



LEGISLATIVE BULLETIN

Issue No. 5 – February 9th, 2018

Legislative Overview

This upcoming week is sure to be a busy one for the Arizona Legislature. Friday, February 16th is the last day for bills to be heard in their chamber of origin. Appropriations committees in both the House and Senate will have an additional week to hear bills, however. It's not uncommon for bills to be strategically reassigned to this committee in the week leading up to the deadline – so keep an eye out.

The staff at the League will be busy managing the rush of bills and will be signing into committees throughout the week. Given the impending deadline, the bills set to be heard in committee next week will be in flux. The number of bills per agenda will grow into the double-digits for most committees, many of which will continue late into the night as a result.

Today marks the 33rd day of the legislative session. As of today, all deadlines for bill introductions have lapsed, with a total of 1164 bills having been introduced this session.

1374 – State law; local government violations

SB 1374 state law; local government violations, sponsored by Sen. Kate Brophy McGee (R-Phoenix) was finally assigned to the Senate Government committee. The chairman, Senator Sonny Borrelli (R-Lake Havasu City), has committed to put it on his agenda and the bill should be heard next Wednesday afternoon.

Of course, we would prefer to see the entire law that was put into place with SB 1487 repealed. Unfortunately, some legislators see it as a way to exercise even more control over local governments. Since we are going to have to live with it for now, we would like to see some changes that will make it more equitable. We anticipate we will have to make some compromises but look forward to the opportunity to have a discussion about this issue.

We very much appreciate Senator Brophy McGee for sponsoring the bill and Senator Borrelli for agreeing to calendar it. Please contact your legislators to let them know that the passage of SB 1374 is important to your community.

Speculative Builders

HB 2387, municipal TPT; speculative builders, sponsored by Rep. Tony Rivero (R-Peoria) creates a new preemption that applies to Model City Tax Code Section 416, Contracting: speculative builders. This bill effectively results in the complete elimination of the Speculative Builder classification for all new construction projects, both commercial and residential.

Cities and towns currently impose tax on 65% of the selling price of new construction on the seller, frequently referred to as the developer's Marketing Arm. In commercial projects it is common for these sales to occur after the building has been leased by at least 80%, with those leases usually running for terms of 5 to 10 years, plus options to renew.

The bill provides that any amount the developer attributes to an in-place lease, any other intangible value, or any personal property as stated on the recorded affidavit of value must be subtracted from the selling price, not to exceed the taxable cost of construction amount reported to the State (i.e., the amount reported by the developer's Contracting Arm to calculate State and County tax – typically cost of construction plus 5% "reasonable profit").

The bill does not provide a method for valuing the in-place leases, other intangibles or personal property. These ambiguities leave taxpayers and the cities with no uniform method for application. The inclusion of the phrase "other intangibles" opens the door to claiming exemption for the entire selling price down to the stated minimum, construction cost plus 5% used by the Contracting Arm.

The bill is retroactive through the statute of limitations, meaning all sales of new construction within the past four or six years. Refund claims are limited to \$10,000 total per city to be distributed amongst all claimants, but no deadline for filing is set. All existing (presumably unpaid) assessments that exceed the tax liability under this method are deemed "remitted and forgiven." All related tax liens must be released.

Please contact your representatives and tell them the cities and towns oppose this bill for the following reasons:

- 1) The wholesale elimination of this tax classification through creation of an overly broad exemption will have a devastating revenue impact on cities and towns;

- 2) Most cities have been allowing a reduction in selling price for in-place leases for several years, albeit without a consistent method of valuing the leases;
- 3) Cities and towns are actively in the process of adding this specific exemption to the Model City Tax Code with a precise method of valuation to create clarity and uniformity among all cities and towns;
- 4) We welcome an opportunity to work with the industry and experts on business/property valuation to develop an equitable method to recognize the value of leases in question.

Digital Goods & Services

SB 1392 and HB 2479, TPT; digital goods and services, sponsored by Sen. David Farnsworth (R-Mesa) and Rep. Michelle Ugenti-Rita (R-Scottsdale) respectively, are the companion bills that emerged from the interim committee on Digital Goods and Services.

The intent of the bill is to draw a line between “pre-written software” and “specified digital goods” (books, music, movies, etc.) that are “transferred electronically” meaning wholly downloaded or saved in some manner by the user and thus are considered taxable, versus the same items that are “remotely accessed” over the Internet (“in the cloud”) without downloading a complete copy and thus are defined as exempt “specified digital services.”

We feel drawing the line determining tax liability based on whether or not the customer receives an entire copy of the product is simply bad tax policy. Whether the buyer receives a full copy of the program on their personal device or merely accesses the same program over the Internet, they have still purchased or leased the entire program.

This bill creates at least eight new exemptions for transactions that have long been deemed taxable by the DOR and the cities and towns. Since taxpayers do not currently separate their activity in this way on their tax returns it will be very difficult to accurately assess the potential impact but there is no doubt these changes will have a significant negative revenue impact immediately upon approval. An even greater concern is these losses will only continue to grow over time as technology advances and more activity shifts to the Internet.

The new exempted “specified digital services” include all of the following items (with the related classification the transaction is currently being taxed under in parentheses):

- 1) Software as a service or SAAS, meaning access to the provider’s applications running on a cloud infrastructure (Retail or TPP Rental);

- 2) Platform as a service or PAAS, meaning the ability for a purchaser to deploy applications on the provider's cloud infrastructure using the provider's operating system (TPP Rental);
- 3) Infrastructure as a service or IAAS, meaning the ability of the purchaser to deploy, maintain and configure an operating system and applications on the provider's cloud infrastructure (TPP Rental);
- 4) Application service providers or ASPs, meaning a provider that offers access to third-party applications over the Internet (Retail or TPP Rental);
- 5) Hosting services, meaning the operation of data centers where the purchaser either leases space on the center's servers, or colocation services where the purchaser leases space in the data center building to house the purchaser's own servers (TPP Rental or Real/Commercial Property Rental);
- 6) Data storage management, meaning providing a purchaser with storage space on the provider's servers (TPP Rental);
- 7) Data processing and information services, meaning services that allow data to be generated, acquired, stored, processed or retrieved and delivered electronically, if the primary purpose is the processed data or information (Publishing, Job Printing, or Retail);
- 8) Streaming services, meaning subscription access to movies, television shows, music, books or other digital content over the Internet if the subscription does not include the ability to "transfer electronically" (for example, download a full copy of a movie to keep, either forever or that expires after a specified period of time). If the subscription does include an option to download a complete program or receive a hard copy on DVD, the entire subscription is taxable. (TPP Rental);
- 9) Digital authentication services, meaning electronic services used to confirm the identity of persons or websites to provide secure commerce and communications (not taxed);
- 10) Any other cloud-based or remotely accessed computing service (not enough information).

Under the bill, in all cases where the transaction is deemed taxable it will now fall under the Retail classification, even if the true nature is that of a rental, lease, or license for use.

The bill adds new provisions to A.R.S. 42-5040 regarding sourcing to the customer's billing address if no other address is known, as well as allowing for the issuance of a new Multiple Points of Use (MPU) certificate to identify the AZ taxable portion of a

transaction billed to a single location where the digital goods will actually be used in locations throughout the country.

It requires purchasers to report and pay a tax equivalent to the combined Retail tax rate on any taxable purchase from an unlicensed vendor (similar to the MRRA provisions in A.R.S. 42-5008.01) for subsequent distribution of the local portions to the counties and cities as well as inclusion of the state portion in the shared revenue distribution formula.

Rather than placing preemption language in A.R.S. 42-6004, the bill creates a new section, 42-6015, that essentially says the cities will treat these goods and services in the same manner as the State.

Regardless of the outcome, the League has made a commitment to all parties involved that the MCTC will be revised to coincide and maintain conformity with the State application based on whatever changes are ultimately passed into legislation.

The League has been working with ATRA, the DOR, the counties and the committee members on refining the language of these bills and an amendment addressing some but not all of our concerns is expected. As with any major policy shift there are many substantive and technical changes and clarifications that still need to be worked out.

Please contact your representatives and express your concerns over the potential for overwhelming revenue losses now and in the future.

Post-Traumatic Stress Disorders; Presumption

This week the House Health Committee heard HB2501; PTSD; workers' compensation; presumption sponsored by Representative Boyer (R-Phoenix, Glendale). The amended language in HB2501: 1) extends the time to file a workers' compensation claim by tolling the deadline to one year after the last counseling session, 2) creates a presumption of PTSD for the public safety employee unless the employer can prove through a preponderance of evidence the employee's job did not create the PTSD, 3) prohibits the employer from requesting an Independent Medical Exam (IME), 4) increases the number of visits from a minimum of 12 to a total of 48 visits (an additional 36), 5) and requires the employer to pay 100% of the employee's salary during the period of visits if the counselor says the employee is unfit for duty.

The League signed in and spoke in opposition to HB2501 indicating that the League, just as the police officers and firefighters, has the objective of returning these employees to a healthy mental status so that they can return to work and their regular daily lives. However, the League differs in our opinion on how we can get to that mutual objective. Additionally, the League pointed out that A.R.S. § 23-1101 through 1104 require a report to be presented to JLAC for any presumptive legislation. The

report should outline the scientific evidence substantiating such a change, the financial costs of the change, and information on why the current methods are inadequate. There was no report created for this huge shift in how PTSD is handled and we believe it is an important element to finding the best practice going forward.

We expect a stakeholder meeting to take place next week and for us to continue working to amend this bill throughout the session. The bill was voted out of Health 9-0 on 02/08/18.

Food Trucks

The League continues to work through a stakeholder process on HB 2371 mobile food vendors; state licensure, sponsored by Rep. Kevin Payne (R-Peoria). The bill establishes a state licensing scheme, minimum food safety regulations and inspection standards for food truck vendors to be administered by the Department of Health Services and county health departments. The bill as written, however, would upend many local regulations concerning, among others, the use of public property by allowing food truck vendors to conduct business on public property without a permit, fee or permission. In addition, the bill prohibits spacing distances from existing brick and mortar restaurants, allows unrestricted use of any legal parking spaces and prohibits the enforcement of “keep moving” ordinances that restrict the operation of food truck vendors at locations within a certain timeframe. The provisions of the bill would likely have many unintended consequences.

The bill was drafted by the Institute for Justice, a national public interest law firm, in an attempt to keep cities from “imposing anti-competitive regulations” on food truck vendors. During the stakeholder process we explained the provisions of the bill and their potential impact on local regulations to the representatives of the food truck industry, who agreed it was not their intent to completely remove local regulation of their industry and instead they were seeking to establish regulations that are clear, consistent and applicable statewide, but not to undermine policies regarding the use of public property, public safety or the perception of their industry.

The bill is scheduled for a hearing in the Military, Veterans and Regulatory Affairs Committee on Monday and an amendment drafted by the League will be offered that will bring us to a neutral position on the bill for committee and to continue the stakeholder process to refine the bill as it proceeds in the process

Yurts & Hogans

HB 2396 property; subdivision; size; requirements, sponsored by Rep. Bob Thorpe (R-Flagstaff) would allow a property owner in a “rural municipality” (undefined in the bill) to have on their property, in addition to their single family home, a yurt, hogan, RV,

mobile home, or another single family home, any of which could be used as a full-time residence or rental property. The bill would also allow a property owner to subdivide their land into as many five acre or smaller lots as they want as long as the resulting lots are as large as the "average" lot size within 5 miles of the property. Not only would this upend the subdivision statutes by creating a huge exemption, it is also technically unworkable. For example, the "average" lot size would constantly change making it almost impossible to determine if a lot was legally subdivided based on the average lot size *at the time*. Additionally, each time a property owner subdivided their land it would reduce the average in the area allowing for additional subdivisions.

The statutes regulating the subdivision of land have been in place for many years and work together to ensure that when property is bought, sold, or platted for a subdivision, the appropriate infrastructure is planned for and each property has a clear title, legal access and satisfies many other legal requirements for sale. Any exemptions/changes to the subdivision statutes that do not harmonize with the rest of the regulations can have significant unintended consequences, namely what are known as "wildcat" subdivisions (haphazard developments that do not fit into a city or county's general plan).

The League, along with the County Supervisors Association, and Arizona Planning Association, were ready to testify in opposition to the bill this Tuesday in House Federalism, Property Rights and Public Policy but the bill was held. However, it is on next week's agenda for House Federalism, Property Rights, and Public Policy on Tuesday at 2pm. We encourage you to reach out to the members of that committee and ask that they vote "no" on any changes to the subdivision statutes that have not been vetted by all the affected entities.

Recovering Public Monies

SB 1274 public monies; recovery; illegal payments, sponsored by Sen. Warren Petersen (R-Gilbert), is a proposal that originated from the Attorney General's office. It would allow the AG to go after persons who knowingly cause an illegal payment (a disbursement of public funds without authorization of law).

Current statute allows the AG to go after a person that receives an illegal payment but not the person that caused the payment. For example if a county or school district administrator paid out bonuses to employees that were not authorized by law, the AG could only go after the employees that received the bonuses but not the person that intentionally violated the law.

The League has been working with the AG's office on the amendment that was adopted in Senate Government committee this week. The amendment would protect municipal employees that disburse, collect, receive, safe keep, or transfer public monies pursuant to a warrant that appears lawful unless the person knew or had reason to know that

the payment was not authorized by law. The League will continue to work with the AG's office on the bill but is neutral on the bill as amended.

Legislative Bill Monitoring

Due to changes on the legislature's website this year, you will need to take an extra step to see the details of each bill. To see the bills we are tracking, go to the League's [Legislative Bill Monitoring](#) (LBM) page. To see our position and a brief summary, click on the bill number. In the new page, click on the bill number to be redirected to the legislative web site where you can enter the bill number to see all its current status, versions and vote count.