with additional questions may call ADOR's "TPT Simplification Hotline" at **(602) 542-5027**.



The Taxation of Contractors Under the 2015 Amendments to Arizona's Sales Tax Reform Laws

By James G. Busby, Jr.

This special edition state and local tax ("SALT") column summarizes when construction contractors are required to pay transaction privilege ("sales") tax on the construction materials they purchase, and when they are required to pay prime contracting tax on sixty-five percent of their gross receipts instead, under the 2015 amendment to Arizona's sales tax reform laws.

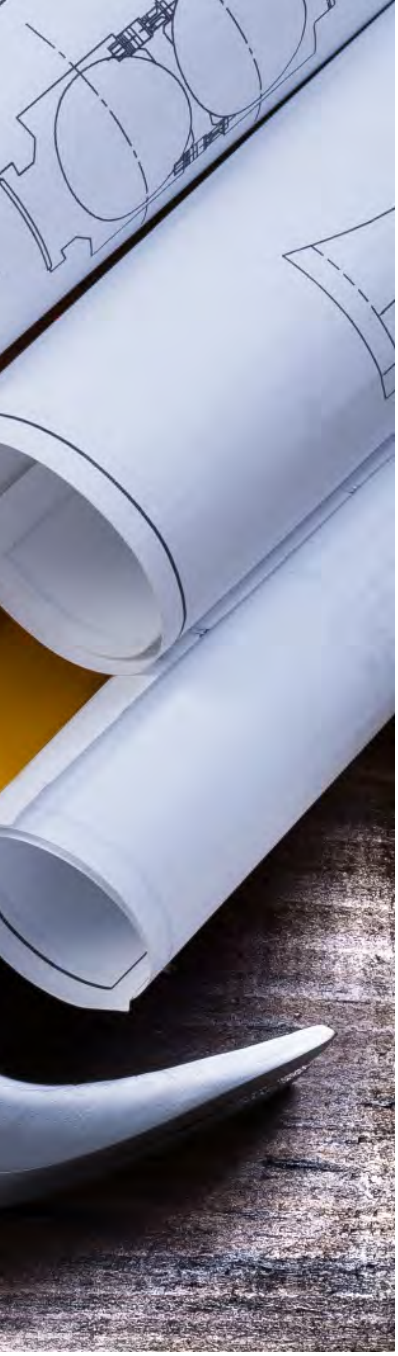
Background – Arizona's Unusual Method of Taxing Contractors Through 2014

Rather than pay sales tax on construction materials like contractors do in most states, until January 1, 2015, all construction contractors in Arizona were entitled to purchase building materials tax free because they or the prime contractor they worked for were subject to Arizona's prime contracting sales tax on sixty-five percent of their gross receipts instead.

Arizona's 2013 and 2014 Sales Tax Reform Efforts

During the 2013 legislative session, Arizona's governor encouraged its legislature to simplify the taxation of contractors in Arizona by repealing Arizona's prime contracting tax and imposing sales tax on the building materials contractors purchase instead, just like most other states do.

However, Arizona municipalities successfully lobbied against this proposal because they were concerned about the fiscal



impact of the proposal (prime contracting taxes are paid to the city where the construction is performed, while retail sales taxes are paid to the city where the retailer is located).

So, instead of eliminating Arizona's prime contracting tax, Arizona's legislature passed House Bill 2111 in 2013, which resulted in a bifurcated system for contractors with tax due on materials for some projects and prime contracting tax due on other projects.

HB 2111 was scheduled to go into effect on January 1, 2015 but, in 2014, because of problems identified with HB 2111 related to the taxation of contractors, the Arizona Legislature repealed the provisions directly related to the taxation of contractors and replaced them with other provisions in HB 2389.

Major Changes, and a Major Amendment to the Changes, Went Into Effect in 2015

Beginning January 1, 2015, pursuant to HB 2389, for some types of projects, contractors were required to pay tax on building materials when they purchase them instead of paying tax on sixty-five percent of their gross receipts. But, for other types of projects, contractors were supposed to continue purchasing building materials tax free because they or the prime contractor they work for is subject to Arizona's prime contracting tax instead.

Unfortunately, HB 2389 did not resolve all of the questions and concerns the construction industry identified regarding the portions of Arizona's sales tax reforms that apply directly to the industry, and many contractors were not even aware of the changes. Thus, while major changes regarding the taxation of contractors in Arizona went into effect on January 1, 2015, many contractors and material suppliers were unaware of the changes and there was widespread misunderstanding regarding how to apply the new rules among those who were aware of the changes.

Accordingly, in one of the first bills to make it through Arizona's legislature in 2015, the legislature amended the sales tax reforms aimed at contractors for the third time in three years. As an "emergency measure," SB 1446 went into effect when Arizona's new governor, Governor Doug Ducey, signed it on February 24, 2015. And, because SB 1446 has a retroactivity clause, it is retroactive to January 1, 2015.

Then, after Arizona's legislature passed SB 1446, it amended the definition of "replacement" in HB 2147. When that definition goes into effect on July 3, 2015, it will be retroactive to January 1, 2015.

Rather than focus on the iterative changes made by Arizona's three sales tax reform bills, this article summarizes Arizona's laws relating to the taxation of contractors as of January 1, 2015 pursuant to SB 1446 and HB 2147. To limit the size of this document, this summary is not intended to be comprehensive. Interested parties should carefully review the bill, or contact a state and local tax professional for assistance.

Construction Materials Are Now Subject to Tax When Used in MRRA Projects

Contractors are subject to tax on tangible personal property incorporated or fabricated into projects in Arizona involving the "maintenance," "repair," "replacement," or "alteration" of real property or existing real property improvements, provided that their contract does not involve more than a "*de minimis*" amount of "modification" activity. Proceeds from such projects (commonly referred to and referred to herein as "MRRA" projects) are not subject to prime contracting tax.

Except as described below in the section related to change orders, for purposes of determining whether a project is taxable as a MRRA project or a prime contracting project, each contract is evaluated independently. So, a contractor may be responsible for paying tax on materials for MRRA projects that it is working on and, at the same time, be responsible for tax as a prime contractor for other projects it is working on.

The *"De Minimis"* Test

The legislature did not define "*de minimis*" but, according to the Arizona Department of Revenue's ("ADOR's") Transaction Privilege Tax Notice TPN 15-1 ("ADOR TPN 15-1"), a "modification activity included in an MRRA contract will be considered '*de minimis*' if the amount attributable to the modification is 15% or less of the total receipts from the total contract."

Proceeds from modification activities, as that term is defined below, are what trigger the prime contracting tax on contractors, or the prime contractor for whom they work. So, under the *de minimis* test, proceeds from projects that involve MRRA activities are subject to prime contracting tax if fifteen percent or more of the proceeds from the project are for modification activities.

Terminology Used Herein

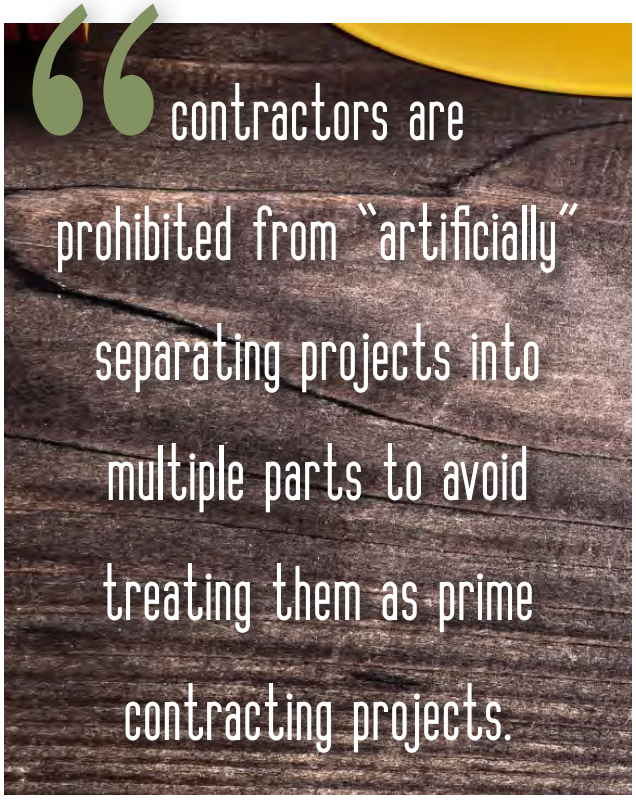
The term "contractor" is used generically in this article to refer to persons or companies who are engaged to perform construction activities involving real property, without regard to whether they are licensed by the Registrar of Contractors to perform such services or required to report sales tax as a prime contractor.

However, the term "prime contractor" refers specifically to persons or companies that should be licensed by one or more of Arizona's taxing authorities to report sales tax on projects that are subject to Arizona's state and local prime contracting taxes.

MRRA Definitions

The legislature did not define "maintenance" but, according to ADOR TPN 15-1, "'maintenance' is the upkeep of property or equipment. Examples of maintenance include: an annual HVAC system checkup that includes topping off any fluids, restaining a wood deck, and refinishing hardwood floors."

Likewise, the legislature did not define "repair" but, according to ADOR TPN 15-1, "'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, fixing a leak from a bathtub or shower, clearing partially or completely blocked pipes of debris, readjusting satellite dishes to restore reception, and replacing worn washers in leaky or totally inoperable faucets."



The legislature defined "replacement" in HB 2147 as "the removal from service of one component or system of existing property or tangible personal property installed in existing property, including machinery or equipment, and the installation of a new component or system or new tangible personal property, including machinery or equipment, that provides similar or an upgraded design or functionality, regardless of the contract amount and regardless of whether the existing component or system or existing tangible personal property is physically removed from the existing property."

The legislature defined "alteration" as "an activity or action that causes a direct physical change to existing property," but imposed limitations on the size of projects that qualify as "alteration" projects. Proceeds from projects that exceed the scope of these limitations are taxed as prime contracting projects rather than as MRRA projects.

But, the legislature specifically provided that "alteration" activities do not include "maintenance, repair or replacement" activities.

The Limit on the Size of Residential Projects that Qualify as "Alteration" Projects

Projects involving properties classified as residential properties for property tax purposes, including some properties owned by certain types of non-profit companies, that exceed twenty-five percent of the most recent full cash value of the property established by the county assessor as of the date of the bid or the date of the contract are not "alteration" projects and must be taxed as prime contracting projects rather than as MRRA projects.

Contractors are prohibited from "artificially" separating projects into multiple parts to avoid treating them as prime contracting projects. But, there is a safe harbor for projects that the owner and contractor reasonably believed would be alteration projects at the inception of the contract if they do not exceed the twenty-five percent test by more than twenty-five percent (for a total of 31.25 percent of the full cash value of the property).

The Limits on the Size of Other Projects that Qualify as "Alteration" Projects

Projects involving other types of properties are not "alteration" projects and must be taxed as prime contracting projects rather than as MRRA projects if: (1) the contract is for more than $750,000 ($937,500 with the safe harbor), (2) the scope of the work directly relates to more than forty percent of the existing square footage of the existing property (fifty percent with the safe harbor), or (3) the scope of the work involves expanding the square footage of existing property by more than ten percent (12.5 percent with the safe harbor). For tenant improvements, ADOR's interpretation of parts (2) and (3) of this test is that the percentages are calculated based only on the portion of the building that the tenant controls.

Here again, contractors are prohibited from "artificially" separating projects into multiple parts to avoid treating them as prime contracting projects. But, there is a safe harbor for projects that the owner and contractor reasonably believed would be alteration projects at the inception of the contract if they do not exceed any of the applicable tests by more than twenty-five percent.

Who Pays the Tax on Materials Used in MRRA Projects, When, and at What Rate?

For tangible personal property incorporated into MRRA projects, unless the property qualifies for an exemption, contractors must either pay sales tax to their Arizona vendors at the time of purchase, or pay an amount equal to tax directly to ADOR and, in some cases, to an Arizona city or town, in the reporting period that includes the month during which the property was

incorporated into the project. Delinquent payments may be subject to penalties and interest.

Contractors who opt to pay sales tax to Arizona vendors of tangible personal property will pay tax at the rate that applies at the time of purchase at the permanent business location of the vendor where the vendor received the order.

Contractors who purchase tangible personal property tax free but then use it in a MRRA project are subject to an amount equal to the tax an Arizona vendor would have been required to pay. That amount is due in the reporting period that includes the month during which the property was incorporated into the project, and the tax rate that applies is the rate in effect where the project is located.

Special inventory rules apply to contractors who purchased building materials tax free but subsequently cancel their prime contracting sales tax license. *See* "Taxation of Inventory Purchased Tax Free by a Contractor Before the Contractor Cancelled its Sales Tax License" below.

Only Amounts Paid Directly to the Taxing Authority for MRRA Projects Offset Prime Contracting Tax Liabilities

As explained above, contractors may either pay sales tax to their Arizona vendors at the time of purchase, or pay an amount equal to tax directly to Arizona taxing authorities for materials used in MRRA projects.

However, only amounts paid directly to Arizona taxing authorities may be used to offset a prime contracting tax liability in situations where the taxing authority later determines that the project should have been taxed as a prime contracting project instead of as a MRRA project.

Accordingly, ADOR is planning to modify Arizona Form 5005 so that contractors responsible for an MRRA project can give one to any subcontractors on the project to direct them not to pay tax on materials when they purchase them because the contractor responsible for the MRRA project will pay an amount equal to the tax directly to Arizona taxing authorities for all materials used in the MRRA project instead.

The Exception for Certain Publicly Funded Road Projects

The analysis described above related to MRRA projects does not apply to certain projects primarily involving surface or subsurface improvements to land (like roads) that are subject to certain public procurement rules. Rather, such publicly funded, road-related projects are specifically taxable as prime contracting projects in the manner outlined below.

But, not all publicly funded road projects are taxable as prime contracting projects, and not all privately funded road projects are taxable as MRRA projects.

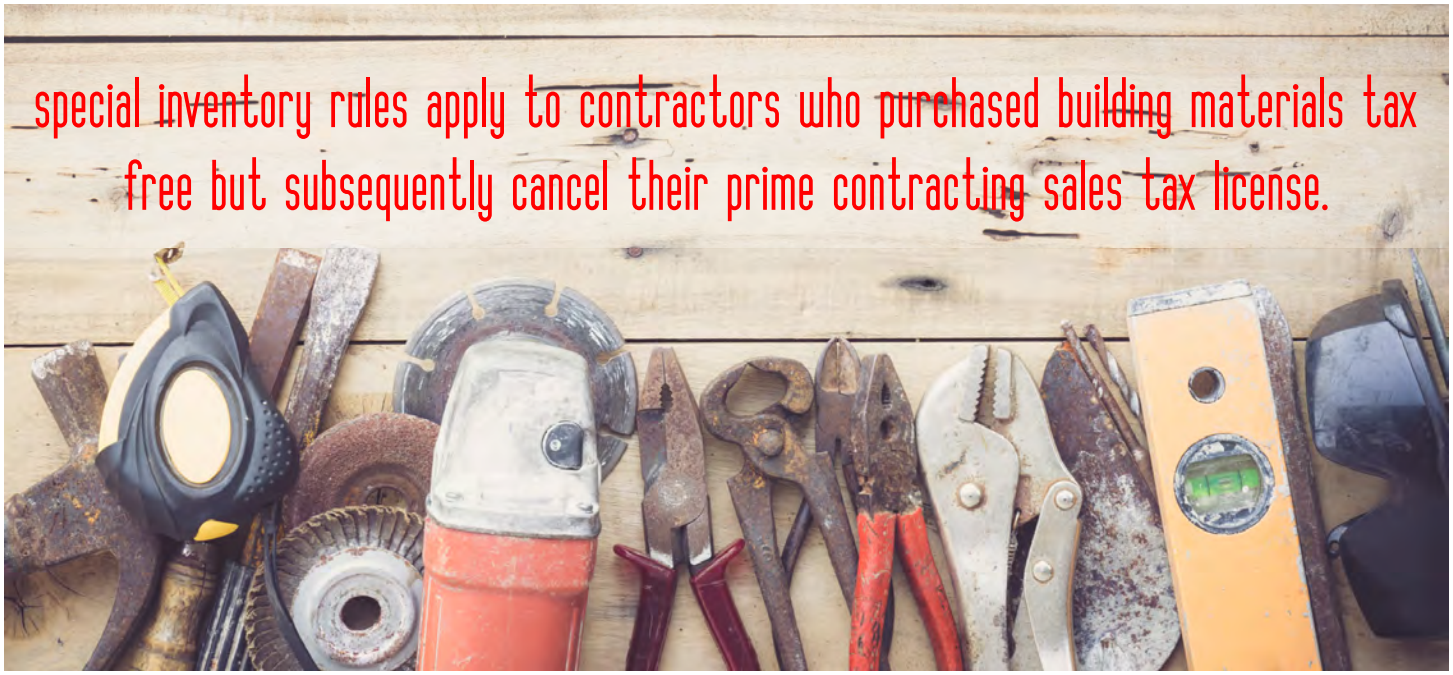
Rather, most ADOR road projects are taxable as prime contracting projects; and most projects for special taxing districts, and all projects for private parties, are subject to the MRRA analysis to determine whether they are taxable as MRRA projects or as prime contracting projects.

When Contractors Are Required to Pay Prime Contracting Tax Instead of Paying Tax on Construction Materials

When fifteen percent or more of a contractor's proceeds from a particular project are for "modification" activities rather than for MRRA activities, the prime contractor's proceeds from that project are subject to prime contracting tax, and the contractors working on such projects may purchase tangible personal property to be incorporated or fabricated into that project tax free.

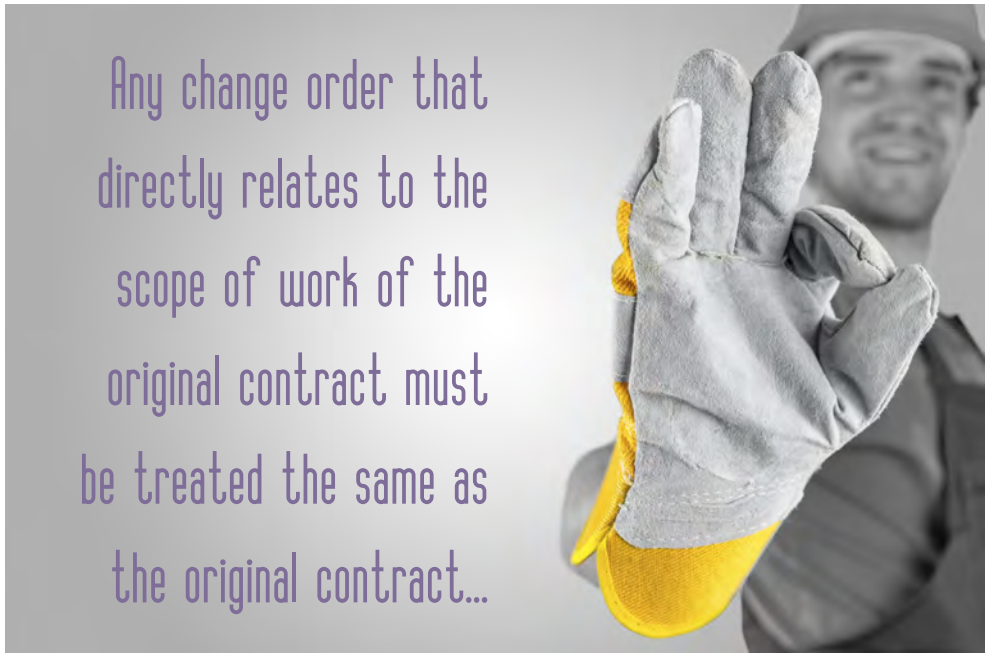
Prime contracting tax applies to sixty-five percent of prime contractors' gross receipts, after allowable exemptions and deductions, at the tax rate in effect where the construction activities are performed.

"Prime contractor" is still defined as "a contractor who supervises, performs or coordinates the modification of any



building, highway, road, railroad, excavation, manufactured building or other structure, project, development or improvement including the contracting, if any, with any subcontractors or specialty contractors and who is responsible for the completion of the contract."

Subcontractors on prime contracting projects who can prove that they were working for a prime contractor on a particular job, and that the prime contractor was liable for tax on the proceeds from which the subcontractor was paid, are not subject to prime contracting tax on that job. The best way for a subcontractor to prove that it is not subject to prime contracting tax on a particular job is to obtain a fully completed copy of Arizona Form 5005 from the prime contractor for the job.



The New Definition of "Modification"

The legislature amended the definition of "modification" so it now means "construction, grading and leveling ground, wreckage or demolition." And, the legislature specifically provided that modification does not include any: (1) MRRA project, (2) wreckage or demolition of existing property, or any other activity that is a necessary component of a MRRA project, and (3) mobilization or demobilization related to a MRRA project, such as the erection or removal of temporary facilities to be used by contractors working on the project.

How Change Orders Are Taxed

While contractors normally have to evaluate each contract independently to determine whether it is a MRRA project or a prime contracting project, special rules apply for change orders.

Any change order that directly relates to the scope of work of the original contract must be treated the same as the original contract, regardless of the amount of modification activities included in the change order.

However, for change orders that do not directly relate to the scope of work of the original contract, the change order is treated as a new contract and must be independently evaluated to determine whether it is a MRRA project or a prime contracting project.

The tax treatment of subsequent change orders follows the tax treatment of the contract or change order to which the scope of work of the subsequent change order directly relates. And, if a subsequent change order does not directly relate to the scope of work of an existing contract or change order, then it must be evaluated independently to determine whether it is a MRRA project or a prime contracting project.

The treatment of change orders outlined above does not alter or affect the treatment of change orders for other purposes, including the application of new tax rates to change orders.

Exemptions for Qualifying Hospitals and Health Care Organizations, Native Americans, Manufacturers, Utilities, Telecommunication Companies, Mines, etc.

Contractors may purchase and pass along the cost of tangible personal property without tax when it is incorporated or fabricated into a project for a qualifying hospital or health care organization, whether they are engaged in a prime contracting project or a MRRA project. Qualifying hospitals and health care organizations must obtain letters from ADOR every year stating that they qualify for these exemptions, and contractors who work for them should keep a copy of such letters in their files.

Although ADOR does not issue annual letters to them, the same rules apply to projects located on Indian reservations for Indian tribes and Native Americans who are registered members of the tribe.

Contractors also may purchase and pass along the cost of qualifying machinery, equipment, and other tangible personal property without tax when it is incorporated or fabricated into a project for a manufacturer, processor, job printer, utility company, telecommunications company, mine, or other qualifying business, whether the contractor is engaged in a prime contracting project or a MRRA project.

To document the exemptions referred to in this section, contractors should obtain a copy of Arizona Form 5000 from their customer claiming the relevant exemption, give a copy to their vendors, and keep a copy for their files.

Exemption Certificates for Building Materials

Contractors and their subcontractors who are working on a project that is subject to prime contracting tax may purchase tangible personal property that will be incorporated or fabricated into real property as part of the project tax free.

Prime contractors and their subcontractors who are working on a MRRA project also have the option of purchasing tangible personal property that will be incorporated or fabricated into

a MRRA project tax free. However, as described above, ultimately such materials are subject to tax.

Contractors, including subcontractors, who are licensed as prime contractors with ADOR for sales tax purposes should use Arizona Form 5000 to purchase building materials tax free from Arizona vendors.

Subcontractors who are not licensed as prime contractors for sales tax purposes are not permitted to purchase building materials tax free unless they get a copy of Arizona Form 5009L from the prime contractor they are working for, and such certificates are only good for particular projects and must be approved by ADOR before they are valid.

Issues Related to Tax Licenses, Registrar of Contractor Licenses, and Building Permits

Contractors who only work on MRRA projects, or who only work as subcontractors on prime contracting projects, are not required to retain their sales tax license if they already have one, or to obtain a sales tax license if they are just going into business. However, subcontractors without sales tax licenses who work for prime contractors on prime contracting jobs are not able to purchase building materials for such jobs tax free unless they get a copy of Arizona Form 5009L from the prime contractor they are working for on a particular project.

Arizona's Registrar of Contractors may no longer require contractors to provide a sales tax license number when applying for or renewing a contractor's license.

Cities, towns, and counties may not require an applicant for a building permit to hold a sales tax license or a business license as a condition for issuing the permit. But, cities and towns may require a contractor who has a building permit but does not have a business license from the city or town to apply for a business license within thirty days of issuing the permit.

The Taxation of Inventory Purchased Tax Free by a Contractor Before the Contractor Cancelled its Sales Tax License

Contractors who purchased tangible personal property tax free because it was to be incorporated into a taxable prime contracting project but subsequently cancel their sales tax license and use, consume, or sell the property are liable for tax on such items. The amount due must be reported on or before the business day preceding the last business day of the month following the month in which the contractor uses the property in a taxable manner described below. Otherwise, penalties and interest may apply.

If such property is used in a MRRA project or otherwise used or consumed, unless an exemption, deduction, or exclusion applies, tax is due based on the purchase price of the property at the rate in effect where the property was used or consumed. But, if the contractor who hired a subcontractor with such property provided the subcontractor with a certificate stating that the contractor is liable for tax or other amounts due on such property, the subcontractor is not liable for tax or other amounts due on such property unless the subcontractor had reason to believe that the certificate was erroneous or incomplete. Rather, in such situations, the contractor who provided the certificate is liable for the tax or other amount due.

If such property is sold, the amount due is based on the amount of the payment received by the contractor at the rate in effect at the contractor's principal place of business in Arizona.

If such property is discarded and the contractor does not receive payment of any kind, no sales tax is due.

Special Rule Re: Taxation of Inventory of Contractors Who Cancelled Their Sales Tax License Before May 1, 2015

The following one-time special rules apply to contractors who cancel their sales tax license before May 1, 2015 and have an inventory of materials that they purchased tax free because they were intended to be incorporated into a construction project.

As long as such contractors had no intent to evade taxation, they may make a reasonable estimation of the value of their inventory on hand at the time they cancelled their license and, if the estimate of value is: (1) $10,000 or less, the contractor is not liable for any tax that otherwise would be due, (2) more than $10,000, then the first $10,000 is not subject to tax and the contractor may opt to report tax on the remainder either: (a) in the manner outlined in the previous section, (b) in a single payment based on the tax rate in effect at the contractor's principal place of business, or (c) in twelve equal monthly installments beginning immediately following the month in which the contractor's sales tax license is cancelled based on the tax rate in effect at the contractor's principal place of business.

Safe Harbors for Contracts Bid Before May 1, 2015

For contracts or other binding obligations bid or entered into before May 1, 2015, contractors: (1) may, at their option, treat proceeds from the contract as a project that is taxable under the prime contracting classification, and (2) shall be held harmless from any additional tax, penalty, or interest if ADOR later determines that the contractor's good faith treatment of the project, either as a prime contracting project or a MRRA project, was incorrect.

What's Next for Contractors in Arizona?

Recognizing that they fell short of their goal to "simplify the administration of Arizona's transaction privilege tax in order to alleviate taxpayer confusion, [and] relieve businesses from unnecessary compliance costs," the 2015 Legislature stated that the purpose of SB 1446 is "to clarify and simplify the transaction privilege tax reform measures [previously enacted] until such time as the prime contracting classification can be repealed.

So, hopefully there will soon be enough votes in the legislature to repeal Arizona's now-more–complicated-than-ever method of taxing contractors and replace it with a pure tax on materials like most other states employ. tln

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