



Contracting

LEGISLATIVE CHANGES IMPACTING BUSINESS AND TAXATION

Status

- ▶ New legislative bills introduced February 2, 2015:
- ▶ They are: SB1446 and HB2590 (same text)
- ▶ Changes the law on Contracting taxation that became effective January 1, 2015
- ▶ Retroactive to January 1, 2015
- ▶ Expect quick action by the legislature
- ▶ This bill has approval from the Contracting Industry, ADOR and the League of Arizona Cities and Towns

Definitions

- ▶ MRRA – This is an exclusion from the Contracting classification. The tax is based on materials purchase price only
- ▶ MRRA is an acronym for the contracting industry that helps to identify activities that are taxed on materials only:
 - ▶ **M** Maintenance – regular work to keep things in order
 - ▶ **R** Repair – Repairs to an existing part, unit
 - ▶ **R** Replacement – of the same part or unit or function
 - ▶ **A** Alteration – changes to something that exists

Business Impacts

- ▶ A city or county cannot require a tax or business license as a condition prior to issue a building permit
- ▶ A city or county can require a business license within 30 days of issuance of the building permit
- ▶ The Registrar of Contractors (ROC) no longer requires a contractor to hold a tax license to get or renew an ROC license
- ▶ A contractor that uses materials purchased without tax paid to the vendor in an MRRA job will pay an amount equal to the Retail tax based on the job site and the contractor's purchase price.

Three types of contractors

- ▶ Contractors that never do MRRA work – examples: Prime Contracting, new construction, home builders, commercial builders, public road builders
 - This group should KEEP their TPT License
- ▶ Contractors that only do MRRA work – examples: handymen, smaller maintenance, repair and replacement businesses like plumbers, HVAC, etc.
 - This group can CANCEL their license, but they can also keep it if they are uncertain
- ▶ Contractors that do both MRRA and Prime Contracting work – examples: many remodelers, most subcontractors
 - This group should KEEP their TPT License

Alterations

- ▶ Alteration is only in MRRA now – all tax is based on the purchase price of materials
- ▶ Two types: Residential and non-residential
- ▶ Separate thresholds for residential and non-residential are established in statute to distinguish between “Alteration” and “Prime Contracting”

Residential Alterations

To qualify as a Residential Alteration that is taxed based on materials:

- ▶ The value of the original contract must be no more than 25% of the current Full Cash Value per the County Assessor website.
- ▶ If the Full Cash Value changes between the bid and the contract, the higher value is used.

Non-Residential Alterations

To qualify as a Non-Residential Alteration that is taxed based on materials ALL THREE criteria must be met:

- ▶ 1. The original contract price is < \$750,000 *AND*,
- ▶ 2. Scope of the job *ALTERS* < 40% of the existing square footage, *AND*,
- ▶ 3. Scope of the job *ADDS* < 10% of the original square footage as new square footage to the building.

Additional Considerations for All Alteration Jobs

- ▶ Change orders that are reasonably related to the original scope of work are deemed part of the original contract and the complete job is treated as an Alteration
- ▶ Provided the original contract qualified, reasonably related change orders can cause the job to exceed the Alteration thresholds by up to 25% of each criteria and the job will still remain qualified for treatment as an Alteration job
- ▶ Roads and other heavy construction jobs subject to a public procurement process are always taxed as Contracting
(there are specified Special Districts that this does not apply to)

Exemption Certificates

- ▶ DOR Form 5000 – Prime contractors continue to use this form as they always have to buy materials exempt – materials are taxed as part of the contracting job – this is not a change
- ▶ DOR Form 5009L – New Form. Provided by the prime contractor to a non-licensed subcontractor (non-licensed because the subcontractor only does MRRA work). DOR issues the 5009L to the prime contractor for the job. Prime contractor only needs a 5009L from DOR *if* the prime will be hiring a unlicensed subcontractor who will buy materials at retail.

Non-taxable MRRA

For any Contractors doing work both as a taxable prime contracting and doing exempt MRRA jobs:

- ▶ Recommended:
- ▶ Purchase all materials tax exempt since it is not known how that inventory will be used
- ▶ When materials, purchased tax exempt, are used in an exempt MRRA job, pay the tax at the retail rate on the purchase price of the materials to the city where the work is performed. This shifts the tax from a non-state-shareable use tax to a state-shared revenue retail tax and adds direct local tax back into the mix.

Existing Inventory

To recover the tax due for all inventory that was purchased tax exempt by an unlicensed MRRA contractor:

- ▶ First \$10,000 in inventory exempted from use tax
- ▶ Remaining inventory is subject to tax and can be paid in any one of three ways:
 - ▶ 1. As Use tax in one lump sum, based on the business location;
 - ▶ 2. As Use tax above, but spread over 12 months;
 - ▶ 3. As the materials are used up, based on the Retail tax rate applied to purchase price, where the job is being done.

Retroactivity and Hold Harmless

- ▶ This bill is retroactive to January 1, 2015
- ▶ All existing contracts/bids entered into by the last day of the month 60 days after enactment will be honored as written:
 - ▶ If contract was based on Prime Contracting – honored
 - ▶ If contract was reasonably believed to be MRRA – honored