



LEGISLATIVE BULLETIN

Issue No. 6 – February 16th, 2018

Legislative Overview

Today is the 40th day of session and this week the legislature wrapped up the first round of committee hearings for the session. The Appropriations Committees in both chambers, however, have next week to take action on assigned bills. Next week is "crossover week," which means there will be extensive activity with several floor calendars to move bills to the opposite chamber in time for the next committee deadline. This is one of the times of year we see strike-everything amendments offered in the Appropriations Committees to keep moving through the process bills that were held up in another committee or that were not quite ready for primetime.

We expect floor sessions next week to last several hours in the House as the chamber will be working to amend, debate and vote on over 100 bills. The Senate tends to have fewer bills moving through the process, so we don't expect their workload to be the same as the House.

Occupational Licensing

Last year, the legislature failed to pass a bill that would have preempted cities and towns from adopting any new occupational licenses or fees. That bill has come back this session as SB1404 occupational regulation; municipalities; counties, sponsored by Sen. Steve Smith (R-Maricopa).

As written, it would allow a city or town to continue licensing professions it already licenses, but if a new industry or occupation sprang up the local government would have its hands tied. Additionally, if a neighboring community did not already license an activity, and under the bill was prohibited from beginning to do so, it would create an incentive for bad actors in that industry to move to the unprotected community.

In addition to SB1404, the same proponents are also pushing HB2532 occupational regulation; municipalities; counties; prohibition, sponsored by Rep. Kevin Payne (R-Peoria). This bill would prohibit cities and towns from licensing a list of *specific* occupations including secondhand dealers, junk dealers, auctioneers and transient merchants. These professions are licensed in most communities because of the risk

they pose for facilitating the transfer of stolen property and preying on vulnerable citizens and are emblematic of why we need local occupational licenses.

The League testified in opposition to both bills this week but unfortunately both measures passed out of committee. As they move through the process, we will provide updates and sound the alarm when there is an opportunity to stop these bills.

HURF Distribution; Cities, Towns, Counties

This week the House Transportation and Infrastructure Committee considered HB2514; HURF distributions; cities, towns, counties sponsored by Representative David Cook (R-Globe). The amended language in HB2514 changes the distribution of HURF funds by directing an initial \$18M to rural counties and cities before calculating the additional funds based on the traditional formula.

The League signed in and spoke in opposition to HB2514, indicating we do not believe it is useful to pit rural cities versus urban cities and rural counties versus urban counties. Rather, we believe the root cause of the HURF funding problem is that the available pool of money is too small since the gas tax has not been raised since 1991. The current gas tax of 18¢, adjusted for inflation, is 33¢ in today's dollars.

Additionally, the League identified that while the purchasing power of the pool of HURF funds continues to decline, the state has swept HURF funds every year since 1982 to fund operations of the Department of Public Safety (DPS) because DPS does not have a dedicated funding source. Since 2001, the state has swept \$1.1B from HURF resulting in degrading roads statewide and fewer road projects.

We would be better served by addressing the lack of overall funds in HURF and finding a dedicated funding source for DPS. Those actions would address the root cause of the problem, and rural and urban cities and counties would all be better capable of serving the needs of their citizens. The bill was voted out of committee 5-3 on Wednesday.

SB1374 state law; local government violations

SB1374 was defeated in the Senate Government Committee on Wednesday by a party-line vote of 3-4. The bill was sponsored by Sen. Kate Brophy McGee (R-Phoenix) at the request of the League to make some procedural changes to SB1487. Committee Chair Sen. Sonny Borelli (R-Lake Havasu City) sponsored an amendment which took out the requirement that the legislator filing a complaint against a city or town must have at least a portion of that city within their legislative district, and the ability for the city to recover attorney's fees. What was left was a longer timeline for the investigation and response, and the ability of a city to have due process with a direct appeal to the Arizona Supreme Court, the same as the Attorney General. But, after considerable

discussion and opposition from some groups including the NRA, the bill failed to move out of committee. The League thanks Sen. Brophy McGee for sponsoring the bill and Mayor Christian Price of Maricopa, who testified in support of it.

Statewide Cable License – HB2579

This week the House Commerce Committee heard HB2579 video service; certificates of authority. The bill sponsor is by Rep. Jill Norgaard (R-Phoenix) and the proponent of the bill is Cox Communications.

This bill is a preemption of local authority with a “one size fits all” state license agreement that will no longer hold cable companies accountable to residents through their local governments. The bill takes away the ability of a local cable license to protect residents in preserving property values by preventing visual blight caused by unfettered proliferation of overhead lines that would now be allowed by the bill. It removes protections for residential and business subscribers such as maintaining a level or quality of video services provided by the cable operator; requiring that a cable operator give a 30-day prior notice to customers of any changes in rates, programming, services or channel positions; and requiring buildout of the network so that all residents and businesses will have access to video services. Under this bill, the only recourse for cable subscribers is to complain to the FCC, where enforcement is unlikely to occur timely, if ever.

The bill contains provisions that would shift the costs of some street repair, restoration and undergrounding of facilities to the taxpayers who have already made investments to maintain public streets and roads within their communities and should not have to bear the costs associated with repairing and maintaining the integrity of the street system that was diminished as a result of the cable operator’s street cuts.

The bill also does not protect residents because there is no ability for local or state government to effectively enforce the Cable Act provisions regulating cable operators. Delegation of authority to the Secretary of State to issue “certificates” gives the Secretary of State no authority to address any problems caused by cable operators nor does it give the Arizona Corporation Commission any authority. The bill merely appoints the Secretary to serve as an administrative record keeper. If cable licensing is forced to move to the state level, the Corporation Commission, which oversees other utilities, would be better equipped and have the technical expertise to oversee this.

In addition, the bill would allow cable operators to terminate their newly negotiated licenses with municipalities within the next 2 years, which could violate the contracts clause of the U.S. and Arizona constitutions.

We have repeatedly requested COX and the sponsor to hold the bill this session to allow for a proper stakeholder process; however the bill continues to move through the process.

Speculative Builders

HB2387, 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.

The bill was heard in House Ways & Means on Wednesday, passing out of committee on a vote of 6-3, with Representatives Epstein, Lawrence and Leach voting no. Following the hearing the League met with the sponsor's representative who agreed to work with the League and city and town tax administrators on potential amendments or a non-legislative solution. The bill is awaiting action in House Rules.

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 and Services

SB1392 and HB2479, 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.

These bills were both heard in Senate Finance and House Ways & Means on Wednesday, and each passed with matching amendments that primarily made technical changes. SB1392 passed the Finance committee on a vote of 5-2, with Senators Cajero-Bedford and Farley voting no. Senator Fann requested a fiscal note from the JLBC on the revenue impact of the bill. HB2479 passed House Ways & Means 8-1 with Rep. Epstein voting no. Each bill is awaiting action in its chamber Rules committee.

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.

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.

The bill creates a new section, 42-6015, which requires cities and towns to treat these goods and services in the same manner as the State.

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

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

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.