

Arizona bill proposes significant transaction privilege tax changes

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In brief

House Bill 2657, which generally incorporates Arizona Governor Jan Brewer's proposed transaction privilege tax reforms, was introduced on February 12, 2013. The bill proposes several significant tax changes, including: (1) providing tangible personal property sales sourcing rules for state and municipal taxes; (2) changing the incidence of tax for contractor related transactions from contractors' gross receipts to contractors' purchases of tangible personal property incorporated into a project; (3) providing for the Department of Revenue to serve as the centralized point to collect and enforce the tax; and (4) authorizing county use taxes. The sourcing and county use tax provisions would be effective from and after December 31, 2013, and the remaining changes would be effective from and after December 31, 2014.

Taxpayers selling to or using the services of contractors should consider the effect the bill's changes may have on their Arizona privilege tax liability. Additionally, Arizona taxpayers should understand how the potential sourcing and centralized reporting changes proposed by the bill will impact their compliance responsibilities. [[Arizona House Bill 2657](#), introduced 2/12/13]

In detail

Transaction privilege tax and use tax, generally

Arizona's transaction privilege tax is a tax on the privilege of doing business in the state and is imposed on persons "engaging or continuing in this state" in certain enumerated business classifications. Different rates and tax bases apply depending on a person's business classification. Arizona's use tax is imposed on the storage, use, or consumption in the state of tangible personal property purchased from a retailer or utility business.

Tangible personal property sales sourcing rules - state and municipal

Current statutory law does not provide clear rules for determining the source of where tangible personal property sales are made. This determination is particularly significant when determining what local tax to apply to a particular transaction. Generally, Arizona guidance provides that the taxable event is where a person is 'engaged in business.' Considerations for determining where a retailer is 'engaged in business' include where the

following activities occur: solicitation of the sale, acceptance of the order, maintenance of inventory, processing the order, and receipt of payment. The location where title transfers is not determinative of where the sale occurs.

Effective from and after December 31, 2013, H.B. 2657 would establish that (except for manufactured building dealers) retail sales of tangible personal property would be sourced as follows:

- to the seller's business location if the seller receives the order at an Arizona business location. The seller's business location means the location where any of the following occurs: where the order is received, where the stock is located from which the property is taken, or where the transfer of title or possession occurs.
- to the purchaser's Arizona location if the seller receives the order at a business location outside Arizona

The gross receipts from leasing or renting tangible personal property would be sourced:

- to the lessor's business location (i.e., the address that appears on the lessor's transaction business license), if the lessor has an Arizona business location
- to the lessee's address if the lessor does not have an Arizona business location

Certain transactions currently exempt from the transaction privilege tax based on the destination of tangible personal property would be eliminated by H.B. 2657. For example, the bill would remove exemptions for: (1) sales to out-of-state residents for use outside the state when the property is shipped or delivered outside of Arizona; and (2) sales of tangible personal property shipped or delivered directly to a destination outside the US for use in that foreign country.

Tangible personal property sales sourcing rules - municipalities

Effective from and after December 31, 2013, H.B. 2657 would provide that, for purposes of municipal excise taxes, the jurisdiction with the right to tax a sale of tangible personal property is the jurisdiction:

- where the order is received
- where the stock is located from which the property is taken, if the previous test does not apply to any city or town
- where the transfer of title or possession of the property occurs, if the previous two tests do not apply to any city or town

Change incidence of tax on construction materials

Currently, contractors are generally subject to the transaction privilege tax under either the 'prime contracting' or 'owner builder sales' classifications. Such contractors are subject to the tax measured by 65% of the amount that they charge their customers.

Effective from and after December 31, 2014, H.B. 2657 would shift the incidence of tax for contractor related transactions from taxing the contractor's receipts to taxing the contractor's purchases. The bill accomplishes this in two ways:

- 'prime contracting' and 'owner builder sales' classifications would be eliminated from the list of taxable business classifications
- the sale of tangible personal property to a contractor, regardless of whether it will be incorporated into a building or structure, would generally be considered to be a sale at retail (unless the contractor provides a certificate stating the purchased property will be used for certain taxable retail purposes)

Manufactured building dealer classification

Effective from and after December 31, 2014, H.B. 2657 would add the 'manufactured building dealer' classification, which is comprised of the business of selling manufactured buildings. Such dealers are subject to

the tax measured by 65% of their gross proceeds derived from their business, with some deductions.

Centralized administration of local taxes

Currently, cities and towns may collect their own local transaction privilege tax, use tax, severance tax, and other taxes and may perform their own audits. Alternatively, such localities may contract with the Department of Revenue to collect such taxes and perform audits on their behalf.

Effective from and after December 31, 2014, H.B. 2657 would require that the Department collect all local taxes and perform all audits of local taxes.

Counties authorized to impose use tax

Effective from and after December 31, 2013, H.B. 2657 would allow counties that impose certain excise taxes to impose a tax on the storage, use, or consumption in the county of tangible personal property purchased by a retailer. The tax would have to be approved by voters at a county-wide election.

The takeaway

H.B. 2657 is the proposed legislation derived from the results of the state's Transaction Privilege Tax Simplification Task Force, which issued its [final report](#) on December 13, 2012. While the bill does not incorporate everything proposed by the Task Force, the change in taxing contracting transactions and the centralized collection and enforcement proposed in the bill originate from Task Force suggestions. Notably, the bill does not incorporate the Task Force's sourcing suggestion. The Task Force recommended destination-based sourcing while the bill continues

Arizona's policy of origin-based sourcing.

The bill advances the purpose of establishing uniform transaction tax rules and enforcement across state and municipal jurisdictions. Uniformity is advanced through (1) the state sourcing rules for tangible

personal property since they are modeled after the Model City Tax Code and (2) the centralization of collection and enforcement of local taxes with the Department.

Arizona's major cities have opposed, and will likely continue to oppose, this legislation even though it has strong

support from Governor Brewer and approximately half of the legislature. In particular, the elimination of the prime contracting classification and loss of control of collection and audit functions will have a significant effect on the major cities.

Let's talk

If you have any questions regarding H.B. 2657, please contact:

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