

Arizona - Significant transaction privilege tax changes enacted

June 27, 2013

In brief

Signed by Governor Jan Brewer on June 25, 2013, [H.B. 2111](#) enacts several significant transaction privilege tax changes, including: (1) centralizing the administration of local taxes; (2) changing the incidence of tax for certain contractor related transactions; and (3) repealing an exemption for certain sales made to foreign locations. Unless otherwise noted, the changes are effective from and after December 31, 2014.

Taxpayers selling to or using the services of contractors should consider the affect 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.

In detail

Online portal centralizes administration of local taxes

Currently, certain cities collect their own local transaction privilege tax (TPT), 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.

H.B. 2111 requires that the Department modify its online portal by January 1, 2015, so that taxpayers can pay any state, county, or municipal TPT online. Accordingly, the Department has eighteen months to develop procedures to handle the revised tax

reporting function as well as to implement the changes to the online portal that was instituted by the legislature during the past legislative session.

Centralized audits

Effective January 1, 2015, cities and towns that levy a local TPT must enter into agreements with the Department to provide for unified and coordinated auditing programs. For example, all audits are to include all Arizona taxing jurisdictions regardless of which jurisdiction conducts that audit. Additionally, a city or town may conduct an audit of any taxpayer that is engaged in only one city or town. Generally, the Department will audit taxpayers

with locations in two or more Arizona cities or towns.

Incidence of tax on construction materials changed

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.

Under H.B. 2111, service contractors that work directly for the property owner and whose work is limited to the maintenance, repair, or replacement of existing property

(not including modification) are exempt from the TPT prime contracting classification. Such contractors will be subject to a retail tax on materials purchased to be consumed in performance of their service.

Contractors that do not qualify for the TPT exemption continue to be subject to the prime contracting classification under the TPT. H.B. 2111 provides that such contractors may issue to their material suppliers an exemption certificate under certain conditions applicable to purchases of tangible personal property to be incorporated or fabricated into real property. The Department is charged with supplying such contractors the exemption certificates for their use.

Additionally, the 'owner builder sales' classification is repealed effective January 1, 2015.

Design services and professional services

The prime contracting classification under current law provides an exemption for gross proceeds for design phase services and professional services to the extent a separate written contract is executed for such services before modification begins.

H.B. 2111 provides that the exemption may apply to design phase services and professional services incorporated into a contract that includes taxable contracting services. However, the conditions and pricing of such services must be stated separately from the contracting services.

Tangible personal property sales sourcing rules

Current law does not provide clear rules for determining where tangible

personal property sales are made. This determination is particularly significant when determining what local tax to apply to a 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.

H.B. 2111 establishes that retail sales of tangible personal property (other than for prime contractors) are sourced:

- to the seller's business location if the seller receives the order at an Arizona business location
- to the purchaser's Arizona location if the seller receives the order at a business location outside Arizona.

Gross receipts from leasing or renting tangible personal property are 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.

Exemption for certain foreign sales repealed

Current law provides a TPT exemption for sales of tangible personal property

shipped or delivered directly to a destination outside the US for use in that foreign country. This exemption is repealed under H.B. 2111.

The takeaway

H.B. 2111 implements some of the changes suggested by 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. Additionally, the bill implements many changes to help Arizona get compliant with the requirements of the Marketplace Fairness Act.

The legislation is a result of many months of contentious debate with Arizona localities regarding their concern of the loss of revenue, particularly from the revisions to the contracting classification, as well as concerns by certain cities regarding the centralization of reporting and audit functions. It should be noted that although the contracting related changes are taxpayer friendly, they do create a somewhat more complex system of taxation depending on the type of contracting work performed.

Let's talk

If you have any questions regarding H.B. 2111, please contact:

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