



Certified Public Accountants

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On December 30th, we attended a seminar conducted by the Arizona Dept. of Revenue regarding the new "simplification" rules for transaction privilege tax on contractors. It was very informative and answered a lot of the questions I have been fielding from clients. As seems to be the norm with our state legislature, the new law is written in fairly vague terms and is open to interpretation. It appears that ADOR is trying to be proactive in getting the word out and clarifying how jobs are to be taxed.

The contracting category has been split into two categories, prime contracting and "service" or MRRA (maintenance, repair, replacement or alteration) contracting.

Prime contracting is new construction and/or modification of real property. ADOR's definition of modification is "...to construct, improve, move, wreck or demolish". "Improve" is taking unimproved land and improving it. Improving can include an addition to a building if it is being expanded onto unimproved land.

MRRA contracting consists of maintenance – the upkeep of real property or equipment, repair – returning real property or fixtures/equipment to a usable state from an unusable or partially usable state, replacement – replacing something that exists with something else (includes a betterment), and alteration – making a physical change to real property without changing the identity of the property.

A job can contain elements of both contracting types. An example would be tenant improvements. A contractor could be hired to make tenant improvements within an existing shopping center. Part of the contract would entail the demolition of the existing tenant space and the remainder would be to improve that space. Demolishment falls under the prime contracting category but the improvements to the existing space would be MRRA since they would be replacement or alteration. In this case, if the job is all done under one contract, the contractor must look at the ratio of the prime contracting portion of the job to the MRRA portion of the job. If the prime contracting portion is 15% or less, then the job would all be MRRA. If it is more than 15%, then the entire job would be prime contracting.

Prime contracting jobs are reported and paid by the prime contractor on 65% of the total contract. This is the same as it has been in the past. On MRRA jobs, the contractor is required to pay tax on the materials as they are purchased. MRRA contractors will not pay any additional tax on these jobs and will not report them on the TPT return.

On the following page I have put together a list of the questions and answers from the seminar. I think that they will answer most of the questions I have been asked in the last month. In addition, we are sending you ADOR's Q & A "Arizona Transaction Privilege Tax Notice TPN 14-1".

If you have more questions, please call or email me at dorisl@hblcpa.com and I will do my best to answer your questions or I will get answers from ADOR. You can also contact Lori Beine, lorib@hblcpa.com or George Palomarez, georgep@hblcpa.com.

Sincerely,

Doris Lafave

Q #1: I only perform MRRRA contracting. Do I need a TPT license? A #1: If you only perform MRRRA work for property owners and never do any subcontracting work, then you do not need to have a TPT license going forward.

Q #2: I only perform work as a subcontractor. Do I need a TPT license?

A #2: Yes, if you perform work as a subcontractor for a prime contractor, you will need to retain your license. That work may either be MRRRA or prime contracting work. The prime contractor should advise you whether the job is MRRRA or prime contracting before you bid or accept the job. If the job falls in the MRRRA category, you will pay tax on your materials. If the job is prime contracting, you will need your license to be able to purchase materials tax-free. You will still report the income from the prime contracting work on your TPT return and take a deduction for subcontracting income.

Q #3: I am a prime contractor doing a prime contracting job and will hire subcontractors for the job. What form do I give them?

A #3: If the subcontractor holds a TPT license, then you will provide them with a Form 5005 – Prime Contractor' Certificate – and make it specific to the job as a Single Project Certificate. If the subcontractor does not hold a TPT license, then you will provide them with a Form 5009L – Contractor's Certificate. This form is only to be used for subcontractors who do not hold a TPT license and is job specific. This should be a rare occurrence since a contractor doing work as a subcontractor should hold a license. If you have to provide a Form 5009L, it must be submitted to the Dept. of Revenue and approved prior to you giving it to a subcontractor. We were assured that the turnaround time for the approved form would be short. In either case, be sure you check the ADOR website for the most recent version of the forms.

Q #4: How do I know for sure the subcontractor does or does not hold a TPT license?

A #4: Ask the subcontractor for their TPT license number or a copy of their license. You can then check on the website at <https://www.aztaxes.gov/LicenseVerification>.

Q #5: I am doing prime contracting work. What do I give my vendors so I can purchase materials tax-free?

A #5: Form 5000 – Transaction Privilege Tax Exemption Certificate. Check box #3 as the reason for exemption. Your vendor may require you to give them a new Form 5000 each year.

Q #6: What do I do about contracts that are either in progress at 12/31/14 or were signed in 2014 but not started until 2015 and that now fall under the MRRRA category rather than prime contracting?

A #6: The new legislation did not grandfather existing contractors under the old law. What this means is that anything occurring after 12/31/14 must be taxed according to the new law.

Q #7: I pay my sales tax on the cash receipts method, so I may have billed someone in November or December 2014 but didn't receive the payment until January 2015. What do I do then?

A #7: If the job was completed by December 31, 2014, it would be prime contracting. If the job was not completed, then you can either continue to report the job as prime contracting (see Q #8) or you can figure the tax on the materials to date and pay use tax on those and then pay sales tax on material purchases going forward.

Q #8: Even if an existing job is now an MRRA job, am I allowed to finish reporting it as prime contracting?

A #8: Yes, you can. Since the tax is, in nearly all cases, more under the prime contracting code, the State just gets more money this way so you shouldn't have a problem.

Q #9: I am doing an MRRA job and the materials I purchase are coming from an out-of-state vendor that doesn't charge Arizona sales tax. Now what do I do?

A #9: In this case, you will report the cost of the materials as use tax for the jurisdiction for the job location. In other words, if you are doing a job in Phoenix, you will report it as use tax for both Maricopa County and the City of Phoenix.

Q #10: What do we do with materials in inventory that were purchased for "resale" (no sales tax paid at the time of purchase) but will be used in the future for MRRA jobs?

A #10: You should calculate what you have in inventory as of 12/31/14 that you did not pay sales tax on at the time of purchase. You will then report one-twelfth of this amount on Form TPT-1 for each month in 2015 (January through December) and pay the sales tax calculated. This amount should be reported under the 017 (retail) code with no deductions taken. You will do the same on the city sales tax return.

Q #11: What if I have inventory and I do both prime contracting and MRRA jobs?

A #11: You will need to prepare a list and calculate your inventory as of 12/31/14. As you use these materials in MRRA jobs, you will report the retail TPT due on them, sourcing the materials to the primary location of your business.

Q #12: I have a contract to build a new building on a site where there was a building but the old building was demolished. Is it prime contracting or MRRA?

A #12: This contract would fall under prime contracting because it is a new building and is not considered a replacement or alteration. It is a modification. This answer comes directly from ADOR.

Q #13: I have a contract to build a new building but the property owner already has a concrete slab on the site. Is it prime contracting or MRRA?

A #13: This contract would fall under prime contracting because it is a new building and is not considered MRRA. It is a modification. This answer also comes directly from ADOR.

Q #14: I am a subcontractor on jobs. The general contractor is giving me a Form 5005 but I think the job falls under the MRRA definition. Should I just accept the Form 5005 and not pay tax on my materials when I purchase them?

A #14: You should talk to the prime contractor about your concerns. It may be that, even though your portion of the job might otherwise be MRRA, the total job is a modification that does not meet the de minimus rule of 15% or less prime contracting activity.